Internal Revenue Bulletin

CUMULATIVE BULLETIN 1957-1

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Internal Revenue Bulletin

Cumulative Bulletin 1957–1

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Rev. Rul. 55–603, C. B. 1955–2, 709	Supplemented.	57–175	608
Rev. Rul. 55–680, C. B. 1955–2, 475	Supplemented.	57–196	427
Rev. Rul. 55–700, C. B. 1955–2, 569	Modified	57–288	518
Rev. Rul. 56–16, C. B. 1956–1, 524	Modified	57–57	399
Rev. Rul. 56–74, C. B. 1956–1, 541	Modified	Rev. Proc. 57–11	740
Rev. Rul. 56–76, C. B. 1956–1, 548	Modified	Rev. Proc. 57–7	730
Rev. Rul. 56–76, C. B. 1956–1, 548	Modified	Rev. Proc. 57–8	732
Rev. Rul. 56–134, C. B. 1956–1, 649	Revoked	57–138	543
Rev. Rul. 56–141, C. B. 1956–1, 543	Modified	Rev. Proc. 57–9	734
Rev. Rul. 56–271, C. B. 1956–1, 440	Distinguished.	57–53	291
Rev. Rul. 56–290, C. B. 1956–1, 445	Clarified	57–78	300
Rev. Rul. 56–372, C. B. 1956–2, 187	Distinguished.	57–243	116
Rev. Rul. 56–551, C. B. 1956–2, 1043	Supplemented.	57–175	608
Rev. Rul. 56–582, C. B. 1956–2, 981	Modified	57–288	518
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S. S. T. 247, C. B. 1938–1, 449	Distinguished.	57–1	15
S. S. T. 293, C. B. 1938–1, 432	Distinguished.	57–41	341
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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.
S. M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S. P. R.—Statement of Procedural Rules.
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.
U. S. C.—United States Code.
x and *y* used to represent certain numbers and when used with the word "dollars" represent sums of money.

FOREWORD

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

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

II. Part II includes rulings and decisions which are based on the application of the Internal Revenue Code of 1939, 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 treaties and tax legislation, including related Committee and Conference Reports. This part is subdivided into three subparts according to tax conventions, Treasury Decisions and Revenue Rulings issued with respect thereto (Subpart A), legislation (Subpart B), and Committee Reports (Subpart C). House, Senate and Conference Committee Reports printed in the Bulletin do not include the portion entitled "Changes in Existing Law."

V. Part V is devoted to administrative, procedural, and miscellaneous matters. The weekly Internal Revenue Bulletins contained Part VI consisting of some items of general interest. Other than the disbarment list, which has been incorporated in Part V of this Bulletin, 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 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, Revenue officers and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. In applying rulings and procedures published in the Bulletin, personnel of the Service and others concerned must consider the effect of subsequent legislation, regulations, courts 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. 175 for 1957 should be cited as "Rev. Rul 57–175, C. B. 1957–1, 608." Similarly, Revenue Procedure No. 20 for 1957 should be cited as "Rev. Proc. No. 57–20, C. B. 1957–1, 749." Revenue Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1957–1 contains all rulings, decisions, and legislation pertaining to Internal Revenue matters published in Internal Revenue Bulletins 1–25, inclusive, for the period January 1 to June 30, 1957. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States published in the Internal Revenue Bulletins.

THE 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, 1957, TO JUNE 30, 1957, 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.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Avco Manufacturing Corp.(1)	45633	25	975
Avco Manufacturing Corp	53705	27	547
Beckman Trust, under deed of trust dated May 3, 1932, Hazel B.(2)	55163	26	1172
Berry, Betty, trustee of Harold Berry Trust, transferee, and Selma Berry Trust, transferee (3)	41027 41026	26	344
Berry Trust, Harold, transferee (3)	41027		
Berry Trust, Selma, transferee (3)	41026		
Bradley, D. G	55823	26	970
Brooks, Charles A., estate of (4)	55269	27	295
Burstein, Benjamin, trustee of Anna L. Heit Trust	52241	27	82
Capitol Coal Corp	51955	26	1183

See footnotes at end of tables.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Casey, Brigid Angela, estate of (4)	54939	25	707
Casey, Joseph G., et al., executors of estate of Brigid Angela Casey (4)			
Clark, Edward H.(5)	94259	40	333
Cohen, Betty R	51774	27	221
Cohen, Sidney	51772		
Dingle-Clark Co	51364	26	782
Dixie Shops, Inc., a Michigan Corp.(3)	41150	26	344
Dorminey, J. T	55431	26	940
Edwards, John R., et ux	52647	27	647
Friedlaender, Erwin D	54638	26	1005
Geiger & Peters, Inc	53746	27	911
Goldner, Dezso, et ux	44884	27	455
Heatbath Corp.(6)	17563	14	332
Heim, Muriel	55159	27	270
Heit Trust, Anna L	52241	27	82
Home Title Guaranty Co.(7)	20631	15	637
Howe, Graydon B.(8)	46379	25	376
Howe, Graydon B., transferee (8)	46378		
Hubbard, Debe W., estate of (4)	52124	26	183
Jackson, Charles J., et ux	56249	28	36
Jordan, Hans, et ux	55207	27	265
Kenyon Trust, James A	51265	26	846
Kramer, Benjamin	52238	27	82
Kramer, David	52239		
Kramer, Irving	52240		
Kurtin, Albert, et ux	51666	26	958
Kyron Foundation, Inc	44818	27	37
Latendresse, Frances E.(3)	38986	26	318
Leib, Robert	51773	27	221
Levasseur, Ethel Trafton, executrix of estate of Charles A. Trafton (4) (9)	53576	27	610
	55291		
Manson, Carolyn (formerly Carolyn Solomon) individually, and as administratrix of estate of Hiram Solomon	54472	27	426
McGrath, Albert D., et ux	47206	27	117
McKelvy, William M., et al, executors of estate of May Hicks Sheldon (4)	53616	27	194
Merchants National Bank of Mobile, executor of estate of Debe W. Hubbard (4)	52124	26	183
Merkra Holding Co., Inc	52237	27	82
Morsman, Truman W	61259	27	520
Mudge, Edmund W., estate of (4)	51443	27	188
Mudge, Leonard S., et al., executors of estate of Edmund W. Mudge (4)			
National Thread Co., Inc.(10)	47467	25	940
Newman Machine Co., Inc	44379	26	1030
	52020		
O'Brien, Eloise T. (8)	46373	25	376
O'Brien, Pat (8)	46372		
O'Brien, Pat, et ux., transferees	46374		
Peoples First National Bank & Trust Co., et al., executors of estate of Charles A. Brooks (4)	55269	27	295
Pierson, Miriam Coward	55976	27	330
Reavis, C. Frank, et al., surviving and successor trustees of Hazel B. Beckman Trust (2)	55163	26	1172

See footnotes at end of tables.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report Volume	Report Page
Reynolds, George E., individually, and as executor of estate of Mildred D. Reynolds	39399 39421	26	1225
Reynolds, Mildred D., estate of	39421		
Rubin, Dave, et ux	45971	26	1076
Ryan, Phil L., et ux., transferres (8)	46377	25	376
Schlager, Herbert O., transferee (3)	41028	26	344
Sebago Lumber Co	49686 53383	26	1070
Selwyn Eddy Co. (11)	a 21612	25	1341
Sheldon, May Hicks, estate of (4)	53616	27	194
Solomon, Hiram, estate of	54472	27	426
Stavroudis, Nicholas A., et ux	56217	27	583
Stein, Esther M., estate of (10)	47466		
Stein, Esther M., estate of, and Samuel Stein (10)	47465		
Stein, Samuel (10)	47475	25	940
Stein, Samuel, executor of estate of Esther M. Stein (10)	47465 47466		
Stokby, Edith	44495	26	912
Stone, George Winchester Jr., et ux. (12)	42788	23	254
Tebb, Fred R., et ux	57171		
Tebb, Grace, executrix of estate of Thomas W. Tebb (4)	54161	27	671
Tebb, Neal A., et ux	57172		
Tebb, Thomas W., estate of (4)	54161		
Terneen Productions, Inc. (8)	46380	25	376
Tiffany, Carter (13)	27780	16	1443
Trafton, Charles A., estate of (4) (9)	53576 55291	27	610
Virginian Limestone Corp. (14)	51766	26	553
Weil, Beulah	43366	22	612
Weil, Charles S	43858	23	630
Weil, Charles S. and Adreana	50411		
Wilmington Gasoline Co., a California Corp	45220	27	500
Zucker, Bertram R	51778	27	221

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report Volume	Report Page
Chase National Bank of the City of New York, trustee and alleged transferee of Marie Elizabeth Moran (9) (15)	48652	25	617
Ellis, Harry A., estate of (4)	55204	26	694
Ellis, Helen R., et al., executors of estate of Harry A. Ellis (4)			
Mahoning National Bank, executor of estate of A. P. Steckel	51099	26	600
Moran, Marie Elizabeth (9)	48652	25	617
Newman, Marie M	57283	26	717
Pittston Company	53832	26	967
Poe Manufacturing Co., F. W	38661	25	691

See footnotes at end of tables.

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
Ryan, Gladys [16]	46376	25	376
Ryan, Phil L. [16]	46375		
Siegel, Mildred Irene [9]	52700	26	743
Steckel, A. P., estate of	51099	26	600

[a] United States Board of Tax Appeals.

[1] Acquiescence relates to the issues as to whether (1) petitioner properly claimed the loss sustained upon the liquidation of the American Propeller Corp.; (2) the distribution of certain stocks was a distribution of taxable dividends made out of earnings and profits; (3) payments made under the Extra Compensation Plan were properly accruable and deductible in the fiscal year ended November 30, 1947; and (4) certain tooling expenses incurred by the petitioner were likewise deductible in the same period.

[2] See Rev. Rul. 57-287, page 517, this Bulletin.

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

[4] Estate tax decision.

[5] Nonacquiescence published in C. B. 1939-2, 45, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 57-47, page 23, this Bulletin.

[6] Nonacquiescence published in C. B. 1950-2, 5, regarding the issue of deductions for compensation paid or accrued to controlling stockholders for use of an invention, even though they had granted the petitioner a royalty-free license to use their patent, is withdrawn and acquiescence is substituted therefor. Acquiescence as to the issue of the deduction for expense payments represented by negotiable notes issued by petitioner to its stockholder, was published in C. B. 1955-2, 6.

[7] Nonacquiescence published in C. B. 1953-2, 8, is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 57-48, page 212, this Bulletin.

[8] Acquiescence with respect to the issues regarding the period of the corporate existence, for taxable purposes, of Terneen Productions, Inc.; and as to the amount of salary paid the petitioner, Pat O'Brien, as star of the motion picture produced by the corporation.

[9] Gift tax decision.

[10] Acquiescence relates to the issues involving certain unidentified bank deposits which partially represent unreported sales by the National Thread Co., and unreported taxable income of Esther M. and Samuel Stein; the percentage of unreported company sales allowed to offset unreported purchases; the allowance to the company for travel and selling expenses; and with regard to the statute of limitations barring proceedings against the taxpayers for the years 1942 and 1943.

[11] Nonacquiescence published in C. B. XI-2, 16 (1932), is withdrawn and acquiescence is substituted therefor.

[12] See Rev. Rul. 57-286, page 497, this Bulletin.

[13] Nonacquiescence published in C. B. 1951-2, 6, is withdrawn and acquiescence is substituted therefor.

[14] See Rev. Rul. 57-288, page 518, this Bulletin.

[15] Name changed to Chase Manhattan Bank, successor to Chase National Bank of the City of New York.

[16] Nonacquiescence relates to the issue involving the reporting as a long-term capital gain of the profit realized by petitioner from the sale of one-half of his ten percent interest in the net profits of a motion-picture film.

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 II.—TAX ON CORPORATIONS

SECTION 11.—TAX IMPOSED

26 CFR 1.11: Statutory provisions: tax on corporations. T. D. 6237 [1]

(Also Sections 21, 37, 1.21–1, 1.37.)

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

Income Tax Regulations amended to conform to the Tax Rate Extension Acts of 1956 and 1957, relating to corporate normal tax under section 11(b), and to Public Law 398 (84th Cong.) approved January 28, 1956, relating to the limitation on retirement income under section 37(d), of the Internal Revenue Code of 1954.

DEPARTMENT OF THE TREASURY,
OFFICE OF THE 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 under the Internal Revenue Code of 1954 (26 CFR (1954) Part 1) to the Tax Rate Extension Acts of 1956 [P. L. 458, C. B. 1956–1, 869] and 1957 [P. L. 85–12, page 666, this Bulletin], relating to the extension of corporation normal-tax rate under section 11(b), and to Public Law 398 (84th Cong.), approved January 28, 1956, [C. B. 1956–1, 853]

[1] 22 F. R. 4076.

relating to the earned income limitation on retirement income under section 37(d), of the 1954 Code, such regulations are amended as follows:

PARAGRAPH 1. Section 1.11 is amended by—

(A) Striking out "April 1, 1956", in section 11(b)(1), each time it occurs and inserting in lieu thereof "July 1, 1958", and

(B) Striking out "March 31, 1956", in section 11(b)(2), each time it occurs and inserting in lieu thereof "June 30, 1958", and

(C) Inserting "; sec. 2, Tax Rate Extension Act, 1956; sec. 2, Tax Rate Extension Act, 1957" before the period and the closing bracket of the historical note set forth at the end of section 11.

As amended, section 11(b)(1) and (2) and the historical note in § 1.11 will read as follows:

§ 1.11 STATUTORY PROVISIONS; TAX ON CORPORATIONS.

SEC. 11. TAX IMPOSED * * *

(b) NORMAL TAX—

(1) TAXABLE YEARS BEGINNING BEFORE JULY 1, 1958.

I the case of a taxable year beginning before July 1, 1958, the normal tax is equal to 30 percent of the taxable income.

(2) TAXABLE YEARS BEGINNING AFTER JUNE 30, 1958.—In the case of a taxable year beginning after June 30, 1958, the normal tax is equal to 25 percent of the taxable income.

* * * * * * *

[Sec. 11 as amended by sec. 2, Tax Rate Extension Act, 1955; sec. 2, Tax Rate Extension Act, 1956; sec. 2, Tax Rate Extension Act, 1957.]

PAR. 2. Paragraph (c) of § 1.11–1 is amended to read as follows:

§ 1.11–1 TAX ON CORPORATIONS. * * *

(c) The normal tax is computed by applying to the taxable income the rate of tax in effect for the taxable year. The rates of tax applicable for the respective taxable years are as follows:

	Percent
For taxable years beginning before July 1, 1958	30
For taxable years beginning after June 30, 1958	25

PAR. 3. Paragraph (a) of § 1.21–1 is amended to read as follows:

§ 1.21–1 CHANGES IN RATE DURING A TAXABLE YEAR.—(a) Section 21 applies to all taxpayers, including individuals and corporations. It provides a general rule applicable in any case where (1) any rate of tax imposed by chapter 1 upon the taxpayer is increased or decreased, or any such tax is repealed, and (2) the taxable year includes the effective date of the change, except where that date is the first day of the taxable year. Thus, for example, the normal tax on corporations is, under section 11(b), decreased from 30 percent to 25 percent in the case of a taxable year beginning after June 30, 1958. Accordingly, the tax for a taxable year of a corporation beginning on July 1, 1958, will be computed under section 11(b) at the new rate without regard to section 21. However, for any taxable year beginning before July 1, 1958, and ending on or after that date, the tax will be computed under section 21. For additional circumstances under which section 21 is not applicable, see paragraph (k) of this section.

PAR. 4. Example (2) of § 1.21–1(n) is amended to read as follows:

§ 1.21–1 CHANGES IN RATE DURING A TAXABLE YEAR. * * *

(n) The application of section 21 may be illustrated by the following examples:

* * * * * * *

Example (2). For purposes of this example, the following facts are assumed: The taxpayer is a corporation, its taxable year is the calendar year 1958, its taxable income for both normal tax and surtax purposes is $100,000, and it is

subject to a change in the rate of the normal tax from 30 percent of taxable income to 25 percent of taxable income effective on July 1, 1958. The change in the normal tax rate applicable to the corporation does not affect the amount of any other tax applicable to the corporation under chapter 1. In such case, the tentative tax at the 30 percent rate would be $30,000, and the tentative tax at the 25 percent rate would be $25,000. The proportionate part of the tentative tax at the 30 percent rate is $14,876.71, that is, an amount which is the same proportion of $30,000 as 181 (the number of days from January 1 to June 30, 1958, both dates inclusive) is to 365 (the total number of days in the taxable year). The proportionate part of the tentative tax at the 25 percent rate is $12,602.74, that is an amount which is the same proportion of $25,000 as 184 (the number of days from July 1 to December 31, 1958, both dates inclusive) is to 365.

PAR. 5. In § 1.37, section 37(d)(2) and the historical note at the end of section 37 are revised to read as follows:

§ 1.37 STATUTORY PROVISIONS; RETIREMENT INCOME.

SEC. 37. RETIREMENT INCOME. * * *

(d) LIMITATION ON RETIREMENT INCOME. * * *

(2) In the case of any individual who has not attained the age of 72 before the close of the taxable year, any amount of earned income (as defined in subsection (g))—

(A) In excess of $900 received by the individual in the taxable year if such individual has not attained the age of 65 before the close of the taxable year, or

(B) In excess of $1,200 received by the individual in the taxable year if such individual has attained the age of 65 before the close of the taxable year.

* * * * * * *

[Sec. 37 as amended by Pub. Law 299 (84th Cong.), for taxable years beginning after December 31, 1954, and by Pub. Law 398 (84th Cong.), for taxable years beginning after December 31, 1955. For taxable years beginning before January 1, 1955, sec. 37 (f) contains "; except that such term does not include a fund or system established by the United States for members of the Armed Forces of the United States" after the words "District of Columbia". For taxable years beginning before January 1, 1956, sec. 37(d)(2) provides: "(2) In the case of any individual who has not attained the age of 75 before the close of the taxable year, any amount of earned income (as defined in subsection (g)) in excess of $900 received by the individual in the taxable year."]

PAR. 6. Section 1.37–4 is amended to read as follows:

§ 1.37–4 LIMITATION ON AMOUNT OF RETIREMENT INCOME.—(a) Section 37(d) provides a limitation on the amount of retirement income with respect to which the retirement income credit is allowable. Such credit is computed on the amount of retirement income, as defined in section 37(c), but on not more than the amount determined as the limitation provided by section 37(d). In any event, the maximum amount of retirement income with respect to which the retirement income credit is allowable is $1,200.

(b) The limitation provided by section 37(d) is determined by subtracting from $1,200 the sum of—

(1) Amounts received during the taxable year as (i) a pension or annuity under Title II of the Social Security Act; (ii) a pension or annuity under the Railroad Retirement Acts of 1935 or 1937; (iii) any other pension or annuity which is excludable from gross income, such as persons received under laws relating to veterans; and

(2) (i) For taxable years beginning after December 31, 1955, the amount of earned income received during the taxable year in excess of (*a*) $900, if the individual has not attained the age of 65 before the close of his taxable year, or (*b*) $1,200, if the individual has attained the age of 65 but not 72 before the close of his taxable year; or

(ii) For taxable years begining before January 1, 1956, the amount of earned income received during the taxable year in excess of $900, if the individual has not attained the age of 75 before the close of his taxable year.

(c) In determining the limitation of section 37(d), the following additional rules shall be applicable:

(1) No reduction shall be made on account of any amounts excluded from gross income because of the application of section 72 (relating to annuities), section 101 (relating to life insurance proceeds), section 104 (relating to compensation for injuries or sickness), section 105 (relating to amounts received under accident and health plans), section 402 (relating to taxability of beneficiary of employees' trust), or section 403 (relating to taxation of employees annuities).

(2) For taxable years beginning after December 31, 1955, no reduction for earned income received during the taxable year shall be made in the case of an individual who has attained the age of 72 before the close of his taxable year; and for taxable years beginning before January 1, 1956, no reduction for earned income received during the taxable year shall be made in the case of an individual who has attained the age of 75 before the close of his taxable year.

(3) The term "earned income" has the same meaning as in § 1.37–2(a). (However, the special rule relating to widows and widowers contained in section 37(b) is not applicable in determining the limitation of section 37(d).)

(4) Where the amounts designated in paragraph (b) of this section are treated as community income under community property laws applicable with respect to such income, such amounts shall be treated as received one-half by each spouse.

(5) In no event can the sum of the amounts designated in paragraph (b) of this section reduce the amount of the retirement income, or the credit with respect thereto, to less than zero.

(d) The determination of the limitation of section 37(d) may be illustrated by the following examples:

Example (1). If an individual eligible for the retirement income credit, age 68 at the close of the taxable year 1954, received as his only income during the taxable year $800 of interest and $1,700 as compensation for personal services rendered by him during such year, the individual is entitled for such taxable year to a retirement income credit on $400 of the interest. Since the individual had not attained the age of 75 before the close of the taxable year, the limitation of section 37(d) is determined by subtracting from $1,200 the amount of $800, that is, the amount of earned income ($1,700) which is in excess of $900. The limitation is thus $400 ($1,200 less $800) and the retirement income credit is computed on $400 of the retirement income (the interest item). If the individual had attained the age of 75 before the close of the taxable year 1954, no amount would be subtracted from $1,200 by reason of his earned income and the limitation would then be $1,200 instead of $400, and the retirement income credit would be computed on the entire amount of the interest item of $800.

Example (2). Assume that the individual in example (1) received the same items of income for his 1957 taxable year. Since the individual has attained the age of 65 but not the age of 72 before the close of such taxable year, the limitation of section 37(d) is determined by subtracting from $1,200 the amount of $500, that is, the amount of earned income ($1,700) which is in excess of $1,200. The limitation is thus $700 ($1,200 less $500) and the retirement income credit is computed on $700 of the retirement income (the interest item). If the individual had attained the age of 72 before the close of the taxable year 1957, no amount would be subtracted from $1,200 by reason of his earned income, and the limitation would then be $1,200 instead of $700, and the retirement income credit would be computed on the entire amount of the interest item of $800.

PAR. 7. Section 1.37–5 is amended to read as follows:

§ 1.37–5 ILLUSTRATION OF APPLICATION OF SECTION 37.—The application of section 37 may be illustrated by the following example:

Example. Assume that an individual eligible for the retirement income credit, 70 years of age, unmarried, computed his tax under section 3, has the following items of income for the calendar year 1956:

Dividend income (of which $50 is excluded from gross income under section 116)	$750
Pension under the Railroad Retirement Act of 1937 (entirely excluded from gross income)	600
Disability payments under a workmen's compensation act (entirely excluded from gross income under section 104)	400

Rental income	600
Earned at odd jobs	1,300
First, the taxpayer must compute his tax before the credit, as follows:	
Adjusted gross income ($700 dividend +$600 rental income +$1,300 earned income)	$2,000
Tax before any credit (determined by table in section 3)	230
Less dividend received credit under section 34	28
Tax before retirement income credit	202
Next, the taxpayer must compute his retirement income credit as follows:	
Retirement income includes:	
Dividend income	$700
Rental income	600
Total retirement income	1,300
But the limitations in section 37(d) provide that this amount may not exceed a maximum amount for the taxable year 1956, determined as follows:	
Maximum amount (before reduction)	$1,200
Less railroad retirement pension	600
	600
Less earned income in excess of $1,200	100
Amount of retirement income upon which the credit is computed	500
The retirement income credit is computed by applying the 20-percent rate to the maximum amount of retirement income reduced by the railroad retirement pension and the earned income in excess of $1,200, as follows:	
Maximum amount of retirement income as reduced above	$500
20 percent rate	.20
Retirement income credit	100

Because this Treasury Decision merely provides for the extension of the corporate normal-tax rate under the Tax Rate Extension Acts of 1956 and 1957, and incorporates the liberalizing provisions of Public Law 398 (84th Cong.), it is found unnecessary to issue the Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 5, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on June 10, 1957, 8:51 a. m., and published in the issue of the Federal Register for June 11, 1957, 22 F. R. 4076.)

PART III.—CHANGES IN RATES DURING A TAXABLE YEAR

SECTION 21.—EFFECT OF CHANGES

26 CFR 1.21–1: Changes in rate during a taxable year.

The Income Tax Regulations relating to corporate normal tax are amended. See T. D. 6237, page 7.

SECTION 37.—RETIREMENT INCOME

26 CFR 1.37: Statutory provisions: retirement income.

The Income Tax Regulations relating to the limitation on the retirement income credit are amended. See T. D. 6237, page 7.

26 CFR 1.37–3: Retirement income. (Also sections 652, 661, 662; 1.652(b)–1, 1.661 (b)–1, 1.662(b)–1.) Rev. Rul. 57–277

> For the purpose of computing the retirement income credit of an individual beneficiary of an estate or trust who has attained the age of 65, the proportionate share of the taxable dividends, interest, and rents which he derives from such estate or trust constitutes retirement income within the meaning of section 37(c)(1) of the Internal Revenue Code of 1954.

Advice has been requested whether taxable income consisting of rents, dividends, and interest received from an estate by a beneficiary who has reached the age of 65 qualifies as retirement income for the purpose of the retirement income credit allowed under the provisions of section 37 of the Internal Revenue Code of 1954.

Section 37(a) of the Code provides that, in the case of a retired individual who has received $600 of earned income in each of any ten calendar years before the beginning of the taxable year, there shall be allowed as a credit against his Federal income tax for the taxable year an amount computed according to that section and based upon the individual's retirement income.

Section 37(c)(1) of the Code defines the term "retirement income," in the case of an individual who has attained the age of 65 before the close of the taxable year, as meaning income from pensions and annuities, interest, rents, and dividends, to the extent included in gross income.

In accordance with sections 652(b), 661(b), and 662(b) of the Code, the amount of income for the taxable year required to be distributed currently by an estate or trust shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into a computation of the distributable net income of an estate or trust as the total of each class bears to the total distributable net income of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries.

Accordingly, it is held that, for the purpose of computing the retirement income credit of an individual beneficiary of an estate or trust who has attained the age of 65, the proportionate share of the taxable dividends, interest and rents which he derives from such estate or trust constitutes retirement income within the meaning of section 37(c)(1) of the Code.

26 CFR 1.37–4: Limitations on amount of retirement income. Rev. Rul. 57–101
(Also Section 105; 1.105–4.)

For the purpose of the limitation on retirement income provided by section 37(d)(1) of the Internal Revenue Code of 1954, pensions and annuities which are excludable from gross income under section 105 of the Code do not reduce retirement income in accordance with section 37(e) of the Code. However, wages or payments in lieu of wages (except amounts received as a pension or annuity) that are received for a period during which an employee is absent from work on account of personal injuries or sickness, irrespective of whether they are excludable under section 105(d) of the Code or are in excess of the amount excludable, constitute earned income and should be taken into consideration for the purpose of the limitation on retirement income provided by section 37(d)(2) of the Code

Advice has been requested whether amounts excluded under section 105(d) of the Internal Revenue Code of 1954 are to be used in determining the limitation on retirement income provided by section 37(d) of the Code.

Section 37 of the Code, as amended, provides in part as follows:

(d) * * * For purposes of subsection (a) the amount of retirement income shall not exceed $1,200 less—

(1) in the case of any individual, any amount received by the individual as a pension or annuity—

(A) under Title II of the Social Security Act

(B) under the Railroad Retirement Acts of 1935 or 1937, or

(C) otherwise excluded from gross income and

(2) in the case of an individual who has not attained the age of 72 before the close of the taxable year, any amount of earned income (as defined in subsection (g))—

(A) in excess of $900 received by the individual in the taxable year if such individual has not attained the age of 65 before the close of the taxable year, or

(B) in excess of $1,200 received by the individual in the taxable year if such individual has attained the age of 65 before the close of the taxable year.

(e) * * * Subsection (d)(1) shall not apply to any amount excluded from gross income under section * * * 104 (relating to compensation for injuries or sickness), 105 (relating to amounts received under accident and health plans) * * *.

The amount of retirement income on which the credit is based cannot exceed $1,200 less any amount received by the taxpayer as a pension or annuity under the Social Security Act or the Railroad Retirement Act of 1935 or 1937, as amended, or otherwise excluded from the gross income. Since these amounts are already excluded from income and, hence, do not form a part of the base on which the tax is computed, they are offset against the amount of allowable retirement income. Section 37(e) of the Code in effect provides that for the purposes of section 37(d)(1), pensions in the nature of disability payments (for example, under workmen's compensation acts or by reason of service in the Armed Forces) which are excluded from gross income under section 104 (relating to compensation for injuries or sickness) or under section 105 (relating to amounts received under accident or health plans) do not reduce the amount of retirement income.

For the purposes of section 37(d)(2) of the Code, wherein it is provided that the retirement income shall be reduced by any amount of earned income in excess of $900 or $1,200, depending on the age of the individual, the question that arises is of a different nature, that

is, whether amounts excluded under section 105(d) and the amounts in excess thereof, which are received as wages or payments in lieu of wages for a period during which an employee is absent from work on account of personal injury or sickness, constitute earned income.

Wages received for a period during which an employee is absent from work on account of personal injuries or sickness constitute earned income within the meaning of section 911(b) of the Code as limited by section 37(g) thereof. The fact that the income is excluded by applicable provision of law, section 105(d) of the Code, does not change the character of the income. It merely becomes excluded earned income. In the case of *Augustus B. Chidester, Administrator* v. *United States*, 82 Fed. Supp. 322, it was held that sick leave pay constitutes earned income for the purpose of the exclusion under section 116(a) of the 1939 Code.

Accordingly, it is held that, for the purpose of the limitation on retirement income provided by section 37(d)(1) of the Internal Revenue Code of 1954, pensions and annuities which are excludable from gross income under section 105 of the Code do not reduce retirement income in accordance with section 37(e) of the Code. However, wages or payments in lieu of wages (except amounts received as a pension or annuity) that are received for a period during which an employee is absent from work on account of personal injuries or sickness, irrespective of whether they are excludable under section 105(d) of the Code or are in excess of the amount excludable, constitute earned income and should be taken into consideration for the purpose of the limitation on retirement income provided by section 37(d)(2) of the Code.

Rev. Rul. 57–141

A large investment of capital by a doctor, dentist, or other professional taxpayer in office equipment, such as X-ray machines, is not a material income-producing factor in the taxpayer's business, therefore, the amount of professional fees received shall not be reduced by any expenses connected with the earning of such income but are considered "earned income" in their entirety for the purpose of the limitation in section 37(d)(2) of the Code.

Advice has been requested with respect to what constitutes earned income for the purposes of the retirement income limitation provided by section 37(d)(2) of the Internal Revenue Code of 1954 in the case of doctors and dentists or other professional taxpayers who have large investments in office equipment.

Section 37(d)(2) of the Code provides as follows:

(d) LIMITATION ON RETIREMENT INCOME.—For purposes of subsection (a), the amount of retirement income shall not exceed $1,200 less—

(2) in the case of any individual who has not attained the age of 72 before the close of the taxable year, any amount of earned income (as defined in subsection (g))

(A) in excess of $900 received by the individual in the taxable year if such individual has not attained the age of 65 before the close of the taxable year, or

(B) in excess of $1200 received by the individual in the taxable year if such individual has attained the age of 65 before the close of the taxable year.

Subsection (g) of section 37 provides that for purposes of section 37(d)(2), the term "earned income" has the meaning assigned to such

term in section 911(b), except that such term does not include any amount received as a pension or annuity.

Section 911(b) of the Code provides in part as follows:

> For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, * * *. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, * * *, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

Inasmuch as the amount of capital employed has only an incidental effect on the amount of profits derived from professional fees, the growth of the profession being dependent primarily on the reputation and technical skill of a doctor, dentist or other professional taxpayer, it is held that such capital is not a material income-producing factor in the taxpayer's business. Accordingly, the entire amount received as professional fees, without any reduction for expenses connected with the earning of such income, is considered to be "earned income" for the purpose of the limitation provided by section 37(d)(2) of the Code. See Mim. 3802, C. B. IX-1, 121 (1930).

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

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

SECTION 61.—GROSS INCOME DEFINED

(Also Sections 3121, 3306, 3401; 26 CFR 31.3121(a)-1, 313306(b)-1.)
(Also Part 11, Section 22(a); Regulations 118, Section 39.22(a)-1.)

Rev. Rul. 57-1

> Strike benefit payments paid by a labor union to unemployed members, as well as nonmembers, as the result of a labor strike are includible in the gross income of the recipients in the year received, even though distributed on the basis of need and irrespective of the nature and form of the benefit payments received.
>
> O. D. 552; C. B. 2, 73 (1920), and I. T. 1293, C. B. I-1, 63 (1922), amplified; I. T. 3230, C. B. 1938-2, 136; I. T. 3447, C. B. 1941-1, 191; S. S. T. 247, C. B. 1938-1, 449, and Revenue Ruling 131, C. B. 1953-2, 112, distinguished.

The Internal Revenue Service has been requested to reconsider the position it stated in O. D. 552, C. B. No. 2, 73 (1920), which holds that strike benefits received by a member of a labor union are includible in his gross income for the year during which received. A similar position was taken in I. T. 1293, C. B. I-1, 63 (1922), to hold that amounts paid by an organized union as unemployment benefits to its unemployed members are includible in the gross income of the recipients.

Members of a labor union pay dues to the union, a portion of which is laid aside in a special fund to be used in case of a strike or lockout. Strike benefits are paid according to individual need and have no

correlation to the amount of dues paid by the recipient, or to the amount of benefits received by other members. The strike benefit payments, which are not paid pursuant to any contract, are paid to members as well as nonmembers of the union. Presumably, any benefits to nonmembers are equally in furtherance of the objectives of the strike. The specific question presented is whether the strike benefit payments paid under the above circumstances constitute income or whether they are tax free gifts to the recipients.

Section 61 of the Internal Revenue Code of 1954 states that "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived * * *." This section has the same breadth of scope as section 22(a) of the Internal Revenue Code of 1939 and executes the mandate of the 16th Amendment to the Constitution. See U. S. Senate Report No. 1622, 83rd Congress, 168. For a recent reiteration of this principle, see *Commissioner* v. *Glenshaw Glass Company et al.*, 348 U. S. 426, Ct. D. 1783, C. B. 1955–1, 207. As pointed out by the Court in that case, Congress applied no limitation as to the source of taxable receipts, nor restrictive labels as to their nature.

Strike benefit payments are included within the broad definition of gross income and do not fall within any of the exclusions provided for in the Code, including the exclusions for gifts under section 102. They are paid only upon the event of a strike which is a means employed by the union and its members for securing economic benefits, and, for this reason, they do not constitute amounts gratuitously paid or received. The determination that strike benefit payments are includible in gross income is not affected by the fact that such payments may take the form of staple goods which are distributed on the basis of need or the fact that such payments or distributions are also made to persons who are not members of the union.

The above position does not conflict with I. T. 3230, C. B. 1938–2, 136, wherein unemployment compensation benefits, paid by a state agency from funds withdrawn from the Federal Unemployment Trust Fund pursuant to Title IX of the Social Security Act, were not considered as taxable income, or I. T. 3447, C. B. 1941–1, 191, wherein benefits under the Social Security Act were held not subject to taxation. The benefits in these cases were held not to constitute taxable income because it was believed that Congress intended that such benefits be not subject to tax. However, there is no evidence that Congress intended to exclude strike benefits from income. Nor does the above position conflict with S. S. T. 247, C. B. 1938–1, 449, wherein it was held that strike benefits do not constitute "wages" for the purposes of the Social Security Act, since such benefits do not constitute remuneration for services paid by an employer to an employee. Consistent with the holding therein made, it is held that strike benefits do not constitute wages paid by the union to its members for purposes of income tax withholding and the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. Such benefits are nevertheless income and, as such, are includible in gross income for Federal income tax purposes.

Revenue Ruling 131, C. B. 1953–2, 112, which holds that disaster benefits provided by an employer for his employees are not taxable income, is also distinguishable from the instant situation. That Revenue Ruling stated, in part, "such contributions, measured solely

by need, are considered gratuitous and spontaneous." Such situation does not exist in the instant case since the payments made are neither spontaneous nor primarily donative in character but are made in furtherance of a strike, which is a means employed to secure legitimate economic benefits for members of the union.

Revenue Ruling 54–190, C. B. 1954–1, 46, holds that noncontractual payments made out of a union fund are nevertheless taxable to the recipient union members. In that ruling, the pensions paid to the members were directly attributable to their employment while members of the union as well as to their payment of union dues. The pensions could not be said to be paid to them without consideration and, therefore, were not gifts.

Accordingly, the strike benefit payments received under these circumstances do not constitute gifts but constitute income and are includible in the gross income of the recipients even though distributed on the basis of their need and regardless of whether the recipients are members or nonmembers of the union. If the benefits are paid in goods rather than cash, the fair market value of the goods at the time received is the amount to be included in gross income.

Rev. Rul. 57–2

Amounts withheld by banks or finance companies to cover possible losses on notes purchased from dealers constitute income to dealers employing the accrual method of accounting, to the extent of their interest therein at the time the amounts are recorded on the books of the bank or finance company as a liability to the dealer, regardless of whether charges for worthless notes are also made to the account pursuant to an agreement between the parties. Losses sustained on worthless notes shall be separately established by the dealer as required by section 166 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to state its position with respect to the treatment, for Federal income tax purposes, of amounts withheld by banks and finance companies to cover possible losses on notes purchased from automobile or other dealers employing the accrual method of accounting, and which are recorded on the books of the bank or finance company as a liability of the bank or finance company to the dealer.

The steps generally involved in transactions concerning automobile dealers are as follows: When a car is purchased on credit from a dealer, the purchaser makes a down-payment, either in the form of cash or by turning in another car at an agreed value, the balance being satisfied by the purchaser's promissory note and a supporting conditional sales contract. The face amount of the note reflects two elements—the balance of what would be the purchase price of the car, if bought for cash, and a finance charge. As between the purchaser and the dealer, the transaction is closed and completed at this point with the attendant tax consequences to the dealer.

It is then common practice for the dealer to sell or discount the purchaser's note and sales contract to some financial institution. The finance company or bank acquires the note at a value somewhat less than its face value, the difference representing a charge for its service. Simultaneously, either cash or unrestricted credit is given to the dealer to the extent of the amount reflected in the face value of the note that corresponds to the unpaid balance of the cash retail price of the car.

The difference between the face value of the note and the sum of the finance company's charge and its credit or immediate payment to the dealer (representing part of the finance charge previously mentioned) is then credited on the books of the finance company as a liability of the finance company to the dealer. The accumulation of these credits is generally known as a "dealers reserve" and is the specific object of the present consideration.

Settlement of the liability represented by the reserve is subject to agreement between the particular dealer and the financial institution involved. In some instances, the agreement does not contemplate the charging of any items against the reserve account, while in others the account reflects a running record of various transactions between the parties, that is, both credits and charges are entered, depending upon the nature of the item. Thus, in certain instances, the dealer and the finance company may agree that notes purchased or discounted are to be charged to the reserve account in the event they become worthless.

With regard to those instances where losses incurred by a finance company on notes purchased from automobile dealers may not be charged against the reserve, the credits to the reserve, by the finance company in favor of a dealer who employs the accrual method of accounting constitute income to the dealer at the time such credit is made, even though the dealer is not immediately or even currently able to draw on the entire reserve. See G. C. M. 9571, C. B. X–2, 153 (1931), and *Shoemaker-Nash, Inc.* v. *Commissioner*, 41 B. T. A. 417. The principles involved in the purchase of notes from automobile dealers by banks or finance companies as described above are equally applicable where notes are purchased, under similar conditions, from dealers in items other than automobiles.

Where a dealer's reserve is in the nature of a running account, the charging thereto of worthless notes pursuant to agreement between the parties has no bearing upon the fact that taxable income has been received by the dealer, or upon the time of its realization as otherwise evidenced by the credits to such reserve.

Accordingly, it is held that credits to such reserve, in the case of a dealer employing the accrual method of accounting, constitute income to the dealer at the time such credits are made regardless of whether charges to the account for worthless notes are also made pursuant to an agreement between the parties. Losses sustained on worthless notes are to be separately established by the dealer as required by the provisions of section 166 of the Internal Revenue Code of 1954 relating to bad debts.

In arriving at these conclusions, consideration has been given the case of *Blaine Johnson et al.* v. *United States*, 233 Fed. (2d) 952. See also, *Albert M. Brodsky et ux.* v. *Commissioner*, 27 T. C. No. 23.

(Also Sections 162, 404, 584, 3121, 3306, 3401; 1.584–1, 31.3121(a)–1.) Rev. Rul. 57–37

Contributions conveying fully vested and nonforfeitable interests made by an employer into separate and independently controlled trusts for each employee, each trust created pursuant to a collective bargaining agreement for the purpose of furnishing unemployment and certain other benefits to its eligible employees, constitute additional compensation to the employees for the taxable year in which

such contributions are made, and, as such, are subject to income tax withholding under section 3402 of the Internal Revenue Code of 1954 and the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act at the time paid into the trusts. Such amounts constitute business expenses deductible from gross income under section 404(a)(5) of the Code in the taxable year in which paid. The consolidated funds of the trusts will qualify as common trust funds within the meaning of section 584 of the Code provided the funds are maintained by the trustee in accordance with the requirements of section 584(a)(2) of the Code.

Advice has been rquested as to the Federal income and employment tax treatment of contributions made by an employer, pursuant to a collective bargaining agreement, to individual trusts providing for certain unemployment and other benefits to its employees.

In 1955, corporation *M* entered into an agreement with representatives of its hourly-rated employees. The agreement, which was the result of collective bargaining negotiations and supplementary to a general labor agreement, provided for the establishment of a "security benefit plan," hereinafter referred to as the plan. Under the plan, certain unemployment and other benefits are to be paid to the employees covered by the collective bargaining agreement, provided they are eligible to participate in the plan. Pursuant to the provisions of the plan thus established, corporation *M* entered into an agreement with a trustee, selected by it, establishing for each employee eligible to participate in the plan, a trust, to be known as the employee's "security benefit account." Under the plan, corporation *M* contributes to each employee's security benefit account an amount computed at a specified rate per hour for each hour actually worked by the employee subsequent to the date on which he became eligible to aprticipate in the plan. Contributions to each of such accounts will continue to be made by corporation *M* until the balance in the account reaches a specified maximum amount; thereafter, no further contributions to the account are required to be made until the balance in the account falls below the maximum amount provided for in the plan. The trustee will hold the amount contributed by corporation *M* to each of such accounts and the interest earned thereon as a separate trust estate for the exclusive benefit of the particular employee. No part of the amount contributed by corporation *M* is recoverable by such corporation. The amounts held in the individual employees' accounts, however, may be consolidated by the trustee for investment purposes.

In the event a participating employee's lay-off results from a reduction in force or is temporary in character, or the employee is absent from work because of injury or sickness for at least two consecutive pay periods, he will be eligible to receive payments from his security benefit account for each full pay period of such lay-off or absence. The plan provides that, for the protection of the employee, the funds held by the trustee in the employees' security benefit accounts may not be sold, transferred, assigned, pledged, or otherwise encumbered. Upon termination of employment or retirement of the employee, the balance in his security benefit account will be paid to him. In the event of his death, such balance will be distributed to his designated beneficiary or to his estate. Upon termination of the plan, the trustee will, within one year of the termination date, liquidate the assets of the trusts and pay to each participating employee his pro rata share thereof, computed on the basis of the balances in the security

benefit accounts on the date of such termination. Therefore, each participating employee has a fully vested and nonforfeitable beneficial interest in all amounts contributed or credited to his security benefit account.

In accordance with the provisions of the plan, corporation *M* entered into a trust agreement with a national bank which, acting as trustee, agreed to accept and hold the funds contributed to the security benefit account of each eligible employee as a separate trust estate for the exclusive benefit of each such employee. The trust agreement provides that the funds of all the separate trusts may be commingled, managed, and invested as one or more consolidated funds in United States Government bonds or other equivalent securities. The trustee is required to credit, as of December 31 of each year, earnings, including capital gains less capital losses, from investment of the consolidated funds to the individual employee's security benefit account. However, the trustee is prohibited from making any payment from a security benefit account to the beneficiary thereof until corporation *M* certifies that the beneficiary is eligible to receive such payment. The trust agreement provides, also, that no part of any trust shall ever be diverted to or recovered by corporation *M*, or be used for or diverted to purposes other than the exclusive benefit of the persons entitled thereto, and that no modification of the trust agreement shall be made to make any such use or diversion possible thereunder.

Section 61 of the Internal Revenue Code of 1954 provides, in part, that gross income means all income from whatever source derived, including compensation for services. As stated in *Commissioner* v. *John H. Smith*, 324 U. S. 177, Ct. D. 1633, C. B. 1945, 49, "Section 22(a) of the Revenue Act [of 1938, to which section 61 of the 1954 Code corresponds] is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected." Contributions paid into an irrevocable and nonforfeitable trust by an employer for the benefit of an employee are taxable to the employee when the contributions are made. Revenue Ruling 55–691, C. B. 1955–2, 21.

Section 3401 of the 1954 Code provides that, for the purpose of income tax withholding, the term "wages" means all remuneration paid in cash or other form to an employee for services performed (with certain exceptions not here material) for his employer. Sections 3121 and 3306 of the Code contain similar provisions in defining the term "wages," for purposes of the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, respectively, of subtitle C, 1954 Code).

In the instant case, each employee eligible to participate in the plan agreed through his bargaining representatives that amounts computed at a specified rate on hours worked shall be contributed by corporation *M* to the trustee of the employee's security benefit account. Such contributions, though not made directly to each employee, constitute additional compensation to such employees, are includible in his gross income under section 61 of the Code, and are subject to income tax withholding under section 3402 of the Code, and to the taxes imposed by

the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, *supra*, at the time paid into the trusts.

Section 162(a) of the Code provides that there shall be allowed as a deduction from gross income all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business, including a reasonable allowance for salaries or other compensation for personal services rendered. However, section 404(a) of the Code provides that if contributions are paid under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 or section 212 (relating to expenses for the production of income), but if they satisfy the conditions of either of such sections, they shall be deductible under section 404 of the Code, subject to certain limitations as to amounts. Section 404(a)(5) provides that contributions so paid under a plan (other than pension trusts, employees' annuities, or stock bonus and profit-sharing trusts), where the employees' rights to or derived from such employer's contributions or such compensation are nonforfeitable at the time the contribution or compensation is paid, are deductible by the employer in the year paid.

In the instant case, the contributions by *M* corporation represent compensation for services rendered by the covered employees and, thus, constitute ordinary and necessary expenses within the meaning of that term as used in section 162(a) of the Code. However, since such compensation is paid under a plan which defers the receipt thereof to the participating employees or their beneficiaries, the deductibility of the payments is governed by the provisions of section 404 of the Code. The employees' rights to or derived from the contributions to the employees' accounts are nonforfeitable at the time contributed. Therefore, the amounts thereof will be deductible under the provisions of section 404(a)(5) of the Code in the taxable year or years during which so contributed.

The trust agreement contains no expression of intent contrary to the declaration of establishing thereby a separate and individual trust for each employee eligible to participate in the Plan. Therefore, it is held that a separate trust was created for each employee by the said agreement.

If any of the trusts so created has for a taxable year any taxable income, or gross income of $600 or more, regardless of the amount of taxable income, or has a nonresident alien beneficiary, the trustee will be required to make a Fiduciary Income Tax Return, Form 1041, for each such trust.

The consolidated funds will qualify as common trust funds under section 584 of the Code, provided the funds are maintained in accordance with section 584(a)(2) of the Code in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System partaining to the collective investment of trust funds by national banks. If the provisions of section 584(a)(2) are complied with, the consolidated funds will not be subject to Federal income tax. However, for information purposes only, the trustee should file a Partnership Return, Form 1065, for the consolidated funds.

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(Also Section 120: 26 CFR 1.120–1.) Rev. Rul. 57–46

The amount of $5 per workday designated as a "subsistence allowance" for police officials and all commissioned law enforcement officers under Act 234, Acts of South Carolina, 1955, is not a "statutory subsistence allowance" within the meaning of section 120 of the 1954 Code but constitutes compensation for services rendered and is includible in gross income under section 61(a) of the Code.

Advice has been requested whether the "statutory subsistence allowance" provided under Act 234, Acts of South Carolina, 1955, an Act to Provide for a Subsistence Allowance From the Amounts Appropriated by Acts of the General Assembly for Police Officials and All Commissioned Law Enforcement Officers, approved by the Governor May 25, 1955, is excludable from gross income as "a statutory subsistence allowance" within the meaning of section 120 of the Internal Revenue Code of 1954.

Act 234, *supra*, provides that beginning with the fiscal year 1955–56, of the amounts appropriated by Acts of the General Assembly for police officials and all commissioned law enforcement officers, the sum of five dollars a day for each regular workday shall be designated as "a statutory subsistence allowance."

Pursuant to the South Carolina law, highway patrolmen are assigned territories which allow them to live at home to the extent that they eat all three meals at home each day. No expenses are incurred while on duty, as State-owned automobiles are furnished, together with all gas, oil and repairs. If, at any time, a particular patrolman is assigned temporary duty away from his station, such patrolman is reimbursed for actual subsistence in an amount not to exceed $7.50 per day while in the State or $10 when outside the State. Act 234, *supra*, does not provide for any kind of expenses incident to the performance of police duty, the travel allowance for expenses up to $7.50 or $10 per day for temporary duty assignments away from an official station having been provided for in earlier legislation. Act 234 has not affected the amount of money received by patrolmen. It merely designates that, of the amount appropriated for a patrolman's salary, the amount of $5 a day for each regular workday or $30 each week represents a statutory subsistence allowance. No concurrent laws have been enacted to specifically increase or decrease the rates of pay of highway patrolmen.

Section 61(a) of the Internal Revenue Code of 1954 provides for the inclusion in gross income of amounts received as compensation for services, including fees, commissions, and similar items.

Section 120(a) of the Code provides that gross income does not include any amount received as a statutory subsistence allowance by an individual who is employed as a police official by a State, a Territory, or a possession of the United States, by any political subdivision of any of the foregoing, or by the District of Columbia.

Section 120(b) provides that the amount to which subsection (a) applies shall not exceed $5 per day and that, if any individual receives a subsistence allowance to which subsection (a) applies, no deduction shall be allowed under any other provision of Chapter 1 for expenses in respect of which he has received such allowance, except to the extent that such expenses exceed the amount excludable under subsection (a) and the excess is otherwise allowable as a deduction under Chapter 1.

The term "statutory subsistence allowance" as used in section 120 of the Code is an established amount, apart from salary or other compensation, which is authorized to be paid to an individual who is employed as a police official for meals and other incidental expenses in connection with his duties, and must accordingly be designated to provide for the cost of subsistence expenses incident to the performance of police duties. The allowance under Act 234, *supra*, does not satisfy such a test. The mere designation of an amount paid to a police officer as a "subsistence allowance" will not serve to exclude such amount within the meaning of section 120 of the Code.

Accordingly, it is held that the so-called "subsistence allowance" of $5 per day payable under Act 234, Act of South Carolina, 1955, is not a "statutory subsistence allowance" within the meaning of section 120 of the Code but constitutes compensation for services rendered and is includible in gross income under section 61(a) of the Code. In this connection see Revenue Ruling 55–475, C. B. 1955–2, 37.

Rev. Rul. 57–47

A taxpayer received a sum of money from her tax consultant as recompense for an error made by the latter in the preparation and filing of the taxpayer's individual income tax return. The error had caused the taxpayer to pay more tax than she would have owed had the correct method been employed. *Held*, no taxable income is derived from that part of the recovery received by the taxpayer which does not exceed the amount of tax which she was required to pay because of the error, but the remainder of the recovery, representing interest on the amount deemed overpaid and the fee paid to the consultant for preparing the return, must be included in her gross income in computing her taxable income.

Advice has been requested in regard to the taxability of an amount received by a taxpayer as recompense for an error made by her tax consultant, under the circumstances described below.

A certain taxpayer received a sum of money from her tax consultant as recompense for an error made by the latter in the preparation and filing of the taxpayer's individual income tax return. The error caused the taxpayer to pay more tax than she would have owed had the correct method been employed. When the error was discovered, the statutory period of limitation for recovery of the overpayment of the tax had expired, so the tax consultant paid her, by way of recompense, an amount equal to the difference between the tax which the taxpayer would have paid except for the error and the amount which she was actually required to pay, plus an amount equal to the sum of (1) six per cent interest on such difference from the date the taxpayer paid her tax and (2) the fee which she paid the tax consultant for the preparation of her return. Such fee had been deducted by the taxpayer for income tax purposes and the full amount of the deduction served to reduce her tax for the year of such deduction.

Under the provisions of section 164(b)(1) of the Internal Revenue Code of 1954, no deduction is allowed for Federal income taxes in computing taxable income. The amount received by the taxpayer by way of recompense for the tax paid by her on account of the error made by her tax consultant therefore is not includible in gross income. *Edward H. Clark* v. *Commissioner*, 40 B. T. A. 333.

However, section 212(3) of the Code allows as a deduction expenses for the production of income "in connection with the determination, collection, or refund of any tax," and this includes expense in preparation of tax returns. *David L. Low*, 7 T. C. 363, acquiescence, C. B. 1946–2, 3. Section 111 of the Internal Revenue Code of 1954 provides that gross income shall not include income "attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the recovery exclusion" with respect thereto, which did not result in a reduction of the taxpayer's income tax. Since the taxpayer deducted the fees paid to the tax consultant and received full tax benefit for such deduction, section 111 does not provide for excluding from her gross income that part of the recovery which represented a return to her of such fee. Further, there is no provision for excluding from gross income the amount received by her as interest to compensate her for the loss of use of funds which she could have retained except for the error made by the tax consultant.

In view of the foregoing, it is held that no taxable income is derived from that part of the recovery received by the taxpayer which does not exceed the amount of tax which she was required to pay because of the error made by her tax consultant, but that the remainder of the recovery must be included in gross income in computing her taxable income.

Nonacquiescence in the case of *Edward H. Clark* v. *Commissioner*, 40 B. T. A. 333, C. B. 1939–2, 45, has been withdrawn. See page 4 of this Bulletin.

Rev. Rul. 57–59

Patronage dividend distributions, made by a nonexempt farmers' cooperative to its members who owned the crop at the time delivered to the cooperative, are excludable from the gross income of the cooperative if made in accordance with a pre-existing agreement. Similarly, if a nonexempt cooperative sells part of its products to members and the remainder to nonmembers but pays such dividends to members only, such dividends, to the extent attributable to sales to members, are excludable from the gross income of the cooperative, but any such dividends distributed to members, attributable to sales made to nonmembers, are taxable to the cooperative and to its members.

Advice has been requested as to the treatment, for Federal income tax purposes, of patronage dividend distributions in cash, merchandise, or document form, by a farmers' nonexempt cooperative marketing crops and selling supplies, where the members did not produce the crops but owned them at the time they were delivered to the cooperative and the cooperative distributes patronage dividends attributable to sales to members as well as nonmembers.

Patronage dividends distributed by a farmers' nonexempt cooperative on account of crops purchased from its members are excludable from its gross income to the extent they are distributed, on a true patronage basis in accordance with a pre-existing agreement, to members who owned the crops when they were acquired by the cooperative, even though such members did not produce the crops.

Similarly, if a nonexempt cooperative sells part of its products to members and the remainder to nonmembers, but pays patronage

dividends to its member-patrons only, such dividends are excludable from the gross income of the cooperative to the extent they are attributable to sales to members and are allocated on a true patronage basis in accordance with a pre-existing agreement, even though member-patrons may purchase such products for resale to others.

However, profits distributed to members, which are derived from sales by the cooperative to nonmembers, are taxable to the cooperative and to the members. See I. T. 3208, C. B. 1938–2, 127; I. T. 1499, C. B. I–2, 189 (1922), which hold, in part, that any profits made on business with nonmembers of a cooperative association which may be distributed to members in the guise of rebates are taxable to the association and the members; and S. M. 2595, C. B. III–2, 238 (1924), which holds, in part, that profits made by a farmers', fruit growers', or like association, upon sale to nonmembers, constitute taxable income, irrespective of the fact that such profits were returned to members by reduction of cost or otherwise.

If patronage dividends which meet the foregoing requirements are not paid in cash or merchandise, but each distributee-patron is notified of the amount allocated to him pursuant to a pre-existing obligation, the principles stated in Revenue Ruling 54–10, C. B. 1954–1, 24, with respect to amounts that may be excluded by an exempt cooperative and the tax treatment thereof as to its patrons, are also applicable to a nonexempt cooperative and its patrons. Compare *Colony Farms Cooperative Dairy, Inc.* v. *Commissioner*, 17 T. C. 688, acquiescence, C. B. 1952–1, 1, and *Southwest Hardware Co.* v. *Commissioner*, 24 T. C. No. 12, acquiescence, C. B. 1955–2, 9.

Accordingly, patronage dividend distributions, made by a nonexempt farmers' cooperative to its members who owned the crop at the time delivered to the cooperative, are excludable from the gross income of the cooperative if made in accordance with a pre-existing agreement. Similarly, if a nonexempt cooperative sells part of its products to members and the remainder to nonmembers, but pays such dividends to members only, such dividends, to the extent attributable to sales to members, are excludable from the gross income of the cooperative, but any such dividends distributed to members, attributable to sales made to nonmembers, are taxable to the cooperative and to its members.

Rev. Rul. 57–60

Under the provisions of a kindergarten mileage law enacted by the legislature of a state, a school board may exercise an option of paying the parent or other person three cents a mile for transporting children to and from a kindergarten school, where bus service is not available during the necessary hours of schooling. *Held*, where payments are made under the above-described circumstances by a school board to a parent or other person not in the trade or business of transporting children to school, the money is considered as reimbursement for the recipient's personal expenses and is not includible in his gross income for Federal income tax purposes. The automobile expenses incurred in connection with such transportation are personal expenses for which no deduction is allowable. See Rev. Rul. 55–555, C. B. 1955–2, 20.

Rev. Rul. 57–102

A benefit payment to a blind person under the Public Assistance Law of the Commonwealth of Pennsylvania is not includible in the gross income of the recipient.

Advice has been requested whether a benefit payment to a blind person received under the Public Assistance Law of the Commonwealth of Pennsylvania is includible in his gross income.

The benefits to the blind by the State of Pennsylvania are paid under the Public Assistance Law, as amended, P. L. 399, 2051, enacted by the State of Pennsylvania and approved June 24, 1937, Title 62, Section 2509(c) Purdon's Pennsylvania Statutes Annotated, 1956, for the purpose of providing for and regulating assistance to certain classes of persons requiring relief. Provision is made therein for the administration of the Act by the Department of Public Assistance and county boards of assistance created for this purpose. It authorizes the Department of Public Assistance to cooperate with, and to accept and disburse money received from, the United States Government for assistance to such persons.

The benefit payments which a blind person receives from the State of Pennsylvania constitutes a disbursement from a general welfare fund in the interest of the general public. Such payments are not includible in the gross income of the recipients for Federal income tax purposes. See I. T. 3447, C. B. 1941–1, 191.

(Also Section 3402.) Rev. Rul. 57–164

Lump-sum readjustment payments pursuant to section 265 of the Armed Forces Reserve Act of 1952, 66 Stat. 481, as amended by 70 Stat. 517, received by members of a reserve component are includible in the gross income of the recipients and are subject to the withholding of income tax under section 3402 of the Internal Revenue Code of 1954.

Noncash remuneration paid to retail commission salesmen. See Rev. Rul. 57–18, page 354.

Payments made by employers directly to their employees for the purchase of individual hospitalization and surgical insurance. See Rev. Rul. 57–33, page 303.

Amounts received as a reimbursement for contributions paid to a union negotiated qualified pension plan. See Rev. Rul. 57–104, page 166.

Payments made to a church organization for services performed by its volunteer unpaid workers. See Rev. Rul. 57–135, page 307.

Rental payments for the use of property which a city leases. See Rev. Rul. 57–261, page 262.

SECTION 63.—TAXABLE INCOME DEFINED

Determination of the fraction limiting the credit for foreign taxes where alternative tax method is used. See Rev. Rul. 57–116, page 245.

SECTION 71.—ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

(Also Section 215.) Rev. Rul. 57–125

Premiums paid by a husband on his life insurance policies, of which the wife is to remain the first beneficiary in accordance with a property settlement agreement which became a part of the divorce decree, are not periodic payments within the meaning of section 71 and section 215 of the Internal Revenue Code of 1954.

Advice has been requested whether payments covering life insurance premiums made by a husband on policies insuring his life, pursuant to a property settlement agreement which became a part of the divorce decree, qualify as alimony payments under section 71 and section 215 of the Internal Revenue Code of 1954.

In the instant case, the property settlement agreement provided that the particular policies described therein would be continued in full force and effect by the husband and that he would pay all premiums on such insurance, keep them in good standing, would not make any loans against them, and would not change the beneficiaries, that is, that the wife would remain the first beneficiary and his two children alternate beneficiaries.

The decree granting the divorce provided that the property settlement would be made a part of and incorporated in the decree of divorce and the parties should conform to the agreement as though all the terms were set forth in the decree, thus stipulating that the wife should remain as first beneficiary in all the insurance policies described in the agreement.

The husband made no formal assignment but believed the divorce decree and property settlement divested him of any control of, benefit from, or interest in the policies and placed all such incidents in his former wife in the form of alimony.

Section 71(a)(1) of the Code provides, in part, as follows:

> * * * If a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

Section 215 of the Code makes the following provision:

> * * * In the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross income of his wife, payment of which is made within the husband's taxable year. * * *

I. T. 4001, C. B. 1950–1, 27, states, in part, that premiums paid by a husband on life insurance policies absolutely assigned to his former wife and with respect to which she is the irrevocable beneficiary are includible in the gross income of the wife under section 22(k) of the

Internal Revenue Code of 1939 and deductible by the husband under section 23(u) of that Code. Premiums paid by the husband on the life insurance policies not assigned to the wife and with respect to which she is only the contingent beneficiary are neither includible in the gross income of the wife nor deductible by the husband. This position is equally applicable to sections 71(a)(1) and 215 of the Internal Revenue Code of 1954 since they are the counterparts of sections 22(k) and 23(u), respectively, of the 1939 Code.

In the instant case the husband did not assign the policies in such a manner as to divest himself of their ownership and control. The court decree merely directed him to continue them in full force and effect, to continue his wife as the first beneficiary, to pay all premiums and keep the policies in good standing and not to make loans against them. The effect of these provisions is not to divest him of any control thereof, since any act contrary to the court's direction which the taxpayer could take with respect to the policies would have to be recognized by the insurer in accordance with the contract. The only restraint would be the risk of punitive action by the court against the husband for disobedience of its decree.

Since the taxpayer is still the owner of the policies the premiums are not periodic payments of alimony which are includible in the gross income of his divorced wife. Neither are such payments deductible by him.

Accordingly, it is held that payments covering life insurance premiums made by a taxpayer for the benefit of his divorced wife, on policies not assigned to her, pursuant to a property settlement which became a part of the divorce decree, are not periodic payments within the meaning of section 71 and section 215 of the Internal Revenue Code of 1954.

Amounts paid to a wife for her maintenance and support pursuant to a State court decree awarding alimony pendente lite, which decree was subsequent to a Mexican decree. See Rev. Rul. 57–113, page 106.

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

26 CFR 1.72–8: Effect of certain employer contributions with respect to premiums or other consideration paid or contributed by an employee. Rev. Rul. 57–75

In determining the consideration paid for annuities by employees of states and their political subdivisions whose salaries were not subject to Federal income taxes prior to 1939, the amounts contributed by the employer to be included, pursuant to section 72(f) of the Internal Revenue Code of 1954, where the employer's contributions prior to 1939 were used to purchase individual contracts for specified employees, or were allocated among specified employees under a group contract, or were allocated among specified employees in a self-insured fund, are the amounts so allocated to each individual employee. Where the employer's contributions prior to 1939 were not allocated for the benefit of specified employees at the time

the contributions were made, an estimated allocation among individual employees may be made for the purpose of applying section 72(f) of the Code, provided the method used for making the estimated allocation is reasonable and consistent with the circumstances and the provisions of the plan under which such contributions were made.

Advice has been requested whether, under an employees' pension plan of a state or political subdivision thereof, where the amounts contributed by the employer during the years prior to 1939 were not allocated for the benefit of specified employees, an estimated allocation among individual employees may be made for the purpose of applying section 72(f) of the Internal Revenue Code of 1954.

Section 72 of the Code provides for the taxation of amounts received as annuities under annuity contracts under two methods which exclude from gross income amounts received which are considered to be a return of the investment in the contract, as defined in section 72(c)(1). Subsection (d) of section 72 provides that where part of the consideration paid for the contract is contributed by the employer and the aggregate amount receivable by the employee during the three-year period beginning with the date of the first payment is equal to or greater than the consideration for the contract contributed by the employee, then all amounts received shall be excluded from gross income until there has been excluded an amount equal to the consideration for the contract contributed by the employee; thereafter, all amounts so received shall be included in gross income. Where that portion of the consideration for the contract which is contributed by the employee is not recoverable within the first three years, commencing with the first date of payment, subsection (b) of section 72 provides an exclusion ratio whereby an amount which bears the same ratio to the amount received as the employee's investment in the contract bears to the expected return under the contract, shall be excluded from gross income.

Section 72(f) of the Code provides that, for the purposes of determining the consideration contributed by an employee for an annuity, amounts contributed by the employer shall be included to the extent that (1) such amounts were includible in the gross income of the employee, 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 low applicable at the time of such contribution. See section 1.72–8 of the Income Tax Regulations.

Under the Federal income tax laws in effect for the years 1913 through 1938, compensation of officers and employees of a state or political subdivision thereof engaged in the exercise of essential governmental functions, including public school teachers, was, in general, excluded from gross income unless paid directly or indirectly by the United States or an agency or instrumentality thereof. See T. D. 5214, C. B. 1943, 1188. Employer contributions paid into a pension plan during such years, which would have been so excludable had they been paid directly to the employees, may be treated as consideration paid by the employees under section 72(f). See Rev. Rul. 56–82, C. B. 1956–1, 59.

Where there is available a record of the amount of employer contributions actually allocated to individual employees at the time such contributions were paid, such entries should be used in determining the amount of the section 72(f)(2) consideration. Where there is no record of the actual allocation of employer contributions paid, or where such amount is not readily ascertainable from the records maintained during the pre-1939 period, an estimated allocation may be made using a method reasonable and consistent with the provisions of the plan in effect at the time the employer's contributions were paid in respect of each participant, as well as the circumstances under which such employer contributions were required to be used to meet the cost of the current benefits payable at that time. In making such an estimated allocation, the general principles in the two following paragraphs should be observed.

If there was any unfunded liability under the plan as at January 1, 1939, it cannot properly be assumed that the employer's full share of the cost of benefits accrued prior to 1939 was actually contributed prior to 1939. Furthermore, if the respective employer's contributions were paid into the retirement fund over a period of years, it cannot reasonably be assumed that the funds to meet the entire cost of the benefits accrued before 1939 were contributed by the employer in a lump sum immediately before January 1, 1939. Instead, it must be assumed that contributions were made in such amounts and at such times as will be reasonably consistent with the actual method of funding used during the specified period the employee actually performed services prior to 1939 in an essential government function.

Since section 72(f)(2) refers only to actual employer contributions which would not have been income to the employee if paid to him at the time the contributions were paid into the fund, it is necessary that the method used to estimate each employer's contributions for the benefit of any individual over a period of years eliminate any interest or subsequent forfeitures and increment on the trust assets which may have been used to provide his benefit. The amounts estimated to have been contributed by the employer for benefits accrued prior to 1939 should be consistent with the assumptions (interest, mortality, etc.) used for valuation purposes for the years prior to 1939, rather than those used in valuation at the time of retirement occuring subsequent to such period, since the employer's actual contributions presumably would have been determined on the former actuarial basis. Similarly, the amounts should be calculated with reference to the anticipated retirement benefit used in the last valuation of the plan before 1939, if that benefit was substantially different from the benefit actually paid at retirement. Furthermore, section 72(f)(2) consideration shall not include employer contributions, or that portion of an estimated allocation of any such contribution, where the participant at the time the contribution was actually paid, or deemed to have been paid, was not an employee performing services for the employer in connection with an essential governmental function. See Mim. 3838, C. B. 1938–1, 181.

Although the Internal Revenue Service does not assume responsibility for proposing methods of allocating employer contributions

in particular plans, because the provisions of such plans and the circumstances of contributions vary widely, an adaptation or refinement of the following procedure may produce reasonable and acceptable results in determining the consideration paid by an employee for an annuity where, as in the instant case, contributions of the employer were made prior to 1939 but were not then allocated for the benefit of the specified employees:

(a) determine the total contributions of the political subdivision, with respect to current service costs, in each year prior to 1939 for which any living retired employee had service credited under the plan, expressed as a percentage of total compensation considered under the plan for all covered employees in the particular year;

(b) apply such percentage to the covered compensation in each respective year for each employee then covered under the plan for whom a determination must be made, to determine the employer contributions paid in each such year on behalf of each such employee for current service;

(c) aggregate the annual amounts so determined for each employee for whom a determination must be made; and

(d) if the political subdivision made any additional contributions before 1939, such as with respect to original prior service under the plan, and if any living retired employee had credited service to which such additional contributions were applicable, a portion of such additional contributions should also be allocated to each such employee, taking account, in some reasonable manner, of the actual prior service credits of each such employee as compared to those of the whole group for which such contributions were made.

The sum of the amounts determined in (c) and (d), if any, and the amount contributed by the employee himself would constitute the retired employee's consideration paid for the annuity under section 72 of the Code.

Accordingly, it is held that, in determining the consideration paid for annuities by employees of states and their political subdivisions whose salaries were not subject to Federal income taxes prior to 1939, the amounts contributed by the employer to be included, pursuant to section 72(f) of the Code, where the employer's contributions prior to 1939 were used to purchase individual contracts for specified employees, or were allocated among specified employees under a group contract, or were allocated among specified employees in a self-insured fund, are the amounts so allocated to each individual employee. Where the employer's contributions prior to 1939 were not allocated for the benefit of specified employees at the time the contributions were made, an estimated allocation among individual employees may be made for the purpose of applying section 72(f) of the Code, provided the method used for making the estimated allocation is reasonable and consistent with the circumstances and the provisions of the plan under which such contributions were made.

26 CFR 1.72–9: Tables. T. D. 6233

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

Regulations under section 72 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:

In order to correct clerical errors in the Income Tax Regulations issued under section 72 of the Internal Revenue Code of 1954 (T. D. 6211, 21 F. R. 8853) [C. B. 1956–2, 29], section 1.72–9 is amended as follows:

PARAGRAPH 1. In the sixth division of Table II, the expected return multiple of 43.8 which appears in the tenth column opposite male, age 29 and female, age 34, is amended to read 43.7.

PAR. 2. In the seventh division of Table II, the expected return multiple of 56.5 which appears in the second column opposite male, age 26 and female, age 31, is amended to read 46.5.

PAR. 3. In the fourth division of Table IIA, the expected return multiple of 26.6 which appears in the first column opposite male, age 29 and female, age 34, is amended to read 23.6.

PAR. 4. In the tenth division of Table IIA, the expected return multiple of 12.0 which appears in the fourth column opposite male, age 57 and female, age 62, is amended to read 12.1.

PAR. 5. In the fourth division of Table III, the percent value of 9 which appears in the second column opposite male, age 51 and female, age 56, is amended to read 10.

Because this Treasury Decision merely corrects clerical errors made in the regulations issued under section 72 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 May 9, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on May 14, 1957, 8:45 a. m. and published in the issue of the Federal Register for May 15, 1957, 22 F. R. 3416.)

SECTION 74.—PRIZES AND AWARDS

26 CFR 1.74–1: Prizes and awards. Rev. Rul. 57–19

An award to be presented each year for a five-year period to an outstanding teacher of a college was established by a charitable foundation. The award is not in payment of any particular service which the teacher rendered to the college but is based upon a period of over-all past service to the academic work of the college (*i. e.*, it is not conditioned on any future service thereto). The selection of the recipient of the award is made by a committee composed of students, alumni, and administrative officials of the college from a group of faculty names suggested by the senior class and alumni. None of the suggested persons know that they are being considered and none has done any special work specifically designed to win the award. *Held*, the teacher award made in accordance with the established plan constitutes an award made primarily in recognition of educational achievement and is excludable from the gross income of the recipient as provided by section 74(b) of the Internal Revenue Code of 1954.

Rev. Rul. 57–67

The required filing of a written form and the appearance for a personal interview by a student selected for an award in recognition of his past academic and citizenship achievements, for the purpose of determining the recipients of final awards, do not constitute participation in a contest or proceeding within the meaning of section 74(b) of the Internal Revenue Code of 1954. The award is excludable from gross income.

Advice has been requested whether the required filing of a written form and the appearance for a personal interview, by a student selected for an award in recognition of his past academic and citizenship achievements, constitute participation in a contest or proceeding within the meaning of section 74(b) of the Internal Revenue Code of 1954 and whether the award is includible in gross income.

A corporation makes awards of certificates, trophies, and cash to high school students in a given area for the purpose of encouraging them in their academic and citizenship training. The awards are given primarily in recognition of the students' past achievements in scholastic and citizenship fields. Based on certain judging standards, the faculty of each high school selects a certain number of certificate winners from its student body. They also select a lesser number of trophy winners, who will be judged with winners from other schools for possible cash awards. The students themselves do not apply for consideration for the awards or participate in any function other than their usual student and youth activities. The students selected by the high school faculty as trophy winners are required to fill out a form to be used by the area judging group for determining the possible recipients of cash awards. These trophy winning students are also required to appear for interviews before the area judging group so that some appraisal may be made of their character, personality, cooperation in group discussion, and soundness and logic of thought.

Under the provisions of section 74 of the Code, gross income includes amounts received as prizes and awards, unless such prizes or awards are excludable from gross income under subsection (b). Subsection

(b) excludes from gross income those prizes and awards which are made primarily in recognition of religious, charitable, scientific, educational, artistic, literary or civic achievements, but only if (1) the recipient was selected without any action on his part to enter the contest or proceeding, and (2) the recipient is not required to render substantial future services as a condition to receiving the prize or award.

The students, who were first awarded certificates and then trophies, with no action on their part to enter a contest or proceeding, may possibly win a cash award for the same prior achievements. The fact that the determination of the recipients of the final, or cash, awards is partially based on personal interviews and written forms does not result in the awards being taxable to the recipients by reason of a participation in a contest or proceeding. The appearances for personal interviews and the filing of written forms are not for the purpose of entering the contest or proceeding.

Accordingly, it is held that the required filing of a written form and the appearance for a personal interview by a student selected for an award in recognition of his past academic and citizenship achievements, for the purpose of determining the recipients of final awards, do not constitute the participation in a contest or proceeding within the meaning of section 74 (b) of the Internal Revenue Code of 1954. The award is excludable from gross income.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 102.—GIFTS AND INHERITANCES

26 CFR 1.102. Statutory provisions; gifts and inheritances. T. D. 6220 [1]

(Also Sections 103, 109, 110, 111, 112, 113, 114, 115, 118, 119, 120; 1.103, 1.109, 1.110, 1.111, 1.112, 1.113, 1.114, 1.115, 1.118, 1.119, 1.120.)

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

Regulations under sections 102, 103, 109, 110, 111, 112, 113, 114, 115, 118, 119, 120, and 121 of the Internal Revenue Code of 1954, as amended by section 501 (t), Public Law 881 (84th Cong.).

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 26, 1956, a notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under sections 102, 103, 109, 110, 111,

[1] The publication of this Treasury Decision in 21 F. R. 10484, dated December 28, 1956, contains (1) a series of instructions for modifying the notice of proposed rulemaking published in 21 F. R. 4629, dated June 26, 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.

112, 113, 114, 115, 118, 119, 120, and 121 of the Internal Revenue Code of 1954 was published in the Federal Register (21 F. R. 4629). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so published have been modified and are hereby adopted as set forth below:

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AUTHORITY: §§ 1.102 to 1.103–6, incl., 1.109 to 1.115–1, incl., and 1.118 to 1.121, incl., issued under sec. 7805, I. R. C. 954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.102 STATUTORY PROVISIONS; GIFTS AND INHERITANCES.

SEC. 102. GIFTS AND INHERITANCES.

(a) GENERAL RULE.—Gross income does not include the value of property acquired by gift, bequest, device, or inheritance.

(b) INCOME.—Subsection (a) shall not exclude from gross income—

(1) The income from any property referred to in subsection (a); or

(2) Where the gift, bequest, device, or inheritance is of income from property, the amount of such income.

Where, under the terms of the gift, bequest, devise, or inheritance, the payment, crediting or distribution thereof is to be made at intervals, then, to the extent that it is paid or credited or to be distributed out of income from property, it shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property. Any amount included in the gross income of a beneficiary under subchapter J shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property.

§ 1.102–1 GIFTS AND INHERITANCE.—(a) *General rule.*—Property received as a gift, or received under a will or under statutes of descent and distribution, is not includible in gross income, although the income from such property is includible in gross income. An amount of principal paid under a marriage settlement is a gift. However, see section 71 and the regulations thereunder for rules relating to alimony or allowances paid upon divorce or separation. Section 102 does not apply to prizes and awards (see section 74 and § 1.74–1) nor to scholarships and fellowship grants (see section 117 and the regulations thereunder).

(b) *Income from gifts and inheritances.*—The income from any property received as a gift, or under a will or statute of descent and distribution shall not be excluded from gross income under paragraph (a) of this section.

(c) *Gifts and inheritances of income.*—If the gift, bequest, devise, or inheritance is of income from property, it shall not be excluded from gross income under paragraph (a) of this section. Section 102 provides a special rule for the treatment of certain gifts, bequests, devises, or inheritances which by their terms are to be paid, credited, or distributed at intervals. Except as provided in section 663(a)(1) and paragraph (d) of this section, to the extent any such gift, bequest, devise, or inheritance is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property. Section 102 provides the same treatment for amounts of income from property which is paid, credited, or to be distributed under a gift or bequest whether the gift or bequest is in terms of a right to payments at intervals (regardless of income) or is in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income, they are not to be excluded under section 102 from the taxpayer's gross income.

(d) *Effect of subchapter J.*—Any amount required to be included in the gross income of a beneficiary under sections 652, 662, or 668 shall be treated for purposes of this section as a gift, bequest, devise, or inheritance of income from property. On the other hand, any amount excluded from the gross income of a beneficiary under section 663(a)(1) shall be treated for purposes of this section as property acquired by gift, bequest, devise, or inheritance.

(e) *Income taxed to grantor or assignor.*—Section 102 is not intended to tax a donee upon the same income which is taxed to the grantor of a trust or assignor of income under section 61 or sections 671 through 677, inclusive.

§ 1.103 STATUTORY PROVISIONS; INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS.

SEC. 103. INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS.

(a) GENERAL RULE.—Gross income does not include interest on—

(1) The obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia;

(2) The obligations of the United States; or

(3) The obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

(b) EXCEPTION.—Subsection (a) (2) shall not apply to interest on obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit, to the extent they represent deposits made before March 1, 1941), unless under the respective Acts authorizing the issuance thereof such interest is wholly exempt from the taxes imposed by this subtitle.

(c) CROSS REFERENCES.—For provisions relating to the taxable status of—

(1) Bonds and certificates of indebtedness authorized by the First Liberty Bond Act, see sections 1 and 6 of that Act (40 Stat. 35, 36; 31 U. S. C. 746, 755);

(2) Bonds issued to restore or maintain the gold reserve, see section 2 of the Act of March 14, 1900 (31 Stat. 46; 31 U. S. C. 408);

(3) Bonds, notes, certificates of indebtedness, and Treasury bills authorized by the Second Liberty Bond Act, see sections 4, 5 (b) and (d), 7, 18(b), and 22(d) of that Act, as amended (40 Stat. 290; 46 Stat. 20, 775; 40 Stat. 291, 1310; 55 Stat. 8; 31 U. S. C. 752a, 754, 747, 753, 757c);

(4) Bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation owned by certain nonresidents, see section 3 of the Fourth Liberty Bond Act, as amended (40 Stat. 1311, § 4; 31 U. S. C. 750);

(5) Certificates of indebtedness issued after February 4, 1910, see section 2 of the Act of that date (36 Stat. 192; 31 U. S. C. 769);

(6) Consols of 1930, see section 11 of the Act of March 14, 1900 (31 Stat. 48; 31 U. S. C. 751);

(7) Obligations and evidences of ownership issued by the United States or any of its agencies or instrumentalities on or after March 28, 1942, see section 4 of the Public Debt Act of 1941, as amended (c. 147, 61 Stat. 180; 31 U. S. C. 742a);

(8) Commodity Credit Corporation obligations, see section 5 of the Act of March 8, 1938 (52 Stat. 108; 15 U. S. C. 713a–5);

(9) Debtentures issued by Federal Housing Administrator, see sections 204(d) and 207(i) of the National Housing Act, as amended (52 Stat. 14, 20; 12 U. S. C. 1710, 1713);

(10) Debentures issued to mortgagees by United States Maritime Commission, see section 1105 (c) of the Merchant Marine Act, 1936, as amended (52 Stat. 972; 46 U. S. C. 1275);

(11) Federal Deposit Insurance Corporation obligations, see section 15 of the Federal Deposit Insurance Act (64 Stat. 890; 12 U. S. C. 1825);

(12) Federal Home Loan Bank obligations, see section 13 of the Federal Home Loan Bank Act, as amended (49 Stat. 295, § 8; 12 U. S. C. 1433);

(13) Federal savings and loan association loans, see section 5(h) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 133; 12 U. S. C. 1464);

(14) Federal Savings and Loan Insurance Corporation obligations, see section 402 (e) of the National Housing Act (48 Stat. 1257; 12 U. S. C. 1725);

(15) Home Owners' Loan Corporation bonds, see section 4(c) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 644, c. 168; 12 U. S. C. 1463);

(16) Obligations of Central Bank for Cooperatives, production credit corporations, production credit associations, and banks for cooperatives, see section 63 of the Farm Credit Act of 1933 (48 Stat. 267; 12 U. S. C. 1138c);

(17) Panama Canal bonds, see section 1 of the Act of December 21, 1904 (34 Stat. 5; 31 U. S. C. 743), section 8 of the Act of June 28, 1902 (32 Stat. 484; 31 U. S. C. 744), and section 39 of the Tariff Act of 1909 (36 Stat. 117; 31 U. S. C. 745);

(18) Philippine bonds, etc., issued before the independence of the Philippines, see section 9 of the Philippine Independence Act (48 Stat. 463; 48 U. S. C. 1239);

(19) Postal savings bonds, see section 10 of the Act of June 25, 1910 (36 Stat. 817; 39 U. S. C. 760);

(20) Puerto Rican bonds, see section 3 of the Act of March 2, 1917, as amended (50 Stat. 844; 48 U. S. C. 745);

(21) Treasury notes issued to retire national bank notes, see section 18 of the Federal Reserve Act (38 Stat. 268; 12 U. S. C. 447);

(22) United States Housing Authority obligations, see sections 5(e) and 20(b) of the United States Housing Act of 1937 (50 Stat. 890, 898; 42 U. S. C. 1405, 1420);

(23) Virgin Islands insular and municipal bonds, see section 1 of the Act of October 27, 1949 (63 Stat. 940; 48 U. S. C. 1403).

§ 1.103–1 INTEREST UPON OBLIGATIONS OF A STATE, TERRITORY, ETC.—Interest upon the obligations of a State, Territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia is not includible in gross income. Obligations issued by or on behalf of the State, Territory, or possession of the United States, or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State, Territory, or possession of the United States, or a political subdivision thereof. Certificates issued by a political subdivision for public improvements (such as sewers, sidewalks, streets, etc.) which are evidence of special assessments against specific property, which assessments become a lien against such property and which the political subdivision is required to enforce, are, for purposes of this section, obligations of the political subdivision even though the obligations are to be satisfied out of special funds and not out of general funds or taxes. The term "political subdivision," for purposes of this section, denotes any division of the State, Territory, or possession of the United States which is a municipal corporation, or to which has been delegated the right to exercise part of the sovereign power of the State, Territory, or possession of the United States. As thus defined, a political subdivision of a State, Territory, or possession of the United States may or may not, for purposes of this section, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State, Territory, or possession of the United States.

§ 1.103–2 DIVIDENDS FROM SHARES AND STOCK OF FEDERAL AGENCIES OR INSTRUMENTALITIES.—(a) *Issued before March 28, 1942.*—(1) Section 26 of the Federal Farm Loan Act of July 17, 1916 (12 U. S. C. 931), provides that Federal land banks and national farm-loan associations, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate. Section 7 of the Federal Reserve Act of December 23, 1913 (12 U. S. C. 531), provides that Federal reserve banks, including the capital stock and surplus therein and the income derived

therefrom, shall be exempt from taxation, except taxes upon real estate. Section 13 of the Federal Home Loan Bank Act (12 U. S. C. 1433) provides that the Federal Home Loan Bank including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation, except taxes upon real estate. Section 5 (h) of the Home Owners' Loan Act of 1933 (12 U. S. C. 1464(h)) provides that shares of Federal savings and loan associations shall, both as to their value and the income therefrom, be exempt from all taxation (except surtaxes, estate, inheritance, and gift taxes) imposed by the United States. Under the above-mentioned provisions, income consisting of dividends on stock of Federal land banks, national farm-loan associations, Federal home loan banks, and Federal reserve banks is not, in the case of stock issued before March 28, 1942, includible in gross income. Income consisting of dividends on share accounts of Federal savings and loan associations is includible in gross income but, in the case of shares issued before March 28, 1942, is not subject to the normal tax on income. For taxability of such income in the case of such stock or shares issued on or after March 28, 1942, see section 6 of the Public Debt Act of 1942 (31 U. S. C. 742a) and paragraph (b) of this section. For the time at which a stock or share is issued within the meaning of this section, see paragraph (b) of this section.

(2) Regardless of the exemption from income tax of dividends paid on the stock of Federal reserve banks, dividends paid by member banks are treated like dividends of ordinary corporations.

(3) Dividends on the stock of the central bank for cooperatives, the production credit corporations, production credit associations, and banks for cooperatives, organized under the provisions of the Farm Credit Act of 1933, constitute income to the recipients, subject to both the normal tax and surtax (see section 63 of the Farm Credit Act of 1933 (12 U. S. C. 1138c)).

(b) *Issued on or after March 28, 1942.*—(1) By virtue of the provisions of section 6 of the Public Debt Act of 1942, the tax exemption provisions set forth in paragraph (a) of this section with respect to income consisting of dividends on stock of the Federal land banks, national farm-loan associations, and Federal reserve banks, or on share accounts of Federal savings and loan associations, are not applicable in the case of dividends on such stock or shares issued on or after March 28, 1942.

(2) For the purposes of this section, a stock or share is deemed to be issued at the time and to the extent that payment therefor is made to the agency or instrumentality. The date of issuance of the certificate or other evidence of ownership of such stock or share is not determinative if payment is made at an earlier or later date. Where old stock is retired in exchange for new stock of a different character or preference, the new stock shall be deemed to have been issued at the time of the exchange rather than when the old stock was paid for. These rules may be illustrated by the following examples:

Example (1). A, the owner of an investment share account, consisting of 10 shares, in a Federal savings and loan association, has a single certificate issued before March 28, 1942, evidencing such ownership. In order that A may dispose of half of such shares, the association at his request issues, after March 2, 1942, two 5-share certificates in substi-

tution for the 10-share certificate. The shares evidenced by the two new certificates are deemed to have been issued before March 28, 1942, the shares having been paid for before such date.

Example (2). The X Bank, a member of a Federal reserve bank, owns 50 shares of Federal reserve bank stock, evidenced by a single stock certificate issued before March 28, 1942. On December 31, 1942, the X Bank reduces the amount of its capital stock, as a result of which it is required to reduce the amount of its Federal reserve bank stock to 40 shares. It surrenders the 50-share certificate to the Federal reserve bank and receives a new 40-share certificate. The 40 shares evidenced by such certificate are deemed to have been issued before March 28, 1942. On December 31, 1943, the X Bank increases the amount of its capital stock, as a result of which it is required to purchase 10 additional shares of the Federal reserve bank stock. The Federal reserve bank issues a 10-share certificate evidencing ownership of the new shares. Of the 50 shares then owned by the X Bank, 40 were issued prior to March 28, 1942, and 10 were issued after March 2, 1942.

Example (3). A, the owner of a savings share account in the amount of $100 in a Federal savings and loan association, has a passbook containing a certificate issued prior to March 28, 1942, evidencing such ownership. Subsequent to March 27, 1942, A deposits $10,000 in the account. With respect to the $10,000 deposit, the share is deemed to have been issued after March 27, 1942.

§ 1.103–3 Interest Upon Notes Secured by Mortgages Executed to Federal Agencies or Instrumentalities.—Section 26 of the Federal Farm Loan Act of July 17, 1916 (12 U. S. C. 931), and section 210 of such act, as added by section 2 of the act of March 4, 1923 (12 U. S. C. 1111), provide that first mortgages executed to Federal land banks, joint-stock land banks, or Federal intermediate credit banks, and the income derived therefrom, shall be exempt from taxation. Accordingly, income consisting of interest on promissory notes held by such banks and secured by such first mortgages is not subject to the income tax.

§ 1.103–4 Interest Upon United States Obligations.—(a) *Issued before March 1, 1941.*—(1) Interest upon obligations of the United States issued on or before September 1, 1917, is exempt from tax. In the case of obligations issued by the United States after September 1, 1917, and in the case of obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States, the interest is exempt from tax only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented.

(2) Interest on Treasury bonds issued before March 1, 1941, is exempt from Federal income taxes except surtaxes imposed upon the income or profits of individuals, associations, or corporations. However, interest on an aggregate of not exceeding $5,000 principal amount of such bonds is also exempt from surtaxes. Interest in excess of the interest on an aggregate of not exceeding $5,000 principal amount of such bonds is subject to surtax and must be included in gross income.

(3) Interest credited to postal savings accounts upon moneys deposited before March 1, 1941, in postal savings banks is wholly exempt from income tax.

(b) *Issued on or after March 1, 1941.*—(1) Under the provisions of sections 4 and 5 of the Public Debt Act of 1941, interest upon obligations issued on or after March 1, 1941, by the United States, or any agency or instrumentality thereof, shall not have any exemption, as such, from Federal income tax except in respect of any such obligations which the Federal Maritime Board and Maritime Administration (formerly United States Maritime Commission) or the Federal Housing Administration has, before March 1, 1941, contracted to issue at a future date. The interest on such obligations so contracted to be issued shall bear such tax-exemption privileges as were at the time of such contract provided in the law authorizing their issuance. For the purposes hereof, under section 4 (a) of the Public Debt Act of 1941, a Territory and a possession of the United States (or any political subdivisions thereof), and the District of Columbia, and any agency or instrumentality of any one or more of the foregoing, shall not be considered as an agency or instrumentality of the United States.

(2) In the case of obligations issued as the result of a refunding operation, as, for example, where a corporation exchanges bonds for previously issued bonds, the refunding obligations are deemed, for the purposes of this section, to have been issued at the time of the exchange rather than at the time the original bonds were issued.

§ 1.103–5 Treasury Bond Exemption in the case of Trusts or Partnerships.—(a) When the income of a trust is taxable to beneficiaries, as in the case of a trust the income of which is to be distributed to the beneficiaries currently, each beneficiary is entitled to exemption as if he owned directly a proportionate part of the Treasury bonds held in trust. When, on the other hand, income is taxable to the trustee, as in the case of a trust the income of which is accumulated for the benefit of unborn or unascertained persons, the trust, as the owner of the bonds held in trust, is entitled to the exemption on account of such ownership. In general, see sections 652(b) and 662 (b) and the regulations thereunder.

(b) As the income of a partnership is taxable to the individual partners, each partner is entitled to exemption as if he owned directly a proportionate part of the bonds held by the partnership. For rules relating to partially tax-exempt interest see section 702(a) (7) and the regulations thereunder.

§ 1.103–6 Interest Upon United States Obligations in the Case of Nonresident Aliens and Foreign Corporations, Not Engaged in Business in the United States.—By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919 (31 U. S. C. 750), amending section 3 of the Fourth Liberty Bond Act of July 9, 1918 (31 U. S. C. 750), the interest received on and after March 3, 1919, on bonds, notes, and certificates of indebtedness of the United States while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, if such individual, corporation, partnership, or association is not engaged in business in the United States, is exempt from income taxes. Such exemption applies only to such bonds, notes, or certificates as have been issued before March 1, 1941. Interest derived by a nonresident alien individual, or by a foreign corporation, partnership, or association on such bonds, notes, or certificates issued on or after March 1, 1941, is subject to tax as in the case of taxpayers generally as provided in § 1.103–4 (b).

§ 1.109 STATUTORY PROVISIONS; IMPROVEMENTS BY LESSEE ON LESSOR'S PROPERTY.

SEC. 109. IMPROVEMENTS BY LESSEE ON LESSOR'S PROPERTY.

Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.

§ 1.109–1 EXCLUSION FROM GROSS INCOME OF LESSOR OF REAL PROPERTY OF VALUE OF IMPROVEMENTS ERECTED BY LESSEE.—(a) Income derived by a lessor of real property upon the termination, through forfeiture or otherwise, of the lease of such property and attributable to buildings erected or other improvements made by the lessee upon the leased property is excluded from gross income. However, where the facts disclose that such buildings or improvements represent in whole or in part a liquidation in kind of lease rentals, the exclusion from gross income shall not apply to the extent that such buildings or improvements represent such liquidation. The exclusion applies only with respect to the income realized by the lessor upon the termination of the lease and has no application to income, if any, in the form of rent, which may be derived by a lessor during the period of the lease and attributable to buildings erected or other improvements made by the lessee. It has no application to income which may be realized by the lessor upon the termination of the lease but not attributable to the value of such buildings or improvements. Neither does it apply to income derived by the lessor subsequent to the termination of the lease incident to the ownership of such buildings or improvements.

(b) The provisions of this section may be illustrated by the following example:

Example. The A Corporation leased in 1945 for a period of 50 years unimproved real property to the B Corporation under a lease providing that the B Corporation erect on the leased premises an office building costing $500,000, in addition to paying the A Corporation a lease rental of $10,000 per annum beginning on the date of completion of the improvements, the sum of $100,000 being placed in escrow for the payment of the rental. The building was completed on January 1, 1950. The lease provided that all improvements made by the lessee on the leased property would become the absolute property of the A Corporation on the termination of the lease by forfeiture or otherwise and that the lessor would become entitled on such termination to the remainder of the sum, if any, remaining in the escrow fund. The B Corporation forfeited its lease on January 1, 1955, when the improvements had a value of $100,000. Under the provisions of section 109, the $100,000 is excluded from gross income. The amount of $50,000 representing the remainder in the escrow fund is forfeited to the A Corporation and is included in the gross income of that taxpayer. As to the basis of the property in the hands of the A Corporation, see § 1.1019–1.

§ 1.110 STATUTORY PROVISION: INCOME TAXES PAID BY LESSEE CORPORATION.

SEC. 110. INCOME TAXES PAID BY LESSEE CORPORATION. If—

(1) A lease was entered into before January 1, 1954,
(2) Both lessee and lessor are corporations, and

(3) Under the lease, the lessee is obligated to pay, or to reimburse the lessor for, any part of the tax imposed by this subtitle on the lessor with respect to the rentals derived by the lessor from the lessee,

then gross income of the lessor does not include such payment or reimbursement, and no deduction for such payment or reimbursement shall be allowed to the lessee. For purposes of the preceding sentence, a lease shall be considered to have been entered into before January 1, 1954, if it is a renewal or continuance of a lease entered into before such date and if such renewal or continuance was made in accordance with an option contained in the lease on December 31, 1953.

§ 1.110–1 INCOME TAXES PAID BY LESSEE CORPORATION.—(a) If a lease was entered into before January 1, 1954, if both lessee and lessor are corporations, and if, under the lease, the lessee is obligated to pay, or to reimburse the lessor for, any portion of the tax imposed by subtitle A of the Internal Revenue Code of 1954 upon the lessor with respect to the rentals derived by the lessor from such lease, such payment or reimbursement of tax shall be excluded from gross income of the lessor and no deduction therefor shall be allowed to the lessee. For purposes of this section, a renewal or continuance after December 31, 1953, of a lease entered into before January 1, 1954, shall be considered a lease entered into before January 1, 1954, if such renewal or continuance is made in accordance with an option contained in the original lease on December 31, 1953, or in accordance with an option contained (on December 31, 1953) in an instrument by which the original lease was renewed or continued. Thus, assume that a corporation lessor and a corporation lessee enter into a lease on January 1, 1947. The lease expires on December 31, 1953, but may be renewed for two years at the option of the lessee. On December 31, 1953, the lessee exercises his option, and the parties further agree, in writing, that the terms of the lease may be extended for an additional two years at the lessee's option. On December 31, 1955, the lessee exercises his option. The renewal period covering 1954 and 1955 are controlled by the provisions of section 110. Similarly, section 110 is applicable to the second two-year period to which the lease has been extended. However, section 110 would not be applicable to any further extension of the terms of the lease, since such further extension would not be made pursuant to an option existing on December 31, 1953.

(b) In the case of a lease to which the provisions of section 110 are not applicable, any amounts paid or reimbursed by the lessee corporation with respect to taxes imposed by subtitle A of the Internal Revenue Code of 1954 upon the lessor corporation for rentals derived by the lessor corporation under such lease shall be included in the gross income of the lessor corporation and shall, if otherwise allowable, be allowed as a deduction to the lessee corporation.

§ 1.111 STATUTORY PROVISIONS; RECOVERY OF BAD DEBTS, PRIOR TAXES, AND DELINQUENCY AMOUNTS.

SEC. 111. RECOVERY OF BAD DEBTS, PRIOR TAXES, AND DELINQUENCY AMOUNTS.

(a) GENERAL RULE.—Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.

(b) DEFINITIONS.—For purposes of subsection (a)—

(1) BAD DEBT.—The term "bad debt" means a debt on account of the worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

(2) PRIOR TAX.—The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

(3) DELINQUENCY AMOUNT.—The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time required by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

(4) RECOVERY EXCLUSION.—The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Secretary or his delegate, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this subtitle (not including the accumulated earnings tax imposed by section 531 or the tax on personal holding companies imposed by section 541) or corresponding provisions of prior income tax laws (other than subchapter E of chapter 2 of the Internal Revenue Code of 1939, relating to World War II excess profits tax), reduced by the amount excludable in previous taxable years with respect to such debt, tax, or amount under this section.

(c) SPECIAL RULES FOR ACCUMULATED EARNINGS TAX AND FOR PERSONAL HOLDING COMPANY TAX.—In applying subsections (a) and (b) for the purpose of determining the accumulated earnings tax under section 531 or the tax under section 541 (relating to personal holding companies)—

(1) A recovery exclusion allowed for purposes of this subtitle (other than section 531 or section 541) shall be allowed whether or not the bad debt, prior tax, or delinquency amount resulted in a reduction of the tax under section 531 or the tax under section 541 for the prior taxable year; and

(2) Where a bad debt, prior tax, or delinquency amount was not allowable as a deduction or credit for the prior taxable year for purposes of this subtitle other than of section 531 or section 541 but was allowable for the same taxable year under section 531 or section 541, then a recovery exclusion shall be allowable if such bad debt, prior tax, or delinquency amount did not result in a reduction of the tax under section 531 or the tax under section 541.

§ 1.111–1 RECOVERY OF CERTAIN ITEMS PREVIOUSLY DEDUCTED OR CREDITED.—(a) *General.*—Section 111 provides that income attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. The rule of exclusion so prescribed by statute applies equally with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses referred to in section 127 of the Internal Revenue Code of 1939, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums. The term "recovery exclusion" as used in this section means an amount equal to the portion of the bad debts, prior taxes, and delinquency amounts (the items specifically referred to in section 111), and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction of any tax of the taxpayer under subtitle A (other than the accumulated earnings tax imposed by section 531 or the personal holding company tax imposed by section 541) of the

Internal Revenue Code of 1954 or corresponding provisions of prior income tax laws (other than the World War II excess profits tax imposed under subchapter E of chapter 2 of the Internal Revenue Code of 1939).

(1) *Section 111 items.*—The term "section 111 items" as used in this section means bad debts, prior taxes, delinquency amounts, and all other items subject to the rule of exclusion, for which a deduction or credit was allowed for a prior taxable year. If a bad debt was previously charged against a reserve by a taxpayer on the reserve method of treating bad debts, it was not deducted, and it is therefore, not considered a section 111 item. Bad debts, prior taxes, and delinquency amounts are defined in section 111 (b) (1), (2), and (3), respectively. An example of a delinquency amount is interest on delinquent taxes. An example of the other items not expressly referred to in section 111 but nevertheless subject to the rule of exclusion is a loss sustained upon the sale of stock and later recovered, in whole or in part, through an action against the party from whom such stock had been purchased.

(2) *Definition of "recovery."*—Recoveries result from the receipt of amounts in respect of the previously deducted or credited section 111 items, such as from the collection or sale of a bad debt, refund or credit of taxes paid, or cancellation of taxes accrued. Care should be taken in the case of bad debts which were treated as only partially worthless in prior years to distinguish between the item described in section 111, that is, the part of such debt which was deducted, and the part not previously deducted, which is not a section 111 item and is considered the first part collected. The collection of the part not deducted is not considered a "recovery." Furthermore, the term "recovery" does not include the gain resulting from the receipt of an amount on account of a section 111 item which, together with previous such receipts, exceeds the deduction or credit previously allowed for such item. For instance, a $100 corporate bond purchased for $40 and later deducted as worthless is subsequently collected to the extent of $50. The $10 gain (excess of $50 collection over $40 cost) is not a recovery of a section 111 item. Such gain is in no case excluded from gross income under section 111, regardless of whether the $40 recovery is or is not excluded.

(3) *Treatment of debt deducted in more than one year by reason of partial worthlessness.*—In the case of a bad debt deducted in part for two or more prior years, each such deduction of a part of the debt is considered a separate section 111 item. A recovery with respect to such debt is considered first a recovery of those items (or portions thereof), resulting from such debt, for which there are recovery exclusions. If there are recovery exclusions for two or more items resulting from the same bad debt, such items are considered recovered in the order of the taxable years for which they were deducted, beginning with the latest. The recovery exclusion for any such item is determined by considering the recovery exclusion with respect to the prior year for which such item was deducted as being first used to offset all other applicable recoveries in the year in which the bad debt is recovered.

(4) *Special provisions as to worthless bonds, etc., which are treated as capital losses.*—Certain bad debts arising from the worthlessness

of securities and certain nonbusiness bad debts are treated as losses from the sale or exchange of capital assets. See sections 165(g) and 166(d). The amounts of the deductions allowed for any year under section 1211 on account of such losses for such year are considered to be section 111 items. Any part of such losses which, under section 1211, is a deduction for a subsequent year through the capital loss carryover (any later receipt of an amount with respect to such deducted loss is a recovery) is considered a section 111 item for the year in which such loss was sustained.

(b) *Computation of recovery exclusion.*—(1) *Amount of recovery exclusion allowable for year of recovery.*—For the year of any recovery, the section 111 items which were deducted or credited for one prior year are considered as a group and the recovery thereon is considered separately from recoveries of any items which were deducted or credited for other years. This recovery is excluded from gross income to the extent of the recovery exclusion with respect to this group of items as (i) determined for the original year for which such items were deducted or credited (see subparagraph (2) of this paragraph) and (ii) reduced by the excludable recoveries in intervening years on account of all section 111 items for such original year. A taxpayer claiming a recovery exclusion shall submit, at the time the exclusion is claimed, the computation of the recovery exclusion claimed for the original year for which the items were deducted or credited, and computations showing the amount recovered in intervening years on account of the section 111 items deducted or credited for the original year.

(2) *Determination of recovery exclusion for original year for which items were deducted or credited.*—(i) The recovery exclusion for the taxable year for which section 111 items were deducted or credited (that is, the "original taxable year") is the portion of the aggregate amount of such deductions and credits which could be disallowed without causing an increase in any tax of the taxpayer imposed under subtitle A (other than the accumulated earnings tax imposed by section 531 or the personal holding company tax imposed by section 541) of the Internal Revenue Code of 1954 or corresponding provisions of prior income tax laws (other than the World War II excess profits tax imposed under subchapter E of chapter 2 of the Internal Revenue Code of 1939). For the purpose of such recovery exclusion, consideration must be given to the effect of net operating loss carryovers and carrybacks or capital loss carryovers.

(ii) This rule shall be applied by determining the recovery exclusion as the aggregate amount of the section 111 items for the original year for which such items were deducted or credited reduced by whichever of the following amounts is the greater:

(*a*) The difference between (*1*) the taxable income for such original year and (*2*) the taxable income computed without regard to the section 111 items for such original year.

(*b*) In the case of a taxpayer subject to any income tax in lieu of normal tax or surtax or both (except the alternative tax on capital gains imposed by section 1201, which is disregarded), the difference between (*1*) the income subject to such tax for such original year and (*2*) the income subject to such tax computed without regard to the section 111 items for such original year.

(Neither the amount determined under (*1*) nor the amount under (*2*) of (*a*) or (*b*) of this subdivision shall in any case be considered less than zero.) For this determination of the recovery exclusion, the aggregate of the section 111 items must be further decreased by the portion thereof which caused a reduction in tax in preceding or succeeding taxable years through any net operating loss carryovers or carrybacks or capital loss carryovers affected by such items. This decrease is the aggregate of the largest amount determined for each of such preceding and succeeding years under (*a*) and (*b*) of this subdivision, the computation of each carryover or carryback to the preceding or succeeding year being made under (*1*) of (*a*) and (*b*) of this subdivision with regard to the section 111 items for the original year and such computation being made under (*2*) of (*a*) and (*b*) of this subdivision without regard to such items. For the purpose of the preceding sentence, the computations under both (*1*) and (*2*) of (*a*) and (*b*) of this subdivision shall be made without regard to any section 111 items for such preceding or succeeding year and the carryovers and carrybacks to such year shall be determined without regard to any section 111 items for years subsequent to the original year.

(iii) The determination of the recovery exclusion for original taxable years subject to the provisions of the Internal Revenue Code of 1939 shall be made under § 39.22(b)(12)–1(b)(2) of Regulations 118.

(3) *Example.*—The provisions of this paragraph may be illustrated by the following example:

Example. A single individual with no dependents has for his 1954 taxable year the following income and deductions:

	With deduction of section 111 items		*Without deduction of section 111 items*	
Gross income	-------	$25,000	-------	$25,000
Less deductions:				
Depreciation	$20,000	-------	$20,000	-------
Business bad debts and taxes	6,300	-------	-------	-------
Personal exemption	600	26,900	600	20,600
Taxable income or (loss)	-------	(1,900)	-------	4,400
Adjustment under section 172(d)(4)	-------	600	-------	-------
Net operating loss	-------	(1,300)	-------	-------

The full amount of the net operating loss of $1,300 is carried back and allowed as a deduction for 1952. The aggregate of the section 111 items for 1954 is $6,300 (bad debts and taxes). The recovery exclusion on account of section 111 items for 1954 is $600, determined by reducing the $6,300 aggregate of the section 111 items by $5,700, i. e., the sum of (1) the difference between the amount of the taxable income for 1954 computed without regard to the section 111 items ($4,400) and the amount of the taxable income for 1954 (not less than zero) computed by taking such items into account, and (2) the amount of the net operating loss ($1,300) which caused the reduction in tax for 1952 by reason of the carryback provisions. If in 1956 the taxpayer recovers $400 of the bad debts, all of the recovery is excluded from the income by reason of the recovery exclusion of $600 determined for the original year 1954. If in 1957 the taxpayer recovers an additional $300 of the bad debts, only $200 is excluded from gross income. That is, the recovery exclusion of $600 determined for the original year 1954

is reduced by the $400 recovered in 1956, leaving a balance of $200 which is used in 1957. The balance of the amount recovered in 1957, $100 ($300 less $200), is included in gross income for 1957.

(c) *Provisions as to taxes imposed by section 531 (relating to the accumulated earnings tax) and section 541 (relating to the tax on personal holding companies.*—A recovery exclusion allowed for purposes of subtitle A (other than section 531 or section 541) of the Internal Revenue Code of 1954 shall also be allowed for the purpose of determining the accumulated earnings tax under section 531 or the personal holding company tax under section 541 regardless of whether or not the section 111 items on which such recovery exclusion is based resulted in a reduction of the tax under section 531 or section 541 (or corresponding provisions of prior income tax laws) for the prior taxable year. Furthermore, if there is recovery of a section 111 item which was not allowable as a deduction or credit for the prior taxable year for purposes of subtitle A (not including section 531 or section 541) of the Internal Revenue Code of 1954 or corresponding provisions of prior income tax laws (other than subchapter E of chapter 2 of the Internal Revenue Code of 1939, relating to World War II excess profits tax), but was allowable for such prior taxable year in determining the tax under section 531 or section 541 (or corresponding provisions of prior income tax laws) then for the purpose of determining the tax under section 531 or section 541 a recovery exclusion shall be allowable with respect to such recovery if the section 111 item did not result in a reduction of the tax under section 531 or section 541 (or corresponding provisions of prior income tax laws).

§ 1.112 STATUTORY PROVISIONS; CERTAIN COMBAT PAY OF MEMBERS OF THE ARMED FORCES.

SEC. 112. CERTAIN COMBAT PAY OF MEMBERS OF THE ARMED FORCES.

(a) ENLISTED PERSONNEL.—Gross income does not include compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member—

(1) Served in a combat zone during an induction period, or

(2) Was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone during an induction period; but this paragraph shall not apply for any month during any part of which there are no combatant activities in any combat zone as determined under subsection (c) (3) of this section.

(b) COMMISSIONED OFFICERS.—Gross income does not include so much of the compensation as does not exceed $200 received for active service as a commissioned officer in the Armed Forces of the United States for any month during any part of which such officer—

(1) Served in a combat zone during an induction period, or

(2) Was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone during an induction period; but this paragraph shall not apply for any month during any part of which there are no combatant activities in any combat zone as determined under subsection (c) (3) of this section.

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

(1) The term "commissioned officer" does not include a commissioned warrant officer.

(2) The term "combat zone" means any area which the President of the United States by Executive Order designates, for purposes of this section or corresponding provisions of prior income tax laws, as an area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat.

(3) Service is performed in a combat zone only if performed on or after the date designated by the President by Executive Order as the date of the commencing of combatant activities in such zone, and on or before the date designated by the President by Executive Order as the date of the termination of combatant activities in such zone; except that June 25, 1950, shall be considered the date of the commencing of combatant activities in the combat zone designated in Executive Order 10195.

(4) The term "compensation" does not include pensions and retirement pay.

(5) The term "induction period" means any period during which, under laws heretofore or hereafter enacted relating to the induction of individuals for training and service in the Armed Forces of the United States, individuals (other than individuals liable for induction by reason of a prior deferment) are liable for induction for such training and service.

§ 1.112–1 Compensation of Members of the Armed Forces of the United States for Service in a Combat Zone During an Induction Period, or for Service While Hospitalized as a Result of Such Combat-Zone Service.—(a) In addition to the exemptions and credits otherwise applicable, section 112 provides that there shall be excluded from gross income:

(1) Compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member (i) served in a combat zone during an induction period, or (ii) was hospitalized at any place as a result of wounds, disease, or injury incurred while so serving provided that during all of such month there are combatant activities in some combat zone.

(2) In the case of compensation received for active service as a commissioned officer in the Armed Forces of the United States for any month during any part of which such officer (i) served in a combat zone during an induction period, or (ii) was hospitalized at any place as a result of wounds, disease, or injury incurred while so serving provided that during all of such month there are combatant activities in some combat zone, so much of such compensation as does not exceed $200.

(b) The exclusions under section 112 and this section are applicable only if active service is performed in a combat zone during an induction period. Compensation is subject to exclusion whether or not it is received outside a combat zone or while the recipient is hospitalized or in a year different from that in which the service was rendered for which the compensation is paid. Service is performed in a combat zone only if it is performed in an area which the President of the United States has designated by Executive order, for the purpose of section 112, as an area in which Armed Forces of the United States are or have engaged in combat, and only if it is performed on or after the date designated by the President by Executive order as the date of the commencing of combatant activities in such zone and on or before the date designated by the President by Executive order as the date of the termination of combatant activities in such zone. Section 112(c)(3) provides that June 25, 1950, shall be considered the date of commencing of combatant activities in the combat zone designated in Executive Order 10195. In Executive Order 10585 the President designated January 31, 1955, as of midnight thereof, as the date of termination of combatant activities in the combat zone designated in Executive Order 10195. If a member of the Armed Forces serves in a combat

zone for any part of a month during an induction period, he is entitled to the exclusion for such month to the same extent as if he has served in such zone, for the entire month. If a member of the Armed Forces is hospitalized for a part of a month as a result of wounds, disease, or injury incurred while serving in such zone during an induction period, he is entitled to the exclusion for the entire month provided there are some combatant activities in any combat zone during all of such month.

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

(d) These principles may be illustrated by the following examples (in each case service is performed in a combat zone during an induction period):

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

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

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

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

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

(f) The term "induction period" means any period in which individuals are generally subject to induction into the Armed Forces of the United States under the Universal Military Training and Service Act (50 App. U. S. C. 451) or under similar acts hereafter enacted. The term does not apply to any period in which individuals are not generally subject to induction but are subject to induction by reason of a prior deferment.

(g) The term "commissioned officer" does not include a commissioned warrant officer, and, accordingly, a commissioned warrant officer is entitled to the exclusion allowed to enlisted personnel under section 112(a). The term "compensation", for the purpose of this section, does not include pensions and retirement pay. As to who are members of the Armed Forces of the United States, see section 7701(a)(15).

(h) These exclusions are applicable without regard to the marital status of the recipient of the compensation, and if a husband and wife both meet the requirements of the statute, then each is entitled to the benefit of an exclusion. In the case of a husband and wife domiciled

in a State recognized for Federal income tax purposes as a community property State, any exclusion from gross income under section 112 operates before apportionment of the gross income of the spouses in accordance with community property law. For example, a man and his wife are domiciled in a community property State and he is entitled, as a commissioned officer, to the benefit of the exclusion of $200 for each month under section 112(b). He receives $1,000 as compensation for active service for three months in a combat zone. Of such amount, $600 is excluded from gross income under section 112(b) and only $400 is taken into account in determining the gross income of both husband and wife.

(i) A member of the Armed Forces is in active service if he is actually serving in the Armed Forces of the United States. Periods during which a member of the Armed Forces is absent from duty on account of sickness, wounds, leave, internment by the enemy, or other lawful cause are periods of active service. A member of the Armed Forces in active service in a combat zone who there becomes a prisoner of war or missing in action is deemed, for the purpose of section 112 and this section, to continue in active service in the combat zone for the period for which he is entitled to such status for military pay purposes. These exclusions apply to compensation received by a member of the Armed Forces for services rendered while in active service even though payment is received subsequent to discharge or release from active service. Compensation credited to a decedent's account for a period subsequent to the established date of his death and received by his estate will be excluded under section 112 from the gross income of the estate to the same extent that it would have been excluded from the gross income of the decedent if he had lived and received such compensation.

§ 1.113 STATUTORY PROVISIONS; MUSTERING-OUT PAYMENTS FOR MEMBERS OF THE ARMED FORCES.

SEC. 113. MUSTERING-OUT PAYMENTS FOR MEMBERS OF THE ARMED FORCES.

Gross income does not include amounts received during the taxable year as mustering-out payments with respect to service in the Armed Forces of the United States.

§ 1.113–1 MUSTERING-OUT PAYMENTS FOR MEMBERS OF THE ARMED FORCES.—For the purposes of the exclusion from gross income under section 113 of mustering-out payments with respect to service in the Armed Forces, mustering-out payments are payments made to any recipients pursuant to the provisions of the Mustering-Out Payment Act of 1944 and Subchapter IV of the Veterans Readjustment Assistance Act of 1952. (See 38 U. S. C. 691e and 1011–1016.)

§ 1.114 STATUTORY PROVISIONS; SPORTS PROGRAMS CONDUCTED FOR THE AMERICAN NATIONAL RED CROSS.

SEC. 114. SPORTS PROGRAMS CONDUCTED FOR THE AMERICAN NATIONAL RED CROSS.

(a) GENERAL RULE.—In the case of a taxpayer which is a corporation primarily engaged in the furnishing of sports programs, gross income does not include amounts received as proceeds from a sports program conducted by the taxpayer if—

(1) The taxpayer agrees in writing with the American National Red Cross to conduct such sports program exclusively for the benefit of the American National Red Cross;

(2) The taxpayer turns over to the American National Red Cross the proceeds from such sports program, minus the expenses paid or incurred by the taxpayer—

(A) Which would not have been so paid or incurred but for such sports program, and

(B) Which would be allowable as a deduction under section 162 (relating to trade or business expenses) but for subsection (b) of this section; and

(3) The facilities used for such program are not regularly used during the taxable year for the conduct of sports programs to which this subsection applies.

For purposes of this subsection, the term "proceeds from such sports program" includes all amounts paid for admission to the sports program, plus all proceeds received by the taxpayer from such program or activities carried on in connection therewith.

(b) TREATMENT OF EXPENSES.—Expenses described in subsection (a)(2) shall be allowed as a deduction under section 162 only to the extent that such expenses exceed the amount excluded from gross income by subsection (a) of this section.

§ 1.114–1 PROCEEDS FROM CERTAIN SPORTS PROGRAMS CONDUCTED FOR THE BENEFIT OF THE AMERICAN NATIONAL RED CROSS.—(a) *In general.*—Under section 114, a corporation primarily engaged in the furnishing of sports programs may exclude from its gross income amounts received as proceeds from a sports program conducted by such corporation if each of the following requirements is met:

(1) The corporation agrees in writing with the American National Red Cross to conduct such sports program exclusively for the benefit of the American National Red Cross;

(2) The corporation turns over to the American National Red Cross all the proceeds from such sports program, less only the expense paid or incurred by such corporation which would not have been paid or incurred but for such sports program and which would be allowable as deductions as ordinary and necessary business expenses under section 162(a) except for the provisions of section 114(b); and

(3) The facilities of the corporation used in conducting such sports program are not regularly used during the taxable year for the conduct of sports programs to which section 114(a) applies.

(b) *Certain corporations ineligible.*—Section 114 does not apply in the case of a corporation organized or operated primarily to conduct or furnish, or to participate in the conduct or furnishing of, one or more sports programs for the American National Red Cross.

(c) *Proceeds from a sports program.*—The proceeds from a sports program conducted for the benefit of the American National Red Cross include all amounts received by the conducting corporation, irrespective of when received, on account of such sports program, which amounts would be includible in the gross income of such conducting corporation, except for the provisions of section 114. Where the activities carried on in connection with the sports program include the sale or rental of radio, television, or movie rights, refreshments, souvenirs, parking facilities, programs, advertising, or other goods and services, whether sold or rented directly or through concessionaires, the amounts received by the conducting corporation from such sports program include all amounts received from such activities, but only where such amounts would not have been received by the con-

ducting corporation but for the presentation of the particular sports program. Where the conducting corporation receives payments for concessions on an annual or seasonal basis, and such payments are not increased because of the particular sports program, such payments are not considered as proceeds from such sports program, and any expenses paid or incurred by the conducting corporation on account of such concession operations may not be taken into account under section 114(a)(2) in determining the net amount of the proceeds from such sports program which the conducting corporation is required to turn over to the American National Red Cross; nor are the proceeds of a sports program considered to include amounts received by the conducting corporation which do not constitute gross income of such corporation, such as admissions taxes or the breakage on a pari-mutual wagering pool which is required to be paid over to the State.

(d) *Sports programs.*—(1) Section 114 applies where the program furnished by the conducting corporation consists of sports events such as baseball, football, basketball, or racing but it does not apply to programs or events such as motion pictures, circuses, or dances which are not ordinarily considered to be competitive sporting events.

(2) A sports program includes all of the events normally making up a full program in the particular sport. A single race of a racing program consisting of more than one race would not constitute a sports program, nor would one baseball or basketball game of a doubleheader program constitute a sports program.

(e) *Treatment of expenses.*—Expenses described in section 114 (a)(2) shall be allowable as deductions under section 162 only to the extent that such expenses exceed the amount excluded from gross income under section 114(a).

§ 1.115 STATUTORY PROVISIONS: INCOME OF STATES, MUNICIPALITIES, ETC.

SEC. 115. INCOME OF STATES, MUNICIPALITIES, ETC.

(a) GENERAL RULE.—Gross income does not include—

(1) Income derived from any public utility or the exercise of any essential governmental function and accruing to a State or Territory, or any political subdivision thereof, or the District of Columbia; or

(2) Income accruing to the government of any possession of the United States, or any political subdivision thereof.

(b) CONTRACTS MADE BEFORE SEPTEMBER 8, 1916, RELATING TO PUBLIC UTILITIES.—Where a State or Territory, or any political subdivision thereof, or the District of Columbia, before September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which was to acquire, construct, operate, or maintain a public utility—

(1) If—

(A) By the terms of such contract the tax imposed by this subtitle is to be paid out of the proceeds from the operation of such public utility before any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia; and

(B) A part of such proceeds for the taxable year would (but for the imposition of the tax imposed by this subtitle) accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia,

then a tax on the taxable income from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle, but there shall be refunded to such State, Territory, political subdivision, or the District

of Columbia (under regulations prescribed by the Secretary or his delegate) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this subtitle) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the taxable income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this subtitle, accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax on the taxable income of such person from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle.

(c) CONTRACTS MADE BEFORE MAY 29, 1928, RELATING TO BRIDGE ACQUISITIONS.—Where a State or political subdivision thereof, pursuant to a contract entered into before May 29, 1928, to which it is not a party, is to acquire a bridge—

(1) If—

(A) By the terms of such contract the tax imposed by this subtitle is to be paid out of the proceeds from the operation of such bridge before any division of such proceeds, and

(B) A part of such proceeds for the taxable year would (but for the imposition of the tax imposed by this subtitle) accrue directly to or for the use of or would be applied for the benefit of such State or political subdivision,

then a tax on the taxable income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle, but there shall be refunded to such State or political subdivision (under regulations to be prescribed by the Secretary or his delegate) an amount which bears the same relation to the amount of the tax as the amount which (but for the mposition of the tax imposed by this subtitle) would have accrued directly to or for the use of or would be applied for the benefit of such State or political subdivision bears to the amount of the taxable income from the operation of such bridge for such taxable year. No such refund shall be made unless the entire amount of the refund is to be applied in part payment for the acquisition of such bridge.

(2) If by the terms of such contract no part of the proceeds from the operation of the bridge for the taxable year would, irrespective of the tax imposed by this subtitle, accrue directly to or for the use of or be applied for the benefit of such State or political subdivision, then the tax on the taxable income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this subtitle.

§ 1.115–1 BRIDGES TO BE ACQUIRED BY STATE OR POLITICAL SUBDIVISIONS.—(a) Any State or political subdivision thereof claiming a refund under the provisions of section 115(c) of an amount equal to all or a portion of any income tax levied, assessed, collected, and paid shall file a claim therefor on Form 843 (to which there shall be attached as exhibits the matter hereinafter prescribed) with the district director of internal revenue for the internal revenue district in which the tax was paid, which claim shall be executed on behalf of such State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain:

(1) A statement of the name of the taxpayer, of the amount of tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought;

(2) A full statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 115(c);

(3) A showing which will establish to the satisfaction of the district director that the fiscal officer presenting the claim has authority to receive the amount of the refund on behalf of the State or political subdivision which he assumes to represent and to apply without delay the entire amount of such refund in part payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments considered by the claimant sufficient to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund; and

(4) A statement, verified by a written declaration that it is made under the penalties of perjury, made by or on behalf of the taxpayer that the taxpayer thereby joins with and concurs in the request of the State or political subdivision thereof that a refund of an amount equal to all or a portion of the tax previously paid by such taxpayer be made to such State or political subdivision, that the taxpayer agrees to receive the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of such refund in part payment for the acquisition of such bridge, and that if for any reason the contract which is the basis of the claim for refund is not fully executed and performed, the taxpayer will repay to the United States upon its demand the entire amount of the refund with interest at 6 percent per annum from the date the refund is made without seeking or claiming the benefit of any statute of limitations which prior thereto may have run against the United States.

(b) No refund shall be made of any amount in excess of the amount of the tax levied, assessed, collected, and paid by the taxpayer for any taxable year or period. A separate claim shall be made in respect of each separate taxable year or period. If by the terms of the contract on which the claim is based two or more States or political subdivisions of a State or States are entitled to acquire the bridge, the claim for refund in respect of each separate taxable year or period must be made jointly by the States or political subdivisions thereof so entitled. The amount refunded under section 115(c) and this section is not considered an overpayment, within the meaning of section 6611, relating to interest on overpayments, and no interest shall be allowed or paid upon the amount of the refund.

(c) A check or voucher in payment of a claim for refund allowed under section 115(c) will be drawn in the name of the fiscal officer or officers having authority, as established under paragraph (a) (3) of this section, to receive the same, and will contain an express provision that it is issued for the sole purpose and subject to the conditions prescribed in section 115(c) and this section.

§ 1.118 STATUTORY PROVISIONS; CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION.

SEC. 118. CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION.

(a) GENERAL RULE.—In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

(b) CROSS REFERENCE.—For basis of property acquired by a corporation through a contribution to its capital, see section 362.

§ 1.118–1 CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION.—In the case of a corporation, section 118 provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. Thus, if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. Section 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production. See section 362 for the basis of property acquired by a corporation through a contribution to its capital by its stockholders or by nonstockholders.

§ 1.119 STATUTORY PROVISIONS; MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER.

SEC. 119 MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER.

There shall be excluded from 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—

(1) In the case of meals, the meals are furnished on the business premises of the employer, or

(2) 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.

In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation.

§ 1.119–1 MEALS AND LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER.—(a) *Meals.*—(1) The value of meals furnished to an employee by his employer shall be excluded from the employee's gross income if two tests are met: (i) The meals are furnished on the business premises of the employer, and (ii) the meals are furnished for

the convenience of the employer. The exclusion shall apply irrespective of whether under an employment contract or a statute fixing the terms of employment such meals are furnished as compensation.

(2) The question of whether meals are furnished for the convenience of the employer is one of fact to be determined by analysis of all the facts and circumstances in each case. Ordinarily, meals furnished to the employee during the working day will be deemed furnished for the convenience of the employer. Likewise, meals furnished immediately preceding or immediately following working hours of the employee will be deemed to be for the convenience of the employer if the furnishing of such meals serves a business purpose of the employer other than providing additional or indirect compensation to the employee. Meals furnished on nonworking days, or at times when the employee's presence on the employer's business premises does not serve a business purpose of the employer, do not qualify for the exclusion. If the employee is required to occupy living quarters on the business premises of his employer as a condition of his employment (as defined in paragraph (b) of this section), the exclusion applies to the value of any meals furnished to the employee on such premises. There is no requirement that the employee accept such meals as a condition of employment to qualify for the exclusion.

(b) *Lodging.*—The value of lodging furnished to an employee by his employer shall be excluded from the employee's gross income if three tests are met: (1) The lodging is furnished on the business premises of the employer, (2) the lodging is furnished for the convenience of the employer, and (3) the employee is required to accept such lodging as a condition of his employment. The phrase "required as a condition of his employment" means required in order for the employee to perform properly the duties of his employment. The exclusion shall apply irrespective of whether under an employment contract or a statute fixing the terms of employment such lodging is furnished as compensation.

(c) *Rules.*—(1) For purposes of this section, the term "business premises of the employer" generally means the place of employment of the employee. For example, meals and lodging furnished in the employer's home to a domestic servant would constitute meals and lodging furnished on the business premises of the employer. Similarly, meals furnished to cowhands while herding their employer's cattle on leased land would be regarded as furnished on the business premises of the employer.

(2) The exclusion provided by section 119 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. However, the mere fact that an employee, at his option, may decline to accept meals and lodging tendered in kind will not of itself require inclusion of the value thereof in gross income. Cash allowances for meals or lodging received by an employee are includible in gross income to the extent that such allowances constitute compensation.

(d) *Examples.*—The provisions of section 119 may be illustrated by the following examples:

Example (1). A waitress who works from 7 a. m. to 4 p. m. is furnished without charge two meals a workday. In order to insure that the waitress will commence work on time, the employer encourages her to have her breakfast on his business premises before starting work, although she is not required to have her breakfast there. She is required to have her lunch on such premises. The waitress is permitted to exclude the value of these meals from her gross income under paragraph (a) of this section.

Example (2). The waitress in example (1) is allowed to have meals on the employer's premises without charge on her days off. The waitress is not permitted to exclude the value of such meals from her gross income.

Example (3). A Civil Service employee of a State is employed at an institution and is required by his employer to be available for duty at any time. Accordingly, the employer furnishes the employee with meals and lodging at the institution. Under the applicable State statute, his meals and lodging are regarded as part of the employee's compensation. The employee would nevertheless be entitled to exclude the value of such meals and lodging from his gross income.

Example (4). An employee of an institution is given the choice of residing at the institution free of charge, or of residing elsewhere and receiving a cash allowance in addition to his regular salary. If he elects to reside at the institution the value to the employee of the lodging furnished by the employer will be includible in the employee's gross income because his residence at the institution is not required in order for him to perform properly the duties of his employment.

§ 1.120 STATUTORY PROVISIONS; STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE.

SEC. 120. STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE.

(a) GENERAL RULE.—Gross income does not include any amount received as a statutory subsistence allowance by an individual who is employed as a police official by a State, a Territory, or a possession of the United States, by any political subdivision of any of the foregoing, or by the District of Columbia.

(b) LIMITATIONS.—

(1) Amount to which subsection (a) applies shall not exceed $5 per day.

(2) If any individual receives a subsistence allowance to which subsection (a) applies, no deduction shall be allowed under any other provision of this chapter for expenses in respect of which he has received such allowance, except to the extent that such expenses exceed the amount excludable under subsection (a) and the excess is otherwise allowable as a deduction under this chapter.

§ 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 established amount, apart from salary or other compensation, which is authorized under the laws of a State, a Territory, or a possession of the United States, by any political subdivision of any of the

foregoing, or by the District of Columbia, to be paid to an individual who is employed as a police official of such governmental unit for meals and other incidental expenses in connection with his official duties. 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.

(b) The exclusion provided by section 120 is to be computed on a daily basis, that is, for each day for which the statutory allowance is paid. If the statute providing the allowance does not specify the daily amount of such allowance, the allowance shall be converted to a daily basis for the purpose of applying the limitation provided herein. For example, if a State statute provides for a weekly subsistence allowance, the daily amount is to be determined by dividing the weekly amount by the number of days for which the allowance is paid. Thus, if a State trooper receives a weekly statutory subsistence allowance of $40 for 5 days of the week, the daily amount would be $8, that is, $40 divided by 5. However, for purposes of this section, only $5 per day may be excluded, or $25 on a weekly basis.

(c) Expenses in respect of which the allowance under section 120 is paid may not be deducted under any provision of the income tax laws except to the extent that (1) such expenses exceed the amount of the exclusion, and (2) the excess is otherwise allowable as a deduction. For example, if a State statute provides a subsistence allowance of $3 per day and the taxpayer, a State trooper, incurs expenditures of $4.50 for meals while away from home overnight on official police duties only $3 would be excludable under this section. Expenses relating to such exclusion ($3) may not be deducted under any provision of the income tax laws. However, the remaining $1.50 may be an allowable deduction under section 162 as traveling expenses while away from home in the performance of official duties. See § 1.162–2.

§ 1.121 Statutory Provisions; Cross References to Other Acts.

SEC. 121. CROSS REFERENCES TO OTHER ACTS.

(a) For exemption of—

(1) Adjustments of indebtedness under wage earners' plans, see section 679 of the Bankruptcy Act (52 Stat. 938; 11 U. S. C. 1079);

(2) Allowances and expenditures to meet losses sustained by persons serving the United States abroad, due to appreciation of foreign currencies, see the Acts of March 6, 1934 (48 Stat. 466; 5 U. S. C. 118c) and April 25, 1938 (52 Stat. 221; 5 U. S. C. 118c–1);

(3) Amounts credited to the Maritime Administration under section 9(b)(6) of the Merchant Ship Sales Act of 1946, see section 9(c)(1) of that Act (60 Stat. 48; 50 U. S. C. App. 1742);

(4) Benefits under World War Adjusted Compensation Act, see section 308 of that Act, as amended (43 Stat. 125; 44 Stat. 827, § 3; 38 U. S. C. 618);

(5) Benefits under World War Veterans' Act, 1924, see section 3 of the Act of August 12, 1935 (49 Stat. 609; 38 U. S. C. 454a);

(6) Dividends and interest derived from certain preferred stock by Reconstruction Finance Corporation, see section 304 of the Act of March 9, 1933, as amended (49 Stat. 1185; 12 U. S. C. 51d);

(7) Earnings of ship contractors deposited in special reserve funds, see section 607(h) of the Merchant Marine Act, 1936, as amended (52 Stat. 961, § 28; 46 U. S. C. 1177);

(a) For exemption of—Continued

(8) Income derived from Federal Reserve banks, including capital stock and surplus, see section 7 of the Federal Reserve Act (38 Stat. 258; 12 U. S. C. 531);

(9) Income derived from Ogdensburg bridge across Saint Lawrence River, see section 4 of the Act of June 14, 1933, as amended (54 Stat. 259, § 2);

(10) Income derived from Owensboro bridge across Ohio River and nearby ferries, see section 4 of the Act of August 14, 1937 (50 Stat. 643);

(11) Income derived from Saint Clair River bridge and ferries, see section 4 of the Act of June 25, 1930, as amended (48 Stat. 140, § 1);

(12) Leave compensation payments under section 6 of Armed Forces Leave Act of 1946, see section 7 of that Act (60 Stat. 967; 37 U. S. C. 36);

(13) Mustering-out payments made to or on account of veterans under the Mustering-Out Payment Act of 1944, see section 5(a) of that Act (58 Stat. 10; 38 U. S. C. 691e);

(14) Railroad retirement annuities and pensions, see section 12 of the Railroad Retirement Act of 1935, as amended (50 Stat. 316; 45 U. S. C. 228l);

(15) Railroad unemployment benefits, see section 2(e) of the Railroad Unemployment Insurance Act, as amended (52 Stat. 1097; 53 Stat. 845, § 9; 45 U. S. C. 352);

(16) Special pensions of persons on Army and Navy medal of honor roll, see section 3 of the Act of April 27, 1916 (39 Stat. 54; 38 U. S. C. 393);

(17) Gain derived from the sale or other disposition of Treasury Bills, issued after June 17, 1930, under the Second Liberty Bond Act, as amended, see Act of June 17, 1930 (C. 512, 46 Stat. 775; 31 U. S. C. 754).

(18) Dependency and indemnity compensation paid to survivors of members of a uniformed service and certain other persons, see section 210 of the Servicemen's and Veterans' Survivor Benefits Act.

(b) For extension of military income-tax-exemption benefits to commissioned officers of Public Health Service in certain circumstances, see section 212 of the Public Health Service Act (58 Stat. 689; 42 U. S. C. 213).

[Sec. 121(a)(18) added by section 501(t) of P. L. 881 (84th Cong.) effective January 1, 1957]

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved December 31, 1956.

W. RANDOLPH BURGESS,
Acting Secretary of the Treasury.

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26 CFR 1.102–1: Gifts and inheritances. Rev. Rul. 57–233

Grants of funds made by the United States Government to eligible members of certain groups, bands, or tribes of American Indians for their relocation and vocational training are considered to be gifts which are excludable from the gross income of the recipients for Federal income tax purposes.

Advice has been requested with respect to the status for Federal income tax purposes of grants received from the United States Government by eligible members of certain groups, bands or tribes of American Indians under the relocation and vocational training

program operated by the United States Department of the Interior, Bureau of Indian Affairs.

Public Law 587, 68 Stat. 718, 25 U. S. C. 564, Public Law 588, 68 Stat. 724, 25 U. S. C. 691, and Public Law 762, 68 Stat. 1099, 25 U. S. C. 741, were enacted by the Eighty-third Congress, second session, to provide for the termination of Federal supervision over the groups, bands, or tribes of Indians named in those Acts. Those Acts also authorize the Secretary of the Interior to undertake a special program of education and training designed to help the members of the tribe to earn a livelihood, to conduct their own affairs, and to assume their responsibilities as citizens without special services because of their status as Indians.

Pursuant to those Acts and authorization, a program of vocational training for those eligible Indians who desire to relocate and secure training has been placed in operation by the Department of the Interior, Bureau of Indian Affairs. Under this program, eligible Indians are assisted to relocate from the reservation area to urban industrial centers and secure vocational training at such centers.

Within the limits of available appropriations grants, are made, subject to strict supervision by the Bureau of Indian Affairs, to eligible Indians for language training, orientation in non-Indian community customs and living standards, vocational training and related subjects, transportation to the place of training or instruction, and subsistence during the course of training or instruction. The recipients of such financial assistance are required to certify that they are not able, out of available funds or other resources, to finance their relocation and training costs, and they must further certify that they will return any unused funds to the Bureau of Indian Affairs.

Section 102 of the Internal Revenue Code of 1954 provides that gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

The Indians herein concerned are wards of the United States Government. The grants made to them are sufficient to cover only the expenses incurred by them for vocational training and related expenses. The Government receives no consideration for such grants and the Indians incur no obligations other than to carry out the relocation and vocational training plans, regular school attendance, etc., as a result of the payments. Such action is in accord with the intent of the Federal Government to help the American Indian become self-supporting and ultimately free and equal citizens. See House Concurrent Resolution 108, 67 Stat. B132.

In view of the foregoing, the Internal Revenue Service considers that Congress intended such payments to be gifts and, as such, they are excludable from the gross income of the recipients for Federal income tax purposes.

SECTION 103.—INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

26 CFR 1.103: Statutory provisions; interest on certain governmental obligations.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

26 CFR 1.103–1: Interest upon obligation of a State, Territory, etc. Rev. Rul. 57–49

Where twenty-five series of municipal bonds, the interest on which is wholly exempt from Federal income taxes, maturing in 1956 to 1980, inclusive, and bearing interest at rates varying from four down to one percent per annum, were originally purchased in 1955 from a municipality, upon accepted bid, by a dealer in securities for a lump (unallocated) sum slightly above their total par (face) amount, and thence purchased from him by investors at different prices for each series ranging from 21 percent above par down to 32 percent below par, no part of any such purchase discount constitutes discount at which bonds were issued, nor otherwise additional compensation provided or incurred by the municipality for the use of money loaned, and, therefore, will not be exempt as additional municipal bond interest upon its realization by them. If the investors hold the bonds until redemption thereof by the municipality, they will then realize recognized gain of the entire excess of the (par) redemption price received over the purchase price which they paid. If, instead, the investors sell the bonds, they will then realize recognized gain of the entire excess of the sale price received or accrued over such purchase price, or sustain recognized loss of the excess of such purchase price over the sale price received or accrued. Such gains or losses to the investors will be taxable or allowable to them as capital gains or losses, i. e., in accordance with and subject to the capital gain and loss provisions of the Internal Revenue Code of 1954.

Advice has been requested regarding the proper treatment, for Federal income tax purposes, of "discount" at which investors purchased from a dealer in securities certain interest-bearing serial municipal bonds which, together with other bonds issued by the municipality at the same time, were originally purchased from it by him for a lump sum slightly above the total par (face) amount of all the bonds.

The dealer in securities in November, 1955, made a bid to the City of R of $8004x$ dollars, plus accrued interest to date of delivery, for $8000x$ dollars face amount of its serial bonds composed of twenty-five series, of $320x$ dollars face amount each, maturing in 1956 to 1980, inclusive, and bearing annual interest at four percent on ten series, two percent on seven series, two and one-quarter percent on five series, and one percent on three series, respectively. The amount offered for the bonds was a single lump sum for all of them, payable upon their delivery, without any allocation or specification of bid price as to particular bonds or series of bonds. The bid, accompanied by a substantial remittance to bind it, was accepted by the city and, pursuantly, it delivered all the bonds to the dealer in December, 1955. The bonds were issued with interest coupons attached and are redeemable upon maturity at par. In making such bid for all the bonds of not less than their total par (face) amount, the dealer specified rates of interest on the various series which he believed would result in the lowest available total interest cost to the city on all of the bonds and still enable him to market them at a net (overall) profit. In this connection, it manifestly was recognized that, sold separately, some of the series would sell at premiums, some at par, and some at discounts, and that some of the premiums and discounts would be very substantial in view of the wide variance between some of the series in maturities and interest rates, especially the latter. The city was prohibited by a statute of the State of P, wherein it was located, from selling any of the bonds at less than par. However, the important fact here is that

all the bonds were originally purchased from the city by a dealer at a single unallocated price of not less than their total par (face) amount, pursuant to a bona fide and arm's-length bid and acceptance. The dealer thence offered and sold the bonds to the public at different prices for each series ranging from $121 per $100 face amount down to $68 per $100 face amount. All such purchasers were investors. They are holding the bonds as such and not as dealers.

Section 103(a)(1) of the Internal Revenue Code of 1954 provides that gross income does not include interest on the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia.

Although the exemption provided in section 103(a)(1), *supra*, expressly relates to "interest" on the obligations therein specified, it was held, in G. C. M. 10452, C. B. XI–1, 18 (1932), that the amount of discount at which noninterest-bearing state or municipal bonds were issued was exempt, under corresponding statutory provisions, upon its realization when the bonds were redeemed, and that, where the bonds were sold by the original purchasers before redemption, each holder thereof was entitled to apportion the amount of the (issue) discount according to the relative extent of his respective holding period. In I. T. 2629, C. B. XI–1, 20 (1932), it was similarly held with respect to the amount of discount at which interest-bearing municipal bonds were issued. See also G. C. M. 21890, C. B. 1940–1, 85. In O. D. 647, C. B. No. 3, 123 (1920), it was stated, "In no case may such exemption exceed the total discount at which the securities were originally sold by the State or municipality."

Such rulings are based on the principle that discount at which bonds and similar obligations were *issued* constitutes compensation (where noninterest-bearing), or additional compensation (where interest-bearing), which the obligor has contracted to pay for the use of the money loaned and, hence, is equivalent to interest for Federal income tax purposes. Stated differently, the issue discount is recognized as being interest in substance although provided in the form of such discount. Therefore, if "interest" on a particular bond is wholly exempt from Federal income taxes, then any discount at which it was issued is also exempt.

All the municipal bonds involved in the instant case were originally purchased, together with other bonds issued by the municipality at the same time, by a dealer at a single unallocated price of not less than their total par (face) amount and, accordingly, were *not issued* at a discount. Nor does it appear that the discount at which the dealer sold some of the bonds to investors was additional compensation otherwise provided or incurred by the municipality for the use of the money loaned to it. As aforestated, the municipality obtained the loaned funds from the dealer pursuant to his lump-sum bid, submitted and accepted, at a price above the total par (face) amount of the bonds which it issued to him for such funds. Such bid and acceptance were bona fide and arm's-length. He acquired ownership of bonds as an *original purchaser*, and acted for himself, and not as broker or agent for the municipality in selling them to the public.

In view of the foregoing, the discount at which the dealer sold to investors some of the municipal bonds originally purchased by him from the municipality at above par is not exempt to them as additional

municipal bond interest, for Federal income tax purposes, upon its realization by them. If the investors hold the bonds until redemption thereof by the municipality, they will then realize recognized gain of the entire excess of the (par) redemption price received over the purchase price which they paid. If, instead, the investors sell the bonds, they will then realize recognized gain of the entire sale price received or accrued over such purchase price, or sustain recognized loss of the excess of such purchase price over the sale price received or accrued. Such gains or losses to the investors will be taxable or allowable as capital gains or losses, *i. e.*, in accordance with and subject to the capital gain and loss provisions of the 1954 Code.

(Also Section 115.) Rev. Rul. 57–151

The income earned by the Oklahoma County Utility Services Authority, a trust created under State law for the furtherance of public functions, is not subject to Federal income tax. Mortgage bonds and debenture notes issued by such Authority for the purpose of financing facilities for certain utility services to a county are considered to be issued in behalf of a political subdivision and the interest paid thereon is also exempt from Federal income tax.

Advice has been requested whether the income realized by the Oklahoma County Utility Services Authority, a trust created under State laws for the furtherance of public functions, and the interest paid on obligations issued by it are exempt from Federal income tax.

Under the terms of an Oklahoma statute entitled "Trusts for the Furtherance of Public Functions," Title 60 Oklahoma Statutes 1951, sections 176–180, as amended by Laws 1953, express trusts may be created with the State or any political subdivision thereof as the beneficiary for the purpose of furthering any authorized function of the beneficiary. Title 60, section 176, Oklahoma Statutes. Before the trusts can become effective, the beneficial interest therein must be formally accepted by the Governor of the State or by the governing body of the political subdivision which is named as the beneficiary in the trust instrument. Title 60, section 177. The statute designates the trustees under such an instrument as an agency of the State and provides that the trust may be terminated only by agreement of the trustees and the governing body of the beneficiary, with the approval of the Governor of the State. Title 60, sections 178 and 180.

The Oklahoma County Utility Services Authority is a trust created, pursuant to the provisions of the statute referred to above, for the purpose of providing municipal utility services, such as water supply, fire protection and sewage disposal, for the residents in the outlying areas of Oklahoma County. The Board of County Commissioners of Oklahoma County has formally accepted the beneficial interest in the trust and has thereby rendered the trust effective. Under the terms of the trust instrument, the Authority is empowered to issue first mortgage revenue bonds, secured on trust properties and unsecured debenture notes. The revenues of the Authority primarily available for meeting its obligations are derived from the sale of water produced and distributed, although the Authority may have other revenues from other operations in which it may engage in the performance of trust purposes. No obligation of the trust, however, shall

ever become a liability of the beneficiary. No funds of the Authority may be diverted to any private use and, upon termination of the trust after payment of all debts and obligations, the remainder of the trust assets shall be distributed to the beneficiary. The Supreme Court of the State of Oklahoma sustained the validity of the trust and the acceptance of the beneficial interest by the Board of County Commissioners of Oklahoma County, and held that the trustees under the trust instrument are an agency of the State of Oklahoma and its regularly constituted authority for the performance of the functions for which the trust was created. *Board of County Commissioners* v. *Warren*, Okl., 285 P. 2d 1034 (1955).

On the basis of the facts present in this case, it is held that the income to be earned by the Oklahoma County Utility Services Authority from the furnishing of municipal utility services such as water supply, fire protection and sewage disposal, and which income will never accrue to the benefit of any person, firm, or corporation except the county which is the beneficiary of the trust, will not be subject to Federal income tax. It is further held that the mortgage bonds and debenture notes to be issued by the Authority for the purpose of financing the facilities to be used in providing municipal utility services will be considered as issued in behalf of the County, a political subdivision, and the interest paid thereon will be exempt from Federal income tax under section 103(a)(1) of the Internal Revenue Code of 1954. Cf. Rev. Rul. 54-296, C. B. 1954-2, 59.

Rev. Rul. 57-187

Bonds issued by an Industrial Development Board formed under Title 37, Chapter 17 of the Code of Alabama, are considered issued in behalf of a municipality, a political subdivision of the State. Interest received on such bonds is exempt from Federal income tax under section 103(a)(1) of the 1954 Code.

Advice has been requested whether interest received on bonds issued by an Industrial Development Board formed under Title 37, Chapter 17 of the Code of Alabama, is exempt from Federal income tax.

Under Title 37, Chapter 17 of the Alabama Code 1940, sections 815–830, as amended, the legislature has authorized the incorporation in the several municipalities of public corporations designated as Industrial Development Boards to acquire, own, lease and dispose of properties to the end that such corporations may be able to promote industry and develop trade by inducing manufacturing, industrial and commercial enterprises to locate in the State. Title 37, Section 816.

Under the statute an Industrial Development Board may be formed only after the governing body of the municipality concerned has given its formal approval to the creation of the Board and to the form of certificate of incorporation. Title 37, Section 817. The board of directors of each Industrial Development Board is elected by the governing body of the municipality concerned and serves without compensation. Title 37, Section 821. The corporate powers include the power to acquire, improve, maintain, equip and furnish projects, to lease such projects and collect rent; to sell and convey

any and all of its property whenever the board of directors shall find such action to be in furtherance of the purposes for which the corporation was organized; and to issue bonds for the purpose of carrying out any of its powers. Title 37, Section 822.

All bonds shall be payable solely out of revenues and receipts derived from the leasing or sale by the corporation of its projects. Title 37, Section 823. The municipality shall not be liable for the payment of principal or interest on any of the bonds of the corporation. Title 37, Section 826.

Industrial Development Boards are exempt from all State taxation, and interest on bonds issued by an Industrial Development Board is likewise exempt from State taxes. Title 37, Section 825. Industrial Development Boards are nonprofit corporations and no part of their net earnings may inure to the benefit of any private person. Title 37, Section 827. Upon dissolution of an Industrial Development Board, the title to all property owned by it shall vest in and become the property of the municipality in which the Board is located. Title 37, Section 828.

Section 103(a) of the Internal Revenue Code of 1954 excludes from gross income interest on the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia.

Section 1.103–1 of the Income Tax Regulations provides in part, "* * * Obligations issued by or on behalf of the State, Territory, or possession of the United States, or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, or the obligations of a State, Territory, or possession of the United States, or a political subdivision thereof. * * *"

Revenue Ruling 54–106, C. B. 1954–1, 28, holds that bonds issued by or in behalf of a municipality for the purpose of financing the acquisition or construction of municipally owned industrial plants for lease to private enterprise constitute obligations of a political subdivision. The same principle is equally applicable to bonds issued by an Industrial Development Board in behalf of a municipality.

Accordingly, in view of the circumstances in the instant case, it is held that bonds issued by an Industrial Development Board formed under Title 37, Chapter 17 of the Code of Alabama, are considered issued in behalf of a municipality, a political subdivision of the State. Interest received on such bonds is exempt from Federal income tax under section 103(a)(1) of the Code.

SECTION 105.—AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS

26 CFR 1.105–4: Wage continuation plans. Rev. Rul. 57–76

"Retirement age" is defined for the purpose of excluding an employee's disability pension from gross income pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations.

Advice has been requested as to the time at which employees reach retirement age for purposes of excluding from gross income disability pension benefits referred to in section 1.105–4(a) of the Income Tax Regulations under the Internal Revenue Code of 1954.

Subject to certain limitations, section 105(d) of the Code excludes from gross income amounts received by an employee pursuant to the provisions of a wage continuation plan "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." The exclusion applies at a weekly rate of $100.

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

(2)(i)—Section 105(d) 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" * * * includes plans under which payments are continued as long as the employee is absent from work on account of personal injury or sickness. It includes * * * plans under which benefits are continued until the employee either is able to return to work or reaches retirement age. * * *.

* * * * * * *

(3)(i). * * * 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 an employee receives under this plan before he reaches retirement age, but section 105(d) does not apply to the payments which such an employee receives after he reaches retirement age.

It is held that, for the purpose of excluding an employee's disability pension from gross income pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations, "retirement age" will be deemed to be

(1) The lowest age specified in the appropriate written employees' 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 corresponds with the employer's actual practice and is reasonable in view of all the pertinent facts and circumstances; or

(2) in the absence of a written employees' pension annuity plan meeting the requirements of (1) above, the age, if any, at which it has been the practice of the employer to terminate, due to age, the services of the class of employees to which the particular employee belongs, provided such age is reasonable in view of all the pertinent facts and circumstances; or

(3) if neither (1) nor (2) is applicable, age 65, the retirement age (as defined in (1) above) generally specified in the old-age and survivors insurance provisions of the Social Security Act and the age at which the retirement income credit provided by section 37 of the Code generally becomes effective.

In any instance where the retirement age as defined above appears to be substantially higher with respect to one class of employees than it is for another class of employees or for employees generally, the facts will be carefully examined to determine whether such higher age is a bona fide retirement age.

The application of the rules stated above is illustrated by the following examples:

Example (1). The *M* company has a formal retirement annuity plan which is covered by a contract issued by an insurance company.

It provides a regular retirement annuity beginning at age 62 for any employee who has remained at work with the company until age 62 or who has completed 15 years or more of service with the company. It also provides a disability pension to any employee who becomes totally and permanently disabled.

The regular annuity at age 62 is equal to two percent of the employee's total earnings with the company and for this purpose the period during which the employee receives a disability pension is considered as a period of service. Employees with 15 years or more of service may retire at age 55 on an actuarially reduced annuity.

The disability pension is equal to two percent of the employee's total earnings with the company. If the employee has less than 15 years of service when he becomes disabled, the disability pension is continued for a maximum of 60 months. If he has at least 15 years of service, the disability pension continues until the employee reaches age 62, at which time his regular retirement annuity commences.

For the purpose of excluding disability pension benefits pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations, employees of the *M* company reach retirement age at age 62.

Example (2). The *N* company retirement plan provides that the employer will contribute each year an amount equal to eight percent of each employee's compensation into a retirement trust, which amount is credited to individual employee accounts. Each employee's account is also credited soon after the year-end with investments earnings at the average rate earned on the trust's assets. When an employee reaches age 65, the amount accumulated in his account is used to purchase a single premium annuity from an insurance company, or, at the employee's option, will be applied in accordance with annuity tables adopted by the plan trustees to pay him an annuity from the trust. An employee may also continue working, with the consent of the employer, after age 65, but there are no more credits to his account other than the investment earnings. In such case, the amount accumulated at actual retirement is applied to purchase or pay an annuity, as aforesaid.

If the employee should become disabled before age 65, the amount accumulated in his account at the time he becomes disabled is paid to him at the rate of $50 a month until exhausted or until he reaches age 65, if sooner. In the latter event, the balance is applied to pay an annuity to him in accordance with the aforesaid tables. An employee may also retire at his own request any time after reaching age 55 and have the amount accumulated in his account applied either to purchase an annuity for him or to pay an annuity to him from the trust, based on his age at actual retirement.

For the purpose of excluding disability pension benefits pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations, the retirement age of an employee covered by this plan is age 65, because the amount of annuity purchasable with the accumulation in the employee's account in case of retirement before age 65 is automatically reduced actuarially in accordance with insurance company annuity rates and the annuity tables adopted by the trustees.

Example (3) The Civil Service Retirement Act of May 29, 1930, 46 Stat. 468, 5 U. S. C. 691, as amended, to October 1956, provides among other things, that certain service or disability retirement benefits will be paid to eligible civilian employees of the United States

Government. In general, an employee may elect to retire and receive an immediate service annuity, the amount of which is not actuarially or similarly reduced, at any time after he meets one of the following age and service conditions:

(1) Age 50 with 20 years of service as an investigatory employee.
(2) Age 60 with 30 years of service.
(3) Age 62 with five years of service.

With respect to employees separated from the service before October 1, 1956, provisions of the Act are substantially as follows: The service annuity (in most cases) is equal to one and one-half percent of average annual basic salary for each year of service, or one percent of average annual basic salary plus $25 for each year of service if that amount is larger, but in no case may the annuity exceed 80 percent of average annual basic salary. ("Average annual basic salary" is used to denote the average annual basic salary received by the employee during any five consecutive years of allowable service at the option of the employee.) If an employee retires with less than 15 years of service, he may not elect a joint and survivorship annuity; however, there is no actuarial or similar reduction in the annuity payments. At age 55 after 30 years of service an employee may elect to retire and receive an immediate annuity equal to the annuity computed as above and reduced by one-quarter of one percent for each month the employee is under age 60. Also, an employee who is separated involuntarily through no fault of his own after completing 25 or more years of service may receive an immediate annuity computed and reduced in the same manner. With certain exceptions, retirement is compulsory at age 70 after 15 years of service. If an employee becomes totally disabled after completing five years of civilian service and before meeting specified age and service requirements, he may be retired on a disability annuity computed in the same manner as the service annuity.

For the purpose of excluding disability annuity payments pursuant to section 1.105–4(a) (3) (i) of the Income Tax Regulations, a civilian employee of the United States Government reaches retirement age at the earliest applicable age described in conditions (1), (2) and (3) above.

Example (4). The retirement plan of *O* company is uninsured and unfunded. Notice of the plan benefits is printed in a handbook furnished all employees.

Under the plan, an employee who has at least 20 years of service may retire at age 60 on a pension, the yearly amount of which is equal to 40 percent of his average salary for the five years immediately preceding retirement. He may also retire at any time after reaching age 50 if he has at least 20 years of service, but his pension is the actuarial value at that time of the pension he would have received had he remained in the service to age 60, except in case of disability retirement.

If the employee becomes totally and permanently disabled after completing 20 years of service, he may retire regardless of his age and receive a pension computed at 40 percent of his average salary for the last five years without the actuarial reduction.

For the purpose of excluding a pension received on account of disability, pursuant to section 1.105-4(a) (3) (i) of the Income Tax Regulations, the retirement age of an employee of *O* company is age 60.

Example (5). The P corporation has a limited number of employees. It has no formal wage continuation or retirement plan, but it has a custom of continuing the salaries of all employees who are absent from work on account of personal injuries or sickness for short periods and of granting pensions to key employees who become totally and permanently disabled. All employees have knowledge of this custom. In 1955 two key employees were retired from service on account of total and permanent disability at ages 59 and 73, respectively, and received disability pensions. There are at present four active full-time key employees. Their respective ages are 33, 56, 68 and 76.

For the purpose of excluding disability pensions pursuant to section 1.105–4(a)(3)(i) of the Income Tax Regulations the retirement age of all key employees of the *P* corporation is age 65.

See section 72 of the code for the exclusion from gross income of portions of amounts received as an annuity or as a distribution from an employee's trust or annuity plan. See sections 104 and 105 (e) of the Code for the exclusion from gross income of certain amounts received under an accident and health plan.

Rev. Rul. 57–152

The wages received by an elected precinct officer in the State of Arizona, whose salary is fixed by law and continued for a period during which he was absent from work on account of sickness, are excludable from his gross income to the extent provided in section 105(d) of the Internal Revenue Code of 1954. Such exclusion should be taken into account for the taxable years in which the amounts are received regardless of the period for which the payments are made.

Advice has been requested whether an elected precinct officer in the State of Arizona may exclude from gross income amounts received for a period during which he was absent from work on account of sickness.

In the instant case, an elected constable in Arizona was ill and hospitalized for a period of nine months, such period covering a part of two years. A deputy carried on the duties of the office, and the constable continued to receive his salary during the period of his absence.

Under the provisions of section 105(d) of the Internal Revenue Code of 1954, wages or payments in lieu of wages received by an employee pursuant to 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 following limitations: (1) the exclusion does not apply to the extent that the amounts received exceed a weekly rate of $100; and (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 period of absence unless the employee is hospitalized on account of sickness for at least one day during the period of absence.

The term "wage continuation plan" means an accident or health plan 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 personal injuries or sickness. 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.

Article 4, Part 2, Section 17 of the Constitution of the State of Arizona, as amended in 1953, provides that the legislature shall never grant any extra compensation to any public officer, agent, servant or contractor after the services have been rendered or the contract entered into, nor shall the compensation of any public officer be increased or diminished during his term of office. This section applies to all officers having fixed terms and to the acts of all salary fixing bodies, whether the office was created by the Constitution or by statute. See *A. M. Crawford* v. *George W. P. Hunt*, 17 Pac. (2d) 802.

The Arizona Code provides that the precinct officers shall be a justice of the peace and a constable who shall be elected by the qualified electors of the precinct at the general election for State and county officers for terms of four years each. Section 17–504 of the Arizona Code of 1939, Annotated, as amended by Laws 1945, Ch. 69, Section 1, p. 185. The Arizona Code also provides that at the regular June meeting of the various boards of supervisors preceding a general election, said boards shall fix the salaries of all precinct officers excepting justices of the peace and constables whose salaries are fixed by separate provision for the two-year period commencing on the first day of the following January. Section 12–711 of the Arizona Code of 1939, Annotated, as amended by Laws 1952, Chapter 120. While the section places certain limits on the salary of a constable, it does not specifically fix his salary. Under the Arizona Code, section 12–404, an office is deemed to be vacant from and after the time the incumbent ceases to discharge the duties of his office for a period of three consecutive months except when prevented by sickness.

The terms "employee" and "wages" as used in section 105(d) of the Internal Revenue Code of 1954 include a public official and his salary. Since the salary was fixed when the constable assumed the duties of the office, could not be increased or diminished during the term of office, and was continued when discharge of duties was prevented by his sickness, there was in the instant case a wage continuation plan for the purposes of section 105(d) of the Code.

Accordingly, it is held that the wages received by an elected precinct officer in the State of Arizona whose salary is fixed by law and continued for a period during which he was absent from work on account of sickness are excludable from his gross income to the extent provided in section 105(d) of the Code. Such exclusion should be taken into account for the taxable years in which the amounts are received regardless of the period for which the payments are made.

Rev. Rul. 57–178

An employee who is receiving a disability pension from an employer, which is excludable from gross income subject to the limitations provided in section 105(d) of the Internal Revenue Code of 1954, 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.

Advice has been requested as to the income tax status of a pension received by reason of retirement on account of disability where the retired employee receives earned income from other sources (such as wages, commissions, or benefit from the operation of a business).

Subject to certain limitations, section 105(d) of the Internal Revenue Code of 1954 excludes from gross income amounts received by an employee pursuant to the provisions of a wage continuation plan 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. The term "wage continuation plan" includes plans under which benefits are continued until the employee either is able to return to work or reaches retirement age. If a plan provides that an employee, who is absent from work on account of a personal injury or sickness, will receive a disability pension as long as he is disabled, section 105(d) is applicable to any payments which such an employee receives under this plan before he reaches retirement age. See section 1.105–4(a)(3)(i) of the Income Tax Regulations. With respect to the time at which employees reach retirement age for the purpose of excluding disability pension benefits, see Rev. Rul. 57–76, page 66 of this Bulletin. The determination of whether an employee is absent from work should be made in accordance with section 1.105–4(a)(4) and (5) of the Income Tax Regulations.

The amount which is paid to an employee as wages or payments in lieu of wages for a period of absence from work due to a personal injury or sickness is determined by reference to the plan under which the amount is paid. If a disability pension constitutes an amount which is excludable under section 105(d) of the Code, the fact that the employee engages in a gainful occupation either as a self-employed individual or as an employee of another employer does not require different treatment with respect to the disability pension, since the employee's absence from work with the employer providing the pension is not terminated by such other employment.

Accordingly, it is held that 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.

Receipt of wages or payment in lieu of wages for period during which employee is absent from work on account of injuries or sickness with respect to retirement income credit. See Rev. Rul. 57–101, page 13.

SECTION 109.—IMPROVEMENTS BY LESSEE ON LESSOR'S PROPERTY

26 CFR 1.109: Statutory provisions; improvements by lessee on lessor's property.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 110.—INCOME TAXES PAID BY LESSEE CORPORATION

26 CFR 1.110: Statutory provisions; income taxes paid by lessee corporation.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

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

26 CFR 1.111: Statutory provisions; recovery of bad debts, prior taxes, and delinquency accounts.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 112.—CERTAIN COMBAT PAY OF MEMBERS OF THE ARMED FORCES

26 CFR 1.112: Statutory provisions; certain combat pay of members of the Armed Forces.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 113.—MUSTERING-OUT PAYMENTS FOR MEMBERS OF THE ARMED FORCES

26 CRF 1.113: Statutory provisions; mustering-out payments for members of the Armed Forces.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 114.—SPORTS PROGRAMS CONDUCTED FOR THE AMERICAN NATIONAL RED CROSS

26 CFR 1.114: Statutory provisions; sports programs conducted for the American National Red Cross.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 115.—INCOME OF STATES, MUNICIPALITIES, ETC.

Income earned by the Oklahoma County Utility Services Authority, a trust created under State law for the furtherance of public functions. See Rev. Rul. 57–151, page 64.

26 CFR 1.115: Statutory provisions; income of States, municipalities, etc.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

26 CFR 1.117–1: Exclusion of amounts received as a scholarship or fellowship grant. (Also Part II, Section 22(b); Regulations 118, Section 39.22(b)(3).) Rev. Rul. 57–50

> The portion of a fellowship grant for the academic year, 1953–1954, received in 1953 as a part of a Rockefeller Public Service Award in recognition of outstanding service by a civilian in the Federal Government, constitutes a gift and is excludable from the gross income of the recipient under the provisions of section 22(b)(3) of the Internal Revenue Code of 1939. That portion of the award received in 1954 is subject to the provisions of section 117(b)(2) of the Internal Revenue Code of 1954 and is excludable from gross income to the extent provided therein.

Advice has been requested with respect to the taxability of a Rockefeller Public Service Award under the circumstances described below.

The Rockefeller Public Service Award Program was established in 1952 by a grant made to Princeton University and is administered by the University. It is designed to give special recognition to outstanding public service by civilians in Federal Government and to establish incentives for the continuance and advancement of those in public service. Persons may become candidates for the award either by nomination by Government agencies or by direct application. A committe recommends candidates to the trustees of the University, and the trustees make the final decision regarding the selection of the recipient of the award.

The taxpayer herein involved received a fellowship grant as a Rockefeller Public Service Award, which included a sum equivalent to his yearly salary and expenses incident to his plan of study for the academic year beginning in September 1953 and ending in May 1954. The taxpayer was not a candidate for a degree.

Section 22(b)(3) of the Internal Revenue Code of 1939, applicable to the year 1953, provides for the exclusion from gross income of amounts received as gifts.

The award in the instant case was made in recognition of past achievements and present abilities of the recipient and for his training and educational development, and not for the advancement of a specific research project as in *Ephraim Banks* v. *Commissioner*, 17 T. C. 1386, and *Ti Li Loo* v. *Commissioner*, 22 T. C. 220, nor for the advancement of research or creative work as in I. T. 4056, C. B. 1951–2, 8. Therefore, that portion of the award received in 1953 constitutes a gift within the meaning of section 22(b)(3) of the 1939 Code. See Rev. Rul. 54–110, C. B. 1954–1, 28. Compare *Leroy J. Robertson* v. *United States*, 343 U. S. 711, Ct. D. 1746, C. B. 1952–2, 66.

Section 117(b)(2) of the Internal Revenue Code of 1954, applicable to the year 1954 and subsequent years, provides that where the recipient of a fellowship grant is not a candidate for a degree, amounts received as a scholarship or a fellowship grant are exempt from taxation only if the grantor is, among other things, a tax-exempt organization. The maximum amount exempt from taxation in any taxable year is $300 multiplied by the number of months for which the amounts are received under the grant during the taxable year plus any amount received which is specifically designated to cover expenses for travel, research, clerical help, or equipment and which is expended for these purposes during the taxable year. The exemption will not be allowed beyond a total of 36 months, whether or not consecutive and even though the amounts received are less than $300 a month. The exemption also extends to the value of contributed services and accomodations, such as room, board and laundry.

The recipient of the award herein is not a candidate for a degree and the grantor of the award is a tax-exempt organization. The portion of the award received during the taxable year 1954 thus comes within the provisions of section 117(b)(2) of the 1954 Code.

Accordingly, it is held that the portion of a fellowship grant for the academic year 1953–1954, received in 1953 as a part of a Rockefeller Public Service Award in recognition of outstanding service by a civilian in the Federal Government, constitutes a gift and is excludable from the gross income of the recipient under the provisions of section 22 (b) (3) of the Internal Revenue Code of 1939. That portion of the award received in 1954 is subject to the provisions of section 117(b)(2) of the Internal Revenue Code of 1954 and is excludable from gross income to the extent provided therein.

Rev. Rul. 57–131

A nonresident alien, a professional teacher in a school of agriculture of a foreign university, came to the United States for a period of nine months as an *M* foundation exchange fellow. The *M* foundation is exempt from income tax under section 501(c)(3) of the Internal Revenue Code of 1954. He visited and observed the work of research departments of seed companies, studied the organization and operation of certain branches of the Department of Agriculture, conducted studies and observed operations of numerous schools of agriculture at universities situated throughout the United States and, finally, as the last project on his exchange program, he attended a course of study at a university. During his stay in the United States, he was not employed by, nor did he render any service to, a United States employer; his status was strictly that of an observer. The allowances granted him by the *M* exchange foundation were specifically for the cost of books and related materials, hotel accommodations and meals for himself and his wife, incidental travel expenses, and tuition for his course at the university. In addition he received reimbursement from the foundation for actual transportation expenses to and from his native country and for all transportation expenses while in the United States. *Held*, the allowances granted by the *M* exchange foundation, an organization of the type described in section 501(c)(3) of the Code

which is exempt from Federal income tax under section 501(a) of the Code, were made to the instant individual for the purpose of aiding him in the pursuit of study or research and, therefore, are excludable from his gross income under section 117(a) of the Code to the extent provided in subsections (a) (2) and (b) (2) of section 117.

Amounts received from the John Simon Guggenheim Memorial Foundation as a fellowship grant. See Rev. Rul. 57–286, page 497.

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26 CFR 1.117–4: Items not considered as scholarships or fellowship grants.

Grants made in support of a basic scientific research project which are conducted on an independent basis. See Rev. Rul. 57–127, page 275.

SECTION 118.—CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION

26 CFR 1.118: Statutory provisions; contributions to the capital of a corporation.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

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

26 CFR 1.119: Statutory provisions; meals or lodging furnished for the convenience of the employer.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

SECTION 120.—STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE

26 CFR 1.120: Statutory provisions; statutory subsistence allowance received by police.

Regulations under the Internal Revenue Code of 1954. See T. D. 6220, page 34.

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26 CFR 1.120–1: Statutory subsistence allowance received by police.

Treatment of an amount designated as a "subsistence allowance" for police officials and all commissioner law officers under South Carolina statute. See Rev. Rul. 57–46, page 22.

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 151.—ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

26 CFR 1.151: Statutory provisions; allowance of deductions for personal exemptions. T. D. 6231[1]

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

Regulations prescribed under part V of subchapter B of chapter 1 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 July 21, 1955, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under part V of subchapter B of chapter 1 (sections 151 to 154, inclusive) of the Internal Revenue Code of 1954 was published in the Federal Register (20 F. R. 5234). After consideration of all such relevant matter as was presented by interested parties regarding the rules proposed, the following regulations, which also give effect to the amendment made to section 152 by section 2 of Public Law 333 (84th Congress), approved August 9, 1955, [C. B. 1955–2, 764], are hereby adopted:

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AUTHORITY: §§ 1.151 to 1.154, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

DEDUCTIONS FOR PERSONAL EXEMPTIONS

§ 1.151 STATUTORY PROVISIONS; ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS.

SEC. 151. ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS.

(a) ALLOWANCE OF DEDUCTIONS.—In the case of an individual, the exemptions provided by this section shall be allowed as deductions in computing taxable income.

[1] 22 F. R. 2938.

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

(c) ADDITIONAL EXEMPTION FOR TAXPAYER OR SPOUSE AGED 65 OR MORE—

(1) FOR TAXPAYER.—An additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year.

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

(d) ADDITIONAL EXEMPTION FOR BLINDNESS OF TAXPAYER OR SPOUSE—

(1) FOR TAXPAYER.—An additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year.

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

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

(e) ADDITIONAL EXEMPTION FOR DEPENDENTS—

(1) IN GENERAL.—An exemption of $600 for each dependent (as defined in section 152)—

(A) Whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $600, or

(B) Who is a child of the taxpayer and who (i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or (ii) is a student.

(2) EXEMPTION DEFINED IN CASE OF CERTAIN MARRIED DEPENDENTS.—No exemption shall be allowed under this subsection for any dependent who has made a joint return with his spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

(3) CHILD DEFINED.—For purposes of paragraph (1)(B), the term "child" means an individual who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer.

(4) STUDENT AND EDUCATIONAL INSTITUTION DEFINED.—For purposes of paragraph (1)(B)(ii), the term "student" means an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins—

(A) Is a full-time student at an educational institution; or

(B) Is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution or of a State or political subdivision of a State.

For purposes of this paragraph, the term "educational institution" 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.

§ 1.151-1 DEDUCTIONS FOR PERSONAL EXEMPTIONS.—(a) *In general.*—(1) In computing taxable income, an individual is allowed a deduction for the exemptions specified in section 151. Such exemptions are: (i) The exemptions for an individual taxpayer and spouse (the so-called personal exemptions); (ii) the additional exemeptions for a taxpayer attaining the age of 65 years and spouse attaining the age of 65 years (the so-called old-age exemptions); (iii) the additional exemptions for a blind taxpayer and a blind spouse; and (iv) the exemptions for dependents of the taxpayer.

(2) A nonresident alien individual who is a bona fide resident of Puerto Rico during the entire taxable year and subject to tax under section 1 or 1201(b) is allowed as deductions the exemptions specified in section 151, even though as to the United States such individual is a nonresident alien. See section 876 and the regulations thereunder, relating to alien residents of Puerto Rico.

(b) *Exemptions for individual taxpayer and spouse (so-called personal exemptions).*—Section 151(b) allows an exemption of $600 for the taxpayer and an additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. Thus, a husband is not entitled to an exemption for his wife on his separate return for the taxable year beginning in a calendar year during which she has any gross income (though insufficient to require her to file a return). Since, in the case of a joint return, there are two taxpayers (although under section 6013 there is only one income for the two taxpayers on such return, i. e., their aggregate income), two exemptions of $600 are allowed on such return, one for each taxpayer spouse. If in any case a joint return is made by the taxpayer and his spouse, no other person is allowed an exemption for such spouse even though such other person would have been entitled to claim an exemption for such spouse as a dependent if such joint return had not been made.

(c) *Exemptions for taxpayer attaining the age of 65 and spouse attaining the age of 65 (so-called old-age exemptions).*—(1) Section 151(c) provides an additional exemption of $600 for the taxpayer if he has attained the age of 65 before the close of his taxable year. An additional exemption of $600 is also allowed to the taxpayer for his spouse if a separate return is made by the taxpayer and if the spouse has attained the age of 65 before the close of the taxable year of the taxpayer and, for the calendar year in which the taxable year of the taxpayer begins, the spouse has no gross income and is not the dependent of another taxpayer. If a husband and wife make a joint return, an old-age exemption of $600 will be allowed as to each taxpayer spouse who has attained the age of 65 before the close of the taxable year for which the joint return is made. The exemptions under section 151(c) are in addition to the exemptions for the taxpayer and spouse under section 151(b).

(2) In determining the age of an individual for the purposes of the exemption for old age, the last day of the taxable year of the taxpayer is the controlling date. Thus, in the event of a separate return by a husband, no additional exemption for old age may be claimed for his spouse unless such spouse has attained the age of 65 on or

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

(d) *Exemptions for the blind.*—(1) Section 151(d) provides an additional exemption of $600 for the taxpayer if he is blind at the close of his taxable year. An additional exemption is also allowed to the taxpayer for his spouse if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. The determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year, in which case such determination shall be made as of the time of such death.

(2) The exemptions for the blind are in addition to the exemptions for the taxpayer and spouse under section 151(b) and are also in addition to the exemptions under section 151(c) for taxpayers and spouses attaining the age of 65 years. Thus, a single individual who has attained the age of 65 before the close of his taxable year and who is blind at the close of his taxable year is entitled, in addition to the so-called personal exemption of $600, to two further exemptions, each of $600, one by reason of his age and the other by reason of his blindness. If a husband and wife make a joint return, an exemption of $600 for the blind will be allowed as to each taxpayer spouse who is blind at the close of the taxable year for which the joint return is made.

(3) A taxpayer claiming an exemption allowed by section 151(d) for a blind taxpayer and a blind spouse shall, if the individual for whom the exemption is claimed is not totally blind as of the last day of the taxable year of the taxpayer (or, in the case of a spouse who dies during such taxable year, as of the time of such death), attach to his return a certificate from a physician skilled in the diseases of the eye or a registered optometrist stating that as of the applicable status determination date in the opinion of such physician or optometrist (i) the central visual acuity of the individual for whom the exemption is claimed did not exceed 20/200 in the better eye with correcting lenses or (ii) such individual's visual acuity was accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees. If such individual is totally blind as of the status determination date there shall be attached to the return a statement by the person or persons making the return setting forth such fact.

§ 1.151–2 Additional Exemptions for Dependents.—(a) Section 151(e) allows to a taxpayer an exemption of $600 for each dependent (as defined in section 152) whose gross income (as defined in section 61) for the calendar year in which the taxable year of the taxpayer begins is less than $600, or who is a child of the taxpayer and who—

(1) Has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or

(2) Is a student, as defined in § 1.151–3 (b).

No exemption shall be allowed under section 151(e) for any dependent who has made a joint return with his spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

(b) The only exemption allowed for a dependent of the taxpayer is that provided by section 151(e). The exemptions provided by section 151(c) (old-age exemptions) and section 151(d) (exemptions for the blind) are allowed only for the taxpayer or his spouse. For example, where a taxpayer provides the entire support for his father who meets all the requirements of a dependent, he is entitled to only one exemption of $600 for his father (section 151(e)), even though his father is over the age of 65.

§ 1.151–3 DEFINITIONS.—(a) *Child.*—For purposes of sections 151(e), 152, and the regulations thereunder, the term "child" means a son, stepson, daughter, stepdaughter, adopted son, or adopted daughter of the taxpayer.

(b) *Student.*—For purposes of section 151(e) and section 152(d), and the regulations thereunder, the term "student" means an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins is a full-time student at an educational institution or is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution or of a State or political subdivision of a State. An example of "institutional on-farm training" is that authorized by the Veterans' Readjustment Assistance Act of 1952, as described in section 252 of such act. A full-time student is one who is enrolled for some part of 5 calendar months for the number of hours or courses which is considered to be full-time attendance. The 5 calendar months need not be consecutive. School attendance exclusively at night does not constitute full-time attendance. However, full-time attendance at an educational institution may include some attendance at night in connection with a full-time course of study.

(c) *Educational institution.*—For purposes of sections 151(e) and 152, and the regulations thereunder, the term "educational institution" means a school maintaining a regular faculty and established curriculum, and having an organized body of students in attendance. It includes primary and secondary schools, colleges, universities, normal schools, technical schools, mechanical schools, and similar institutions, but does not include noneducational institutions, on-the-job training, correspondence schools, night schools, and so forth.

§ 1.152 STATUTORY PROVISIONS; DEPENDENT DEFINED.

SEC. 152 DEPENDENT DEFINED

(a) GENERAL DEFINITION.—For purposes of this subtitle, the term "dependent" means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) as received from the taxpayer):

(1) A son or daughter of the taxpayer, or a descendant of either,

(2) A stepson or stepdaughter of the taxpayer,

(3) A brother, sister, stepbrother, or stepsister of the taxpayer,

(4) The father or mother of the taxpayer, or an ancestor of either,

(5) A stepfather or stepmother of the taxpayer,

(6) A son or daughter of a brother or sister of the taxpayer,

(7) A brother or sister of the father or mother of the taxpayer,

(8) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer,

(9) An individual who, for the taxable year of the taxpayer, has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household, or

(10) An individual who—

(A) Is a descendant of a brother or sister of the father or mother of the taxpayer,

(B) For the taxable year of the taxpayer receives institutional care required by reason of a physical or mental disability, and

(C) Before receiving such instutional care, was a member of the same household as the taxpayer.

(b) RULES RELATING TO GENERAL DEFINITION.—For purposes of this section—

(1) The terms "brother" and "sister" include a brother or sister by the halfblood.

(2) In determining whether any of the relationships specified in subsection (a) or paragraph (1) of this subsection exists, a legally adopted child of an individual shall be treated as a child of such individual by blood.

(3) 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. The preceding sentence shall not exclude from the definition of "dependent" any child of the taxpayer born to him, or legally adopted by him, in the Philippine Islands before January 1, 1956, if the child is a resident of the Republic of the Philippines, and if the taxpayer was a member of the Armed Forces of the United States at the time the child was born to him or legally adopted by him.

(4) A payment to a wife which is includible in the gross income of the wife under section 71 or 682 shall not be treated as a payment by her husband for the support of any dependent.

(c) MULTIPLE SUPPORT AGREEMENTS.—For purposes of subsection (a), over half of the support of an individual for a calendar year shall be treated as received from the taxpayer if—

(1) No one person contributed over half of such support;

(2) Over half of such support was received from persons each of whom, but for the fact that he did not contribute over half of such support, would have been entitled to claim such individual as a dependent for a taxable year beginning in such calendar year;

(3) The taxpayer contributed over 10 percent of such support; and

(4) Each person described in paragraph (2) (other than the taxpayer) who contributed over 10 percent of such support files a written declaration (in such manner and form as the Secretary or his delegate may by regulations prescribe) that he will not claim such individual as a dependent for any taxable year beginning in such calendar year.

(d) SPECIAL SUPPORT TEST IN CASE OF STUDENTS.—For purposes of subsection (a), in the case of any individual who is—

(1) A son, stepson, daughter, or stepdaughter of the taxpayer (within the meaning of this section), and

(2) A student
(within the meaning of section 151(e)(4)),
amounts received as scholarships for study at an educational institution (as defined in section 151(e)(4)) shall not be taken into account in determining whether such individual received more than half of his support from the taxpayer.

[Sec. 152 as amended by sec. 2, P. L. 333 (84th Cong.)]

§ 1.152–1 GENERAL DEFINITION OF A DEPENDENT.—(a)(1) For purposes of the income taxes imposed on individuals by the Internal Revenue Code of 1954, the term "dependent" means any individual described in paragraphs (1) through (10) of section 152(a) over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer.

(2)(i) For purposes of determining whether or not an individual received, for a given calendar year, over half of his support from the taxpayer, there shall be taken into account the amount of support received from the taxpayer as compared to the entire amount of support which the individual received from all sources, including support which the individual himself supplied. The term "support" includes food, shelter, clothing, medical and dental care, education, and the like. Generally, these items of support are measured in terms of the amount of expense incurred by the one furnishing such items. However, if the item of support furnished an individual (either by himself or others) is in the form of goods, services, or other benefits, it will be necessary to measure the amount of such items of support in terms of its fair market value.

(ii) In computing the amount which is contributed for the support of an individual, there must be included any amount which is contributed by such individual for his own support, including income which is ordinarily excludable from gross income, such as benefits received under the Social Security Act. For example, a father receives $800 social security benefits, $400 interest, and $1,000 from his son during 1955, all of which sums represent his sole support during that year. The fact that the social security benefits of $800 are not includible in the father's gross income does not prevent such an amount from entering into the computation of the total amount contributed for the father's support. Consequently, since the son's contribution of $1,000 was less than one-half of the father's support ($2,200) he may not claim his father as a dependent.

(b) Section 152(a)(9) applies to any individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to section 153, of the taxpayer) who lives with the taxpayer and is a member of the taxpayer's household during the entire taxable year of the taxpayer. An individual is not a member of the taxpayer's household if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law. It is not necessary under section 152(a)(9) that the dependent be related to the taxpayer. For example, foster children and children awaiting adoption may qualify as dependents. It is necessary, however, that the taxpayer both maintain and occupy the household. The taxpayer and dependent will be considered as occupying the household for such entire taxable year notwithstanding temporary absences from the household due to special circumstances. A nonpermanent failure to occupy the

common abode by reason of illness, education, or vacation shall be considered temporary absence due to special circumstances. The fact that the dependent dies during the year shall not deprive the taxpayer of the deduction if the dependent lived in the household for the entire part of the year preceding his death. Likewise, the period during the taxable year preceding the birth of an individual shall not prevent such individual from qualifying as a dependent under section 152(a)(9). Moreover, a child who actually becomes a member of the taxpayer's household during the taxable year shall not be prevented from being considered a member of such household for the entire taxable year, if the child is required to remain in a hospital for a period following its birth, and if such child would otherwise have been a member of the taxpayer's household during such period.

(c) In the case of a child of the taxpayer who is under 19 or who is a student, the taxpayer may claim the dependency exemption for such child provided he has furnished more than one-half of the support of such child for the calendar year in which the taxable year of the taxpayer begins, even though the income of the child for such calendar year may be $600 or more. In such a case, there may be two exemptions claimed for the child: One on the parent's (or stepparent's) return, and one on the child's return. In determining whether the taxpayer does in fact furnish more than one-half of the support of an individual who is a child, as defined in paragraph (a) of § 1.151–3, of the taxpayer and who is a student, as defined in paragraph (b) of § 1.151–3, a special rule regarding scholarships applies. Amounts received as scholarships, as defined in paragraph (a) of § 1.117–3, for study at an educational institution shall not be considered in determining whether the taxpayer furnishes more than one-half the support of such individual. For example, A has a child who receives a $1,000 scholarship to the X college for one year. A contributes $500, which constitutes the balance of the child's support for that year. A may claim the child as a dependent, as the $1,000 scholarship is not counted in determining the support of the child. For purposes of this paragraph, amounts received for tuition payments and allowances by a veteran under the provisions of the Servicemen's Readjustment Act of 1944 or the Veterans' Readjustment Assistance Act of 1952 are not amounts received as scholarships. See also § 1.117–4. For definition of the terms "child", "student", and "educational institution", as used in this paragraph, see § 1.151–3.

§ 1.152–2 Rules Relating to General Definition of Dependent.—(a) To qualify as a dependent an individual must be a citizen or resident of the United States or be a resident of the Canal Zone, the Republic of Panama, Canada, or Mexico at some time during the calendar year in which the taxable year of the taxpayer begins. A resident of the Republic of the Philippines who was born to or legally adopted by the taxpayer in the Philippine Islands before January 1, 1956, at a time when the taxpayer was a member of the Armed Forces of the United States, may also be claimed as a dependent if such resident otherwise qualifies as a dependent. For definition of "Armed Forces of the United States", see section 7701(a)(15).

(b) A payment to a wife which in includible in her gross income under section 71 or section 682 shall not be considered a payment by her husband for the support of any dependent.

(c) A legally adopted child of an individual shall be treated as a child of such individual by blood.

(d) In the case of a joint return it is not necessary that the prescribed relationship exist between the person claimed as a dependent and the spouse who furnishes the support; it is sufficient if the prescribed relationship exists with respect to either spouse. Thus, a husband and wife making a joint return may claim as a dependent a daughter of the wife's brother (wife's niece) even though the husband is the one who furnishes the chief support. The relationship of affinity once existing will not terminate by divorce or the death of a spouse. For example, a widower may continue to claim his deceased wife's father (his father-in-law) as a dependent provided he meets the other requirements of section 151.

§ 1.152–3 MULTIPLE SUPPORT AGREEMENTS.—(a) Section 152(c) provides that a taxpayer shall be treated as having contributed over half of the support of an individual for the calendar year (in cases where two or more taxpayers contributed to the support of such individual) if—

(1) No one person contributed over half of the individual's support,

(2) Each member of the group which collectively contributed more than half of the support of the individual would have been entitled to the dependency exemption but for the fact that he did not contribute more than one-half of such support,

(3) The member of the group claiming the dependency exemption contributed more than 10 percent of the individual's support, and

(4) Each other person in the group who contributed more than 10 percent of such support files a written declaration that he will not claim the dependency exemption for such individual for any taxable year beginning in such calendar year.

(b) Application of the rule contained in paragraph (a) of this section may be illustrated by the following examples:

Example (1). Brothers A, B, C, and D contributed the entire support of their mother in 1956 in the following percentages: A, 30 percent; B, 20 percent; C, 29 percent; and D, 21 percent. Any one of the brothers, except for the fact that he did not contribute more than half of her support, would have been entitled to claim his mother as a dependent. Consequently, any one of the brothers could claim a deduction for the exemption of the mother provided a written declaration (as provided in paragraph (c) of this section) from each of the other brothers it attached to his income tax return. Even though A and D together contributed more than one-half the support of the mother, A, if he wished to claim his mother as a dependent, would be required to attach written declarations from B, C, and D to his income tax return, since each of those three contributed more than 10 percent of the support and, but for the support requirement, would have been entitled to claim the dependency exemption.

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Example (2). E, an individual who resides with his son, received $1,500 during the calendar year 1956, which constituted his entire support for that year. The source of the $1,500 was as follows:

Source	*Amount received*	*Percentage of total*
Social Security	$375	25
N, an unrelated neighbor	165	11
B, a brother	210	14
D, a daughter	150	10
S, a son	600	40
Total received by E	$1,500	100

B, D, and S are persons each of whom, but for the fact that he did not contribute more than half of the $1,500, could claim E as a dependent for a taxable year beginning in 1956. The three together contributed $960, or 64 percent of the $1,500, and, thus, each is a member of the group to be considered for the purpose of section 152(c). B and S are the only members of such group who can meet all the requirements of section 152 (c) and either one could claim E as a dependent for his taxable year beginning in 1956 provided he attached to his income tax return a written declaration (as provided in paragraph (c) of this section) signed by the other, and furnished the other information required by the return with respect to all the contributions to E. Inasmuch as D did not contribute more than 10 percent of E's support, she is not entitled to claim E as a dependent for a taxable year beginning in 1956 nor is she required to file a written declaration with respect to her contributions to E. N contributed over 10 percent of the support of E in 1956 but, since he is an unreleated neighbor, he does not qualify as a member of the group for the purpose of the multiple support agreement under section 152(c).

(c) The member of a group of contributors who claims the dependency deduction for an individual under the multiple support agreement provisions of section 152(c) must attach to his income tax return for the year of the deduction a written declaration from each of the other persons who contributed more than 10 percent of the support of such individual and who, but for the failure to contribute more than half of the support of the individual, would have been entitled to claim the dependency exemption. The written declaration required by this paragraph may be made on Form 2120, which contains a statement of the fact of contribution and a waiver of the claim for dependency exemption. Any declaration made other than on Form 2120 shall conform to the substance of Form 2120. The taxpayer claiming the exemption should be prepared to furnish other information, when required, which will substantiate his right to claim such exemption. Such information may include a statement showing the names of all contributors (whether or not members of the group described in section 152(c)) and the amount contributed by each to the support of the claimed dependent.

§ 1.153 STATUTORY PROVISIONS; DETERMINATION OF MARITAL STATUS.

SEC. 153. DETERMINATION OF MARITAL STATUS.

For purposes of this part—

(1) The determination of whether an individual is married shall be made as of the close of his taxable years; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

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

§ 1.153–1 DETERMINATION OF MARITAL STATUS.—For the purpose of determining the right of an individual to claim an exemption for his spouse under section 151 (b), the determination of whether such individual is married shall be made as of the close of his taxable year, unless his spouse dies during such year, in which case the determination shall be made as of the time of such death. An individual legally separated from his spouse under decree of divorce or separate maintenance shall not be considered as married. The provisions of this section may be illustrated by the following examples:

Example (1). A, who files his returns on the basis of a calendar year, married B on December 31, 1956. B, who had never previously married, had no gross income for the calendar year 1956 nor was she the dependent of another taxpayer for such year. A may claim an exemption for B for 1956.

Example (2). C and his wife, D, were married in 1940. They remained married until July 1956 at which time D was granted a decree of divorce. C, who files his income tax returns on a calendar year basis, cannot claim an exemption for D on his 1956 return as C and D were not married on the last day of C's taxable year. Had D died instead of being divorced, C could have claimed an exemption for D for 1956 as their marital status would have been determined as of the date of D's death.

§ 1.154 STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 154. CROSS REFERENCES.

(1) For definitions of "husband" and "wife", as used in section 152(b)(4), see section 7701(a)(17).

(2) For deductions of estates and trusts, in lieu of the exemptions under section 151, see section 642(b).

(3) For exemptions of nonresident aliens, see section 873(d).

(4) For exemptions of citizens deriving income mainly from sources within possessions of the United States, see section 931 (e).

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved April 22, 1957.

DAN THROOP SMITH,
Deputy to the Secretary

(Filed by the Division of the Federal Register on April 25, 1957, 8:48 a. m. and published in the issue of the Federal Register for April 26, 1957, 22 F. R. 2938.)

SECTION 162.—TRADE OR BUSINESS EXPENSES

(Also Section 404; 26 CFR 1.404(a)–10.) Rev. Rul. 57–88

Amounts paid to employees pursuant to an employee's current payment profit-sharing plan are deductible under section 162 of the Internal Revenue Code of 1954, provided such amounts plus other compensation paid each employee meet the test of reasonableness, represents payments for services rendered as distinguished from gifts or dividends, and there was no plan to defer the payment of compensation beyond the time when it first became administratively feasible to make such payment.

Such payments when made early in the following year by an accrual method taxpayer are deductible in the year in which the profits were earned provided (a) the amounts to be paid are determinable through a formula prior to the close of the taxable year in which the profits were earned, and (b) there is a definite obligation whereby the eligible employees are notified (either individually or as a group) of their proposed share in the profits before the end of the taxable year in which the profits were earned.

In a current payment profit-sharing plan of this type, each corporation in a group of affiliated corporations adopting the plan is entitled to a deduction for only those payments made by it to its own employees from its own profits. The group of affiliated corporations may not claim the benefits of section 404(a)(3)(B) of the Code.

Advice has been requested whether amounts paid to employees by an accrual method corporation pursuant to a current payment profit-sharing plan for employees are deductible in the year in which the profits were earned, even when paid early in the following year, and whether the benefits of section 404(a)(3)(B) of the Internal Revenue Code of 1954, with regard to payment by an affiliated corporation, may be claimed.

In addition to a qualified employees' pension trust, a corporation and its wholly-owned subsidiary established an employees' current payment profit-sharing incentive plan whereby a stated percentage of the consolidated book net income is distributed each year, provided the amount to be distributed is deductible for Federal income tax purposes. The amount of profits to be shared under the plan are apportioned among the regular full time employees with at least one year of service prior to the plan year, in the proportion that the regular annual compensation of each participant for the calendar year bears to the aggregate of such compensation of all eligible employees for such year. The plan is subject to termination by the board of directors at the end of any plan year.

Section 162 of the Code provides, in part, that 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 a reasonable allowance for compensation for personal services actually rendered.

Section 404(a) of the Code provides for a deduction, subject to certain limitations, of contributions paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or compensation paid or accrued on account of any employee under a plan deferring the receipt of such compensation. Section 404(a)(3)(B) further provides in the case of a profit-sharing plan of a group of corporations,

which is an affiliated group within the meaning of section 1504, that if any member of the affiliated group is prevented from making a contribution to the plan solely because it has no current or accumulated earnings or profits or because such earnings or profits are less than the contributions which it would otherwise have made, the contribution which the member is thus prevented from making may, subject to certain limitations, be made for the benefit of the employees of such corporation by the other members of the group that have profits. In that event, the member making such a contribution may then take a deduction for such contributions.

Since, in the instant case, the amounts allocated and promptly paid direct to the individual employees are current rather than deferred compensation, section 404 of the Code does not apply. However, it is held that contributions or amounts paid under an unfunded cash or current payment profit-sharing plan by an employer to his employees may be deducted under section 162 of the Code for Federal income tax purposes, providing such amounts, plus other compensation paid each participating employee, meet the test of reasonableness, are in fact payments for services rendered, as distinguished from gifts or dividends, and there was no plan to defer the payment of compensation beyond the time when it first becomes administratively feasible to make such payment. Where the amounts paid under the plan are so paid by an accrual method taxpaper soon after the close of the taxable year, it is held that they are deductible in the year in which the profits were earned provided (a) the amounts to be paid are determinable by a formula prior to the close of the taxable year in which the profits were earned, and (b) the corporations have definitely obligated themselves whereby the eligible employees (either individually or as a group) are advised of their proposed share of the profits before the end of the taxable year in which the profits were earned. See Rev. Rul. 55–446, C. B. 1955–2,531.

It is further held that the benefits of section 404(a)(3)(B) of the Code are not available to either corporation. Therefore, each corporation, is entitled only to a deduction for payments made from its own profits to its own employees, regardless of whether returns are made on a consolidated or separate return basis.

(Also Section 262.) Rev. Rul. 57–143

Work clothing consisting of white cap, white shirt or white jacket, white bib overalls, and standard work shoes, which a painter is required by his union to wear on the job, is not distinctive in character or in the nature of a uniform. The fact that the union requires a painter to wear such clothing is not sufficient to warrant the allowance of the cost and maintenance thereof as a deductible business expense. See Mimeograph 6463, C. B. 1950–1, 29; compare *John E. Conn, et ux.* v. *Commissioner*, Tax Court Memorandum Opinion entered June 17, 1952, which held that the cost and maintenance of blue work clothes worn by a welder in his work, at the request of his foreman, was not deductible as a business expense. The cost and maintenance of such clothing represent nondeductible personal expense.

Contributions by an employer to a group of separate and individual trusts each providing unemployment and other benefits to a designated employees. See Rev. Rul. 57–37, page 18.

Deductibility of amounts paid as a reimbursement for contributions to a union negotiated qualified pension plan. See Rev. Rul. 57–104, page 166.

Amount expended by a corporate taxpayer for health-restoring program for one of its executives. See Rev. Rul. 57–130, page 108.

SECTION 163.—INTEREST

26 CFR 1.163: Statutory provisions; itemized deductions for individuals and corporations; interest. T. D. 6223[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 163 of the Internal Revenue Code of 1954.

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

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

On July 6, 1955, notice of proposed rulemaking regarding the regulations under section 163 relating to interest for taxable years beginning after December 31, 1953, and ending after August 16, 1954, of the Internal Revenue Code of 1954 was published in the Federal Register (20 F. R. 4775). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

AUTHORITY: Sec. 7805 of the I. R. C. of 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.163 STATUTORY PROVISIONS; ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS; INTEREST.

SEC. 163. INTEREST.

(a) GENERAL RULE.—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

(b) INSTALLMENT PURCHASES WHERE INTEREST CHARGE IS NOT SEPARATELY STATED—

(1) GENERAL RULE.—If personal property is purchased under a contract—

(A) Which provides that payment of part or all of the purchase price is to be made in installments, and

(B) In which carrying charges are separately stated but the interest charge cannot be ascertained,

then the payments made during the taxable year under the contract shall be treated for purposes of this section as if they included interest equal to 6 percent of the average unpaid balance under the contract during the taxable year. For purposes of the preceding sentence, the average unpaid balance is the sum of the unpaid bal-

[1] 22 F. R. 473.

ance outstanding on the first day of each month beginning during the taxable year, divided by 12.

(2) LIMITATION.—In the case of any contract to which paragraph (1) applies, the amount treated as interest for any taxable year shall not exceed the aggregate carrying charges which are properly attributable to such taxable year.

(c) CROSS REFERENCES.

(1) For disallowance of certain amounts paid in connection with insurance, endowment, or annuity contracts, see section 264.

(2) For disallowance of deduction for interest relating to tax-exempt income, see section 265 (2).

(3) For disallowance of deduction for carrying charges chargeable to capital account, see section 266.

(4) For disallowance of interest with respect to transactions between related taxpayers, see section 267.

§ 1.163–1 INTEREST DEDUCTION IN GENERAL.—(a) Except as otherwise provided in sections 264–267, inclusive, interest paid or accrued within the taxable year on indebtedness shall be allowed as a deduction in computing taxable income.

(b) Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Payments of Maryland or Pennsylvania ground rents are deductible as interest if the ground rent is redeemable, but are treated as rent if the ground rent is irredeemable and in such case are deductible only to the extent they constitute a proper business expense.

(c) Interest calculated for costkeeping or other purposes on account of capital or surplus invested in the business which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross income. Interest paid by a corporation on scrip dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, cannot be deducted in computing taxable income. (See, however, section 583.) In the case of banks and loan or trust companies, interest paid within the year on deposits, such as interest paid on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company, may be deducted from gross income.

§ 1.163–2 INSTALLMENT PURCHASES WHERE INTEREST CHARGE IS NOT SEPARATELY STATED.—(a) *In general.*—Whenever there is a contract for the purchase of personal property providing for payment of part or all of the purchase price in installments and there is a separately stated carrying charge (including a finance charge, service charge, and the like) but the actual interest charge cannot be ascertained, a portion of the payments made during the taxable year under the contract shall be treated as interest and is deductible under section 163 and this section. Section 163(b) contains a formula, described in paragraph (b) of this section, in accordance with which the amount of interest deductible in the taxable year must be computed. This formula is designed to operate automatically in the case of any installment purchase, without regard to whether payments under the contract are made when due or are in default. For applicable limitations when an obligation to pay is terminated, see paragraph (c) of this section.

(b) *Computation.*—The portion of any such payments to be treated as interest shall be equal to 6 percent of the average unpaid balance under the contract during the taxable year. For purposes of this computation, the average unpaid balance under the contract is the sum of the unpaid balance outstanding on the first day of each month beginning during the taxable year, divided by 12.

(c) *Limitations.*—The amount treated as interest under section 163(b) and this section for any taxable year shall not exceed the amount of the payments made under the contract during the taxable year nor the aggregate carrying charges properly attributable to each contract for such taxable year. In computing the amount to be treated as interest if the obligation to pay is terminated as, for example, in the case of a repossession of the property, the unpaid balance on the first day of the month during which the obligation is terminated shall be zero.

(d) *Illustrations.*—The provisions of this section may be illustrated by the following examples:

Example (1). On January 20, 1955, A purchased a television set for $400, including a stated carrying charge of $25. The down payment was $50, and the balance was paid in 14 monthly installments of $25 each, on the 20th day of each month commencing with February. Assuming that A is a cash method, calendar year taxpayer and that no other installment purchases were made, the amount to be treated as interest in 1955 is $12.38, computed as follows:

YEAR 1955	
First day of	*Unpaid balance outstanding*
January	$0
February	350
March	325
April	300
May	275
June	250
July	225
August	200
September	175
October	150
November	125
December	100
	$2,475

Sum of unpaid balances $2,475÷12=$206.25;
6% thereof=$12.38

Example (2). On November 20, 1955, B purchased a furniture set for $1,250, including a stated carrying charge of $48. The down payment was $50 and the balance was payable in 12 monthly installments of $100 each, on the first day of each month commencing with December 1955. Assume that B is a cash method, calendar year taxpayer and that no other installment purchases were made. Assume further that B made the first payment when due, but made only one other payment on June 1, 1956. The amount to be treated as interest in 1955 is $4, and the amount to be treated as interest in 1956 is $33, computed as follows:

YEAR 1955	
First day of	*Unpaid balance outstanding*
December	$1200

Sum of unpaid balances $1200÷12=$100
6% thereof=$6
Carrying charges attributable to 1955=$4

YEAR 1956	
First day of	*Unpaid balance outstanding*
January	$1100
February	1000
March	900
April	800
May	700
June	600
July	500
August	400
September	300
October	200
November	100
	$6600

Sum of unpaid balances $6600÷12=$550
6% thereof=$33
Carrying charges attributable to 1956=$44 ($4×11)

Example (*3*). Assume the same facts as in example (2), except that the furniture was repossessed and B's obligation to pay terminated as of July 15, 1956. The amount to be treated as interest in 1955 is $4, computed as in example (2) above. The amount to be treated as interest in 1956 is $25.50, computed as follows:

YEAR 1956	
First day of	*Unpaid balance outstanding*
January	$1100
February	1000
March	900
April	800
May	700
June	600
July–November	–0–
	$5100

Sum of unpaid balances $5100÷12=$425
6% thereof=$25.50
Carrying charges attributable to 1956=$44 ($4×11)

(e) *Effective date.*—The provisions of section 163 are effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954. The rule provided in section 163(b) and this section applies to payments made during such taxable years regardless of when the contract of sale was made.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved January 17, 1957.

DAN THROOP SMITH,
Deputy to Secretary of the Treasury.

(Filed by the Division of the Federal Register on January 23, 1957, at 8:48 a. m., and published in the issue of the Federal Register for January 24, 1957, 22 F. R. 473.)

26 CFR 1.163–1: Interest deduction in general.
(Also Part II, Section 23(b); Regulations 118, Section 39.23(b)-1.)

Rev. Rul. 57–198

Revenue Ruling 55–12, C. B. 1955–1, 259, which amplified Revenue Ruling 168, C. B. 1953–2, 19, holds that a payment made for the privilege of prepaying an indebtedness is not one which can be said to be for the use of borrowed money, but is in the nature of a penalty to gain release from a pre-existing contractual liability to make payments in the future, and therefore cannot be classified as a payment of interest within the meaning of section 23(b) of the Internal Revenue Code of 1939. In the case of *General American Life Insurance Company* v. *Commissioner*, 25 T. C. 1265, acquiescence, C. B. 1956–2, 5, it was held that penalty payments received from mortgagors who prepaid their mortgage indebtedness constituted interest within the meaning of section 201(c)(1) of the 1939 Code, relating to gross income of life insurance companies. In view of this decision, it is now held that penalty payments made by a taxpayer to his mortgagee for the privilege of prepaying his mortgage indebtedness are deductible as interest under the provisions of section 163 of the Internal Revenue Code of 1954 or section 23(b) of the 1939 Code.

Revenue Ruling 55–12, C. B. 1955–1, 259, and Revenue Ruling 168, C. B. 1953–2, 19, are revoked.

SECTION 166.—BAD DEBTS

Rev. Rul. 57–210

The term "Government insured loans," as used in Paragraph 4 of Mimeograph 6209, applies to all Government insured or guaranteed loans to the extent or percent insured or guaranteed.

Mortgage loans made by banks under Title II of the National Housing Act, as amended, known as Title II F. H. A. loans, are considered to be 100 percent Government guaranteed loans for the purposes of Paragraph 4, Mimeograph 6209.

Advice has been requested whether loans made by banks under Title II of the National Housing Act, 48 Stat. 1246, at page 1248, as amended, 12 U. S. C. 1708, such loans known as Title II F. H. A. loans, are considered 100 percent Government insured loans for the purposes of Paragraph 4 of Mimeograph 6209, C. B. 1947–2, 26.

Regulations of the Federal Housing Administration for mutual mortgage insurance under section 203 of the National Housing Act, *supra*, covering loans made by banks under Title II of that Act, provide that upon default of payments by a mortgagor, the mortgagee at his election has the right to receive the guaranteed Government debentures for the full amount of the unpaid mortgage principal following foreclosure and conveyance of the property to the Federal Housing Commissioner, and that these debentures are accepted in payment of premiums by the Federal Housing Administration, the same as cash. A call was issued on March 31, 1954, by the Federal Housing Administration for redemption on July 1, 1954, at par plus accrued interest, of all of its callable debentures which includes Title II debentures.

Accordingly, it is held that mortgage loans made by banks under Title II of the National Housing Act, *supra*, as amended, known as Title II F. H. A. loans, are considered to be 100 percent Government guaranteed loans for the purposes of Paragraph 4, Mimeograph 6209, *supra*.

Paragraph 4 of Mimeograph 6209, *supra*, provides that Government insured loans should be eliminated from prior year accounts in computing percentages of past losses and also from current year loans in computing allowable deductions for additions to the reserve for bad debts. In applying these provisions it has been the practice of the Service to consider that eliminations are required only of Government insured or guaranteed loans which are 100 percent insured or guaranteed and not of loans which are Government insured or guaranteed to some extent but less than 100 percent.

Upon review, it is concluded that the term "Government insured loans," as used in Paragraph 4 of Mimeograph 6209, *supra*, should not be construed to include only loans which are 100 percent Government insured or guaranteed. In its ordinarily understood sense and definition, the term refers to any loans which are Government insured or guaranteed, in whatever extent or percent. Hence, the eliminations provided for in the Mimeograph of such loans should be made accordingly, *i. e.*, in entirety if the loan is 100 percent Government insured or guaranteed, 90 percent if the loan is 90 percent Government insured or guaranteed, etc. Such application of these provisions of the Mimeograph accords with the general purpose of reserves for bad debts to which it relates.

With respect to returns filed for taxable years ended prior to the date of the publication of this Revenue Ruling, where banks in computing allowable deductions for additions to their bad debt reserves did not eliminate certain Government insured loans because such loans were not 100 percent insured or guaranteed, it will be the administrative policy of the Revenue Service, under the authority of section 7805(b) of the Internal Revenue Code of 1954, not to disturb such treatment.

SECTION 167.—DEPRECIATION

26 CFR 1.167(a)-1: Depreciation in general.

Circumstances under which depreciation adjustments will be made even though accepted without change in a prior return. See Rev. Proc. 57-18, page 748.

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26 CFR 1.167(d)-1: Agreement as to the useful life and rates of depreciation.

Information and instructions for agreements with respect to depreciation of property. See Rev. Proc. 57-10, page 735.

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

Rev. Rul. 57–38

Contributions made to Committees organized to carry out the "People-to-People Program" to acquaint people in foreign countries with the United States' objectives and principles, which Committees are certified by the United States Information Agency to the Commissioner of Internal Revenue as engaged in advancing the Program, and out-of-pocket expenses incurred by individuals in connection with the formation of and in rendering volunteer services to such Committees, constitute allowable deductions under section 170 of the Internal Revenue Code of 1954 as contributions made to or for the use of the United States.

Advice has been requested with respect to the deductibility, for Federal income tax purposes, of contributions to Committees organized to carry out the "People-to-People Program," and actual expenses incurred by the members of the Committees in rendering volunteer services to such Committees.

The United States Information and Educational Exchange Act of 1948, 62 Stat. 6, 22 USC 1431 et seq., was enacted for the purpose of promoting a better understanding of the United States in other countries, and of increasing mutual understanding between the people of the United States and the people of other countries. Among the means to be used in achieving these objectives are (1) an information service to disseminate abroad information about the United States, its people, and governmental policies affecting foreign affairs, and (2) an educational exchange service to cooperate with other nations in (a) the interchange of persons, knowledge, and skills, (b) the rendering of technical and other services, and (c) the interchange of developments in the field of education, the arts and sciences. The Act provides that in carrying out the provisions of the Act it shall be the duty of the Secretary of State to utilize the services and facilities of private agencies through contractual arrangements or otherwise, and that it is the intent of Congress that the Secretary shall encourage participation in carrying out the purposes of the Act by the maximum number of different private agencies in each field consistent with the present or potential market for their services in each country. Effective August 1, 1953, the United States Information Agency was established pursuant to the Reorganization Act of 1949, as amended, and certain of the informational and educational functions formerly vested in the Secretary of State by the above-mentioned act of 1948 were transferred to this Agency.

Pursuant to the above provisions, there was recently initiated the "People-to-People Program," which was approved by the President as an effective means of supplementing the direct activities of the Government in accomplishing the purposes of the Information and Educational Exchange Act. The Program will be organized around Committees functioning in widely different fields. At the request of the President, certain American citizens who are prominently associated with various areas of industry, business, education, etc., will act as chairman of the Committees to carry out the Program in their particular fields. The Committees will constitute private organizations functioning on their own initiative and responsibility to make

the objectives and principles of the United States better understood throughout the world. The United States Information Agency will assist and advise the several Committees, pursuant to the functions of that Agency.

The members of the Committees in rendering gratuitous services incur expenses in connection with the organization of the Committees and in carrying out their purposes.

Section 170 of the Internal Revenue Code of 1954 provides, in part, for the allowance as a deduction in computing taxable income, within the limitations prescribed, of contributions or gifts payment of which is made within the taxable year to or for the use of the United States for exclusively public purposes.

It is held that contributions made to such Committees, for use exclusively in advancing the "People-to-People Program," constitute allowable deductions under section 170 of the Code, subject to the limitations provided by that section, as contributions made for the use of the United States. Such contributions may include out-of-pocket expenses, including the entire amount expended for meals and lodging while away from home, incurred by members of the Committees directly in connection with and solely attributable to the formation of or the rendering of voluntary services to the Committees. The allowance of deductions claimed will be subject to annual certification by the United States Information Agency to the Commissioner of Internal Revenue that the activities of the particular Committee involved are exclusively in furtherance of the "People-to-People Program," and subject further to such verification as may be deemed necessary. Such certification will not relieve the Committees of the responsibility for maintaining adequate records of all receipts and expenditures in order to substantiate deductions claimed.

As used herein the term "Committee" includes incorporated or unincorporated organizations.

Rev. Rul. 57–188

A club whose membership is composed of individuals who are members of a domestic fraternal society operating under the lodge system was formed for the purpose of giving donations to the relatives or friends of deceased members to help defray the expenses incurred in the sickness or death of such members. No dues are paid to the club and the amount paid to the beneficiary is a voluntary contribution by the members. *Held*, contributions made to the club for the purpose of helping to defray sickness or burial expenses of a deceased member of the club constitute contributions made to individuals and, as such, are not deductible by the donors for Federal income tax purposes.

Rev. Rul. 57–211

Payments made to a State hospital for the purpose of reimbursing the State for the care of a person confined in the hospital do not constitute contributions or gifts made to or for the use of a State for exclusively public purposes within the meaning of section 170 of the Internal Revenue Code of 1954. Accordingly, such payments are not deductible as charitable contributions in computing taxable income for Federal income tax purposes.

SECTION 175.—SOIL AND WATER CONSERVATION EXPENDITURES

26 CFR 1.175: Statutory provisions: soil and water conservation expenditures. T. D. 6235 [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 175 of the Internal Revenue Code of 1954, relating to the deduction for soil and water conservation expenditures.

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 29, 1956, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under section 175 of the Internal Revenue Code of 1954 was published in the Federal Register (21 F. R. 4814). After consideration of all such relevent matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted. Such regulations supersede paragraph 6 of Treasury Decision 6118, approved December 30, 1954 (19 F. R. 9896 [C. B. 1955–1,698]; 26 CFR (1954), Parts 1 to 220 (1955 Rev.), par. 6, p. 25):

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AUTHORITY: §§ 1.175 to 1.175–6, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

§ 1.175 STATUTORY PROVISIONS; SOIL AND WATER CONSERVATION EXPENDITURES.

SEC. 175. SOIL AND WATER CONSERVATION EXPENDITURES.

(a) IN GENERAL.—A taxpayer engaged in the business of farming may treat expenditures dhich are paid or incurred by hi mduring the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming, as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

(b) LIMITATION.—The amount deductible under subsection (a) for any taxable year shall not exceed 25 percent of the gross income derived from farming during the taxable year. If for any taxable year the total of the expenditures treated as expenses which are not chargeable to capital account exceeds 25 percent of the gross income derived from farming during the taxable year, such excess shall be deductible for succeeding taxable years in order of time; but the amount deductible under this section for any one such succeeding year (including the expenditures actually paid

[1] 22 F. R. 3849.

or incurred during the taxable year) shall not exceed 25 percent of the gross income derived from farming during the taxable year.

(c) DEFINITIONS.—For purposes of subsection (a)—

(1) The term "expenditures which are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming" means expenditures paid or incurred for the treatment or moving of earth, including (but not limited to) leveling, grading and terracing, contour furrowing, the construction, control, and protection of diversion channels, drainage ditches, earthen dams, watercourses, outlets, and ponds, the eradication of brush, and the planting of windbreaks. Such term does not include—

(A) The purchase, construction, installation, or improvement of structures, appliances, or facilities which are of a character which is subject to the allowance for depreciation provided in section 167, or

(B) Any amount paid or incurred which is allowable as a deduction without regard to this section.

Notwithstanding the preceding sentences, such term also includes any amount, not otherwise allowable as a deduction, paid or incurred to satisfy any part of an assessment levied by a soil or water conservation or drainage district to defray expenditures made by such district which, if paid or incurred by the taxpayer, would without regard to this sentence constitute expenditures deductible under this section.

(2) The term "land used in farming" means land used (before or simultaneously with the expenditures described in paragraph (1)) by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

(d) WHEN METHOD MAY BE ADOPTED.—

(1) WITHOUT CONSENT.—A taxpayer may, without the consent of the Secretary or his delegate, adopt the method provided in this section for his first taxable year—

(A) Which begins after December 31, 1953, and ends after the date on which this title is enacted, and

(B) For which expenditures described in subsection (a) are paid or incurred.

(2) WITH CONSENT.—A taxpayer may, with the consent of the Secretary or his delegate, adopt at any time the method provided in this section.

(e) SCOPE.—The method adopted under this section shall apply to all expenditures described in subsection (a). 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.

§ 1.175–1 SOIL AND WATER CONSERVATION EXPENDITURES; IN GENERAL.—Under section 175, a farmer may deduct his soil or water conservation expenditures which do not give rise to a deduction for depreciation and which are not otherwise deductible. The amount of the deduction is limited annually to 25 percent of the taxpayer's gross income from farming. Any excess may be carried over and deducted in succeeding taxable years. As a general rule, once a farmer has adopted this method of treating soil and water conservation expenditures, he must deduct all such expenditures (subject to the 25-percent limitation) for the current and subsequent taxable years. If a farmer does not adopt this method, such expenditures increase the basis of the property to which they relate.

§ 1.175–2 DEFINITION OF SOIL AND WATER CONSERVATION EXPENDITURES.—(a) *Expenditures treated as a deduction.*—(1) The method

described in section 175 applies to expenditures paid or incurred for the purpose of soil or water conservation in respect of land used in farming or for the prevention of erosion of land used in farming, but only if such expenditures are made in the furtherance of the business of farming. More specifically, a farmer may deduct expenditures made for these purposes which are for (i) the treatment or moving of earth, (ii) the construction, control, and protection of diversion channels, drainage ditches, irrigation ditches, earthen dams, watercourses, outlets, and ponds, (iii) the eradication of brush, and (iv) the planting of windbreaks. Expenditures for the treatment or moving of earth include but are not limited to expenditures for leveling, conditioning, grading, terracing, contour furrowing, and restoration of soil fertility.

(2) The following are examples of soil and water conservation: (i) Construction terraces, or the like, to detain or control the flow of water, to check soil erosion on sloping land, to intercept run-off, and to divert excess water to protected outlets; (ii) Constructing water detention or sediment retention dams to prevent or fill gullies, to retard or reduce run-off of water, or to collect stock water; and (iii) Constructing earthen floodways, levies, or dikes, to prevent flood damage to farmland.

(b) *Expenditures not subject to section 175 treatment.*—(1) The method described in section 175 applies only to expenditures for nondepreciable items. Accordingly, a taxpayer may not deduct expenditures for the purchase, construction, installation, or improvement of structures, appliances, or facilities subject to the allowance for depreciation. Thus, the method does not apply to depreciable nonearthen items such as those made of masonry or concrete (see section 167). For example, expenditures in respect of depreciable property include those for materials, supplies, wages, fuel, hauling, and dirt moving for making structures such as tanks, reservoirs, pipes, conduits, canals, dams, wells, or pumps composed of masonry, concrete, tile, metal, or wood. Similarly, the method is not applicable to expenditures for fertilizer effective substantially longer than one year, since such expenditures are also depreciable. However, the method applies to expenditures for earthen items which are not subject to a depreciation allowance. For example, expenditures for earthen terraces and dams which are nondepreciable are deductible under section 175.

(2) The method does not apply to expenses deductible apart from section 175. Adoption of the method is not necessary in order to deduct such expenses in full without limitation. Thus, the method does not apply to interest (deductible under section 163), nor to taxes (deductible under section 164). It does not apply to expenses for the repair of completed soil or water conservation structures, such as costs of annual removal of sediment from a drainage ditch. It does not apply to expenditures paid or incurred primarily to produce an agricultural crop even though they incidentally conserve soil. Thus, the cost of fertilizer (the effectiveness of which does not last beyond one year) used to produce hay is deductible without adoption of the method described in section 175 . However, the method would apply to expenses incurred to produce vegetation primarily to conserve soil or water or to prevent erosion. Thus, for example, the method would

apply to such expenditures as the cost of dirt moving, lime, fertilizer, seed and planting stock used in gully stabilization, or in stabilizing severely eroded areas, in order to obtain a soil binding stand of vegatation on raw or infertile land.

(c) *Assessments.*—The method applies also to that part of assessments levied by a soil or water conservation or drainage district to reimburse it for its expenditures which, if actually paid or incurred during the taxable year by the taxpayer directly, would be deductible under section 175. Depending upon the farmer's method of accounting, the time when the farmer pays or incurs the assessment, and not the time when the expenditures are paid or incurred by the district, controls the time the deduction must be taken. The provisions of this paragraph may be illustrated by the following example:

Example. In 1955 a soil and water conservation district levies an assessment of $700 upon a farmer on the cash method of accounting. The assessment is to reimburse the district for its expenditures in 1954. The farmer's share of such expenditures is as follows: $400 for digging drainage ditches for soil conservation and $300 for assets subject to the allowance for depreciation. If the farmer pays the assessment in 1955 and has adopted the method of treating expenditures for soil or water conservation as current expenses under section 175, he may deduct in 1955 the $400 attributable to the digging of drainage ditches as a soil conservation expenditure subject to the 25-percent limitation.

§ 1.175–3 Definition of "The Business of Farming".—The method described in section 175 is available only to a taxpayer engaged in "the business of farming". A taxpayer is engaged in the business of farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant. For the purpose of section 175, a taxpayer who receives a rental (either in cash or in kind) which is based upon farm production is engaged in the business of farming. However, a taxpayer who receives a fixed rental (without reference to production) is engaged in the business of farming only if he participates to a material extent in the operation or management of the farm. A taxpayer engaged in forestry or the growing of timber is not thereby engaged in the business of farming. A person cultivating or operating a farm for recreation or pleasure rather than a profit is not enaged in the business of farming. For the purpose of this section, the term "farm" is used in its ordinary, accepted sense and includes stock, dairy, poultry, fruit, and truck farms, and also plantations, ranches, ranges, and orchards. A taxpayer is engaged in "the business of farming" if he is a member of a partnership engaged in the business of farming. See § 1.702–1 (a) (8) (i) and (c) (1) (iv).

§ 1.175–4 Definition of "Land Used in Farming".—(a) For the purpose of section 175, the term "land used in farming" means land which is used in the business of farming and which meets both of the following requirements:

(1) The land must be used for the production of crops, fruits, or other agricultural products or for the sustenance of livestock. The term "livestock" includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry. It does not include fish, frogs, reptiles, and the like.

Land used for the substenance of livestock includes land used for grazing such livestock.

(2) The land must be or have been so used either by the taxpayer or his tenant at some time before, or at the same time as, the taxpayer makes the expenditures for soil or water conservation or for the prevention of the erosion of land. The taxpayer will be considered to have used the land in farming before making such expenditures if he or his tenant has employed the land in a farming use in the past. If the expenditures are made by the taxpayer in respect of land newly acquired from one who immediately prior to the acquisition was using it in farming, the taxpayer will be considered to be using the land in farming at the time that such expenditures are made, if the use which is made by the taxpayer of the land from the time of its acquisition by him is substantially a continuation of the use which was made of the land immediately prior to its acquisition. On the other hand, if the land is being initially prepared by the taxpayer in order to make it suitable for a particular farming use other than the one to which the land was devoted prior to its acquisition by the taxpayer, such land is not considered to be "land used in farming" at the time of its preparation.

(b) The provisions of paragraph (a) of this section may be illustrated by the following examples:

Example (1). A purchases an operating farm from B in the autumn after B has harvested his crops. At the time of such purchase the land is suitable for A's particular farming use without the necessity of making initial preparatory expenditures. Prior to spring plowing and planting when the land is idle because of the season, A makes certain soil and water conservation expenditures on this farm. At the time such expenditures are made the land is considered to be used by A in farming, and A may deduct such expenditures under section 175, subject to the other requisite conditions of such section.

Example (2). C acquires uncultivated land which he intends to develop for farming. Prior to putting this land into production it is necessary for C to clear brush, construct earthen terraces and ponds, and make other soil and water conservation expenditures. The land is not used in farming at the same time that such expenditures are made. Therefore, C may not deduct such expenditures under section 175.

Example (3). D acquires several tracts of land from persons who had used such land for grazing cattle. D intends to use the land for a citrus grove. In order to make the land suitable for this use, D constructs earthen terraces, builds drainage ditches and irrigation ditches, extensively treats the soil, and makes other soil and water conservation expenditures. The land is not used in farming by D at the time he makes such expenditures, but is being initially prepared for use as a citrus grove. Therefore, D may not deduct such expenditures under section 175.

§ 1.175–5 Percentage Limitation and Carryover.—(a) *The limitation.*—(1) *General rule.*—The amount of soil and water conservation expenditures which the taxpayer may deduct under section 175 in any one taxable year is limited to 25 percent of his "gross income from farming."

(2) *Definition of "gross income from farming".*—For the purpose of section 175, the term "gross income from farming" means the gross income of the taxpayer, derived in "the business of farming" as defined in § 1.175–3, from the production of crops, fruits, or other agricultural products or from livestock (including livestock held for draft, breeding, or dairy purposes). It includes such income from land used in farming other than that upon which expenditures are made for soil or water conservation or for the prevention of erosion of land. It does not include gains from sales of assets such as farm machinery or gains from the disposition of land. A taxpayer shall compute his "gross income from farming" in accordance with his accounting method used in determining gross income. (See the regulations under section 61 relating to accounting methods used by farmers in determining gross income.) The provisions of this subparagraph may be illustrated by the following example:

Example. A, who uses the cash receipts and disbursements method of accounting, includes in his "gross income from farming" for purposes of determining the 25-percent limitation the following items:

Proceeds from sale of his 1955 yield of corn	$10,000
Gain from disposition of old breeding cows replaced by younger cows	500
Total gross income from farming	10,500

A must exclude from "gross income from farming" the following items which are included in his gross income:

Gain from sale of tractor	$100
Gain from sale of 40 acres of taxpayer's farm	8,000
Interest on loan to neighboring farmer	100

(3) *Deduction qualifies for net operating loss deduction.*—Any amount allowed as a deduction under section 175, either for the year in which the expenditure is paid or incurred or for the year to which it is carried, is taken into account in computing a net operating loss for such taxable year. If a deduction for soil or water conservation expenditures has been taken into account in computing a net operating loss carryback or carryover, it shall not be considered a soil or water conservation expenditure for the year to which the loss is carried, and, therefore, is not subject to the 25-percent limitation for that year. The provisions of this subparagraph may be illustrated by the following example:

Example. Assume that in 1956 A has gross income from farming of $4,000, soil and water conservation expenditures of $1,600, and deductible farm expenses of $3,500. Of the soil and water conservation expenditures, $1,000 is deductible in 1956. The $600 in excess of 25 percent of A's gross income from farming is carried over into 1957. Assuming that A has no other income, his deductions of $4,500 ($1,000 plus $3,500) exceed his gross income of $4,000 by $500. This $500 will constitute a net operating loss which he must carry back two years and carry forward five years, until it has offset $500 of taxable income. No part of this $500 net operating loss carryback or carryover will be taken into account in determining the amount of soil and water conservation expenditures in the years to which it is carried.

(b) *Carryover of expenditures in excess of deduction.*—The deduction for soil and water conservation expenditures in any one taxable year is limited to 25 percent of the taxpayer's gross income from farming. The taxpayer may carry over the excess of such expenditures over 25 percent of his gross income from farming into his next taxable year, and, if not deductible in that year, into the next year, and so on without limit as to time. In determining the deductible amount of such expenditures for any taxable year, the actual expenditures of that year shall be added to any such expenditures carried over from prior years, before applying the 25-percent limitation. Any such expenditures in excess of the deductible amount may be carried over during the taxpayer's entire existence. For this purpose in a farm partnership, since the 25-percent limitation is applied to each partner, not the partnership, the carryover may be carried forward during the life of the partner. The provisions of this paragraph may be illustrated by the following example:

Example. Assume the expenditures and income shown in the following table:

	Deductible soil and water conservation expenditures				
Year	*Paid or incurred during taxable year*	*Carried forward from prior year*	*Total*	*25% of gross income from farming*	*Excess to be carried forward*
1954	$900	None	$900	$800	$100
1955	1,000	100	1,100	900	200
1956	None	200	200	1,000	None

The deduction for 1954 is limited to $800. The remainder, $100 ($900 minus $800), not being deductible for 1954, is a carryover to 1955. For 1955, accordingly, the total of the expenditures to be taken into account is $1,100 (the $100 carryover and the $1,000 actually paid in that year). The deduction for 1955 is limited to $900, and the remainder of the $1,100 total, or $200, is a carryover to 1956. The deduction for 1956 consists solely of this carryover of $200. Since the total expenditures, actual and carried over, for 1956 are less than 25 percent of gross income from farming, there is no carryover into 1957.

§ 1.176-6 Adoption or Change of Method.—(a) *Adoption without consent.*—A taxpayer may, without consent, adopt the method of treating expenditures for soil or water conservation as expenses for the first taxable year:

(1) Which begins after December 31, 1953, and ends after August 16, 1954, and

(2) For which soil or water conservation expenditures described in section 175(a) are paid or incurred.

Such adoption shall be made by claiming the deduction on his income tax return. For a taxable year ending prior to the adoption of regulations under this section, the adoption of the method described in section 175 shall be made by claiming the deduction on such return for that year, or by claiming the deduction on an amended return filed for that year within 90 days after the date of publication (following adoption) of such regulations in the Federal Register.

(b) *Adoption with consent.*—A taxpayer may adopt the method of treating soil and water conservation expenditures as provided by section 175 for any taxable year to which the section is applicable if consent is obtained from the district director for the district in which the taxpayer's return is required to be filed.

(c) *Change of method.*—A taxpayer who has adopted the method of treating expenditures for soil or water conservation, as provided by section 175, may change from this method and capitalize such expenditures made after the effective date of the change, if he obtains the consent of the district director for the district in which his return is required to be filed.

(d) *Request for consent to adopt or change method.*—Where the consent of the district director is required under paragraph (b) or (c) of this section, the request for his consent shall be in writing, signed by the taxpayer or his authorized representative, and shall be filed not later than the date prescribed by law for filing the income tax return for the first taxable year to which the adoption of, or change of, method is to apply, or not later than 90 days after the date of publication in the Federal Register of the regulations under section 175 following their adoption, whichever is later. The request shall—

(1) Set forth the name and address of the taxpayer;

(2) Designate the first taxable year to which the method or change of method is to apply;

(3) State whether the method or change of method is intended to apply to all expenditures within the permissible scope of section 175, or only to a particular project or farm and, if the latter, include such information as will identify the project or farm as to which the method or change of method is to apply;

(4) Set forth the amount of all soil and water conservation expenditures paid or incurred during the first taxable year for which the method or change of method is to apply; and

(5) State that the taxpayer will make an accounting segregation in his books and records of the expenditures to which the election relates.

(e) *Scope of method.*—Except with the consent of the district director as provided in paragraph (b) or (c) of this section, the taxpayer's method of treating soil and water conservation expenditures described in section 175 shall apply to all such expenditures for the taxable year of adoption and all subsequent taxable years. Although a taxpayer may have elected to deduct soil and water conservation expenditures, he may request an authorization to capitalize his soil and water conservation expenditures attributable to a special project or single farm. Similarly, a taxpayer who has not elected to deduct such expenditures may request an authorization to deduct his soil and water conservation expenditures attributable to a special project or single farm. The authorization with respect to the special project or single farm will not affect the method adopted with respect to the taxpayer's regularly incurred soil and water conservation expenditures. No adoption of, or change of, the method under section 175 will be permitted as to expenditures actually paid or incurred before the taxable year to which the method or change of method is to apply. Thus, if a taxpayer adopts such method for 1956, he cannot deduct any part of such expenditures which he capitalized, or should have

capitalized, in 1955. Likewise, if a taxpayer who has adopted such method has an unused carryover of such expenditures in excess of the 25-percent limitation, and is granted consent to capitalize soil and water conservation expenditures beginning in 1956, he cannot capitalize any part of the unused carryover. The excess expenditures carried over continue to be deductible to the extent of 25 percent of the taxpayer's gross income from farming. No adjustment to the basis of land shall be made under section 1016 for expenditures to which the method under section 175 applies. For example, A has an unused carryover of soil and water conservation expenditures amounting to $5,000 as of December 31, 1956. On January 1, 1957, A sells his farm and goes out of the business of farming. The unused carryover of $5,000 cannot be added to the basis of the farm for purposes of determining gain or loss on its sale. In 1959, A purchases another farm and resumes the business of farming. In such year, A may deduct the amount of the unused carryover to the extent of 25 percent of his gross income from farming and may carry over any excess to subsequent years.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved May 28, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on May 31, 1957, 8:49 a. m., and published in the issue of the Federal Register for June 1, 1957, 22 F. R. 3849.)

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

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

Amounts expended for health-restoring exercises at a resort hotel or athletic club. See Rev. Rul. 57–130, page 108.

SECTION 215.—ALIMONY, ETC., PAYMENTS

(Also Section 71.) Rev. Rul. 57–113

The existence of a Mexican divorce decree prior to a decree awarding alimony pendente lite in a state which does not recognize the validity of the Mexican divorce does not preclude the deductibility under section 215 of the Internal Revenue Code of 1954 of alimony payments pursuant to the state decree.

Advice has been requested whether a husband may deduct for Federal income tax purposes monthly payments to his wife pursuant to a decree awarding alimony pendente lite by the state where his wife resides if he previously was granted a divorce which that state did not recognize.

In May 1954, the husband applied for and was granted a divorce in Mexico. In August of the same year, he remarried. Immediately thereafter, his former wife instituted an action under the law of the state in which she resided contesting the validity of the Mexican

divorce and asking for a legal separation from the husband and an allowance for her support pending the outcome of the litigation. The court granted the wife's motion for an allowance pendente lite in December 1954, and the husband agreed to make the monthly payments for support to the wife pending the outcome of the litigation.

Section 71(a)(3) of the Internal Revenue Code of 1954 provides in part as follows:

> If a wife is separated from her husband, the wife's gross income includes periodic payments * * * received by her * * * from her husband under a decree entered after March 1, 1954, requiring the husband to make the payments for her support or maintenance. This paragraph shall not apply if the husband and wife make a single return jointly.

Section 215 of the Code provides that in the case of a husband described in section 71, there shall be allowed as a deduction amounts includible under section 71 in the gross ncome of his wife, payment of which is made within the husband's taxable year.

In G. C. M. 25250, C. B. 1947–2, 32, payments made under an agreement incident to a Mexican decree, which is not recognized in many American jurisdictions were held deductible. Payments made in good faith incident to a Mexican decree or other decree the validity of which has been questioned, are generally includible in the wife's gross income under section 71 and deductible by the husband under section 215 of the Code. This does not mean that the payments under a later decree which does not recognize the earlier decree are not to be similarly treated. The position taken by the Service in G. C. M. 25250, *supra*, was not intended to recognize the Mexican decree over subsequent decrees in other jurisdictions.

Accordingly, it is held that the existence of a Mexican divorce decree prior to a decree granted in a state which does not recognize the validity of the Mexican divorce does not preclude the deductibility under section 215 of the Internal Revenue Code of 1954 of the pendente lite payments made pursuant to the state decree.

Premiums on life insurance paid by husband for the benefit of divorced wife. See Rev. Rul. 57–125, page 27.

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. 57–45, page 509.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 262.—PERSONAL, LIVING, AND FAMILY EXPENSES

(Also Sections 162, 213.) Rev. Rul. 57–130

Where an employer pays the expenses of one of its executives incurred in connection with securing the benefits of the reconditioning program offered by a resort hotel which specializes in reconditioning and health restoring services, such expenditures generally constitute additional compensation to the executive, and he is required to include the amount thereof in gross income for Federal income tax purposes. Expenditures which are compensatory in nature are deductible by an employer under section 162 of the Code provided the total amount expended, plus other compensation paid to the executive, is no more than reasonable compensation for personal services actually rendered by him.

In the case of an indivdual taxpayer making such payments on his own behalf, the cost of a vacation, even though for reconditioning and health-restoring purposes (*i. e.*, rehabilitation), is not deductible in computing taxable income for Federal income tax purposes under any provision of the Code. Such expenses constitute personal expenses the deduction of which is prohibited by section 262 of the Code.

Advice has been requested with respect to the tax treatment of amounts expended by an executive, or an employer on behalf of an executive, who avails himself of reconditioning and health-restoring services afforded by certain resort hotels and athletic clubs.

Advertisements have appeared in magazines and newspapers describing a tax-deductible, executive rehabilitation plan which certain hotels have instituted to assist an individual in keeping fit.

Section 213(e)(1) of the Internal Revenue Code of 1954 provides, in part, that the term "medical care" means amounts paid—

(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body * * *.

The cost of vacations, health institute fees, or athletic club expenses incurred by an individual to assist in keeping fit are not deductible by him as a medical expense, even though such activities may be beneficial to his general health. See Revenue Ruling 55–261, C. B. 1955–1, 307, especially illustration 9, at page 310.

Section 162 of the Code provides for the deduction, in computing taxable income, of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business.

Where an employer pays the expenses of one of its executives incurred in connection with securing the benefits of the reconditioning program offered by a resort of the type mentioned above, such expenditures generally constitute additional compensation to the executive and he is required to include the amount thereof in gross income for Federal income tax purposes. Expenditures which are compensatory in nature are deductible by an employer under section 162 of the Code, provided the total amount expended, plus other com-

pensation paid to the executive, is no more than reasonable compensation for personal services actually rendered by him.

In the case of an individual taxpayer making such payments on his own behalf, the cost of a vacation, even though for reconditioning and health-restoring purposes (*i. e.*, rehabilitation), is not deductible in computing taxable income for Federal income tax purposes under any provision of the Code. Such expenses constitute personal expenses the deduction of which is prohibited by section 262 of the Code.

Cost and maintenance of work clothing of a painter which is prescribed by the Painter's local union. See Rev. Rul. 57-143, page 89.

SECTION 263.—CAPITAL EXPENDITURES

Rev. Rul. 57-30

A taxpayer maintains a slip and dock which are used by ships delivering materials used in connection with the conduct of his business. At the time of its construction, the sides were riprapped, but operations subsequently have disclosed that due to the propeller action of the ships using the slip the riprap does not stay in place, thus requiring the taxpayer to incur substantial annual expenditures for maintaining the dock in a fully usable condition. In order to remedy the situation and to virtually eliminate the annual maintenance costs, the taxpayer had the slip on the dock side sheet-piled. The cost of the sheet piling was approximately three times the amount previously expended annually for maintenance. The sheet piling will be a permanent improvement to the dock, the useful benefits from which will extend beyond the taxable year. *Held*, the expenditure for sheet piling the slip constitutes a capital investment, within the meaning of section 263(a)(1) of the Internal Revenue Code of 1954, which is recoverable, for Federal income tax purposes, through annual depreciation deductions over the useful life thereof, irrespective of the ultimate saving to be effected otherwise in the maintenance.

SECTION 264.—CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS

26 CFR 1.264: Statutory provisions: items not deductible; certain amounts paid in connection with insurance contracts. T. D. 6228 [1]

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

Regulations under section 264 of the Internal Revenue Code of 1954.

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[1] The publication of this Treasury Decision in 22 F. R. 2710, dated April 18, 1957, contains (1) instructions for modifying the notice of proposed rulemaking published in 21 F. R. 4827, dated June 30, 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.

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 30, 1956, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, except as otherwise provided, under section 264 of the Internal Revenue Code of 1954 was published in the Federal Register (21 F. R. 4872). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so published have been modified and are hereby adopted as set forth below:

AUTHORITY: §§ 1.264 to 1.264–3, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U.S.C. 7805.

§ 1.264 STATUTORY PROVISIONS; ITEMS NOT DEDUCTIBLE; CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS.

SEC. 264. CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS.

(a) GENERAL RULE.—No deduction shall be allowed for—

(1) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

(2) Any amount paid or accrued on indebtedness incurred or continued to purchase or carry a single premium life insurance, endowment, or annuity contract.

Paragraph (2) shall apply in respect of annuity contracts only as to contracts purchased after March 1, 1954.

(b) CONTRACTS TREATED AS SINGLE PREMIUM CONTRACTS.—For purposes of subsection (a)(2), a contract shall be treated as a single premium contract—

(1) If substantially all the premiums on the contract are paid within a period of 4 years from the date on which the contract is purchased, or

(2) If an amount is deposited after March 1, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

§ 1.264–1 PREMIUMS ON LIFE INSURANCE TAKEN OUT IN A TRADE OR BUSINESS. (a) *When premiums are not deductible.*—Premiums paid by a taxpayer on a life insurance policy are not deductible from the taxpayer's gross income, even though they would otherwise be deductible as trade or business expenses, if they are paid on a life insurance policy covering the life of any officer or employee of the taxpayer, or any person (including the taxpayer) who is financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary of the policy. For additional provisions relating to the nondeductibility of premiums paid on life insurance policies (whether under section 162 or any other section of the Internal Revenue Code), see section 262, relating to personal, living, and family expenses, and section 265, relating to expenses allocable to tax-exempt income.

(b) *When taxpayer is a beneficiary.*—If a taxpayer takes out a policy for the purpose of protecting himself from loss in the event of

the death of the insured, the taxpayer is considered a beneficiary directly or indirectly under the policy. However, if the taxpayer is not a beneficiary under the policy, the premiums so paid will not be disallowed as deductions merely because the taxpayer may derive a benefit from the increased efficiency of the officer or employee insured. See section 162 and the regulations thereunder. A taxpayer is considered a beneficiary under a policy where, for example, he, as a principal member of a partnership, takes out an insurance policy on his own life irrevocably designating his partner as the sole beneficiary in order to induce his partner to retain his investment in the partnership. Whether or not the taxpayer is a beneficiary under a policy, the proceeds of the policy paid by reason of the death of the insured may be excluded from gross income whether the beneficiary is an individual or a corporation, except in the case of (1) certain transferees, as provided in section 101(a)(2); (2) portions of amounts of life insurance proceeds received at a date later than death under the provisions of section 101(d); and (3) life insurance policy proceeds which are includible in the gross income of a husband or wife under section 71 (relating to alimony) or section 682 (relating to income of an estate or trust in case of divorce, etc.). (See section 101(e).) For further reference, see, generally, section 101 and the regulations thereunder.

§ 1.264–2 Single Premium Life Insurance, Endowment, or Annuity Contracts.—Amounts paid or accrued on indebtedness incurred or continued, directly or indirectly, to purchase or to continue in effect a single premium life insurance or endowment contract, or to purchase or to continue in effect a single premium annuity contract purchased (whether from the insurer, annuitant, or any other person) after March 1, 1954, are not deductible under section 163 or any other provision of chapter 1 of the Internal Revenue Code of 1954. This prohibition applies even though the insurance is not on the life of the taxpayer and regardless of whether or not the taxpayer is the annuitant or payee of such annuity contract. A contract is considered a single premium life insurance, endowment, or annuity contract, for the purposes of this section, if substantially all the premiums on the contract are paid within four years from the date on which the contract was purchased, or if an amount is deposited after March 1, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

§ 1.264–3 Effective Date; 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 § 1.264–2, to the extent that they relate to amounts paid or accrued on indebtedness incurred or continued to purchase or carry a single premium annuity contract purchased after March 1, 1954, and to the extent they consider a contract a single premium life insurance, endowment, or annuity contract if an amount is deposited after March 1, 1954, with the insurer for payment of a substantial number of future premiums on the contract, shall also apply to taxable years beginning before January 1, 1954, and ending after March 1, 1954, and to taxable years beginning after December 31, 1953, and ending after March 1, 1954, but before

August 17, 1954, although such years are subject to the Internal Revenue Code of 1939.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved April 12, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on April 17, 1957, 8:47 a. m., and published in the issue of the Federal Register for April 18, 1957, 22 F. R. 2710.)

SECTION 270.—LIMITATION ON DEDUCTIONS ALLOWABLE TO INDIVIDUALS IN CERTAIN CASES

(Also Section 6601.) Rev. Rul. 57–179

Interest shall be assessed at the rate of six per centum per annum on the deficiencies resulting from the application of section 270 of the Internal Revenue Code of 1954 regarding the recomputation of tax of individuals whose losses from a business have, in each of five consecutive years, exceeded annual gross income by more than $50,000.

Advice has been requested whether interest shall be assessed on deficiencies resulting from the recomputation of tax under section 270 of the Internal Revenue Code of 1954 due to losses by an individual which exceed annual gross income by more than $50,000 a year for each of five consecutive years.

The deficiencies here involved were determined at the end of the five-year period as provided in section 270 of the Code.

Section 6151 of the Code, with respect to the due date of the taxes, provides in part as follows:

(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, * * * pay such tax at the time and place fixed for filing the return * * *.

Unless specifically otherwise prescribed, the assessment of interest on any deficiency in taxes imposed by the Code is mandatory under the provisions of section 6601(a), which reads as follows:

(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.

Section 6601(c) of the Code provides that the last date prescribed for payment shall be determined under chapter 62 (section 6151 as shown above) with the application of certain rules, none of which provide that no interest shall be charged on deficiencies in tax determined under the provisions of section 270 of the Code. The comparable provisions of the Internal Revenue Code of 1939 also fail to provide an exception to the general rule for charging interest on deficiencies determined under the provisions of section 130 of such Code.

Accordingly, it is held that interest shall be assessed at the rate of six percent per annum on the deficiencies resulting from the application of section 270 of the Internal Revenue Code of 1954 regarding the recomputation of tax of individuals whose losses from a business have, in each of five consecutive years, exceeded annual gross income by more than $50,000.

SECTION 271.—BAD DEBTS OWED BY POLITICAL PARTIES, ETC.

Rev. Rul. 57–189.

In 1951, a taxpayer on the accrual basis correctly accrued income for services rendered to several committees of a political party. In 1952, section 23(k)(6) was added to Internal Revenue Code of 1939 by Public Law 471, 66 Stat. 467, C. B. 1952–2, 357. That section provides, in part, that a bad debt deduction for taxpayers other than banks was unallowable with respect to debts owed by political parties, or branches thereof, for taxable years beginning after December 31, 1951. Section 271 of the Internal Revenue Code of 1954 corresponds to section 23(k)(6) of the Internal Revenue Code of 1939 in not allowing taxpayers other than banks a deduction for bad debts or worthless securities by reason of the worthlessness of any debt owed by a political party. The taxpayer received a number of payments on the accounts over a period of time, but after diligent efforts were made to secure payment of the balances due, there appeared no reasonable likelihood of his collecting any further payments on these accounts after 1955. *Held*, the accounts receivable held by the taxpayer, which represent worthless debts owed by the political party, are not deductible as bad debts.

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATION

SUBPART A.—EFFECTS ON RECIPIENTS

SECTION 306.—DISPOSITIONS OF CERTAIN STOCK

26 CFR 1.306–2: Exceptions. Rev. Rul. 57–103

A publicly-held corporation, for bona fide business reasons, acquired all the assets of a closely-held corporation with only common stock outstanding in return for voting preferred and common stock constituting five percent of the acquiring corporation's outstanding stock, pursuant to a nontaxable reorganization qualifying under section 368(a)(1)(C) of the Internal Revenue Code of 1954. *Held*, although the preferred stock issued in the reorganization to the stockholders of the closely-held corporation constitutes section 306 stock, as defined in section 306(c)(1)(B) of the Code, the issuance of such stock was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax under section 306(b)(4) of the Code.

See section 1.306–2(b)(3) of the Income Tax Regulations. Therefore, the provisions of section 306(a) of the Code, which treats the gain from the sale or other disposition of such stock by the shareholders as ordinary income (other than a redemption in which case the general rules of section 301 will apply), will not be applicable to the disposition of any portion of the preferred stock. See Revenue Ruling 56–116, C. B. 1956–1, 164.

Rev. Rul. 57–212

Preferred stock, issued in a tax-free merger of two large publicly owned corporations and constituting section 306 stock within the meaning of section 306(c)(1)(B) of the Internal Revenue Code of 1954, is subject to sinking fund provisions under which three percent of the outstanding preferred shares are to be redeemed or purchased in the open market annually. *Held*, that the provisions of section 306(a) are not applicable to amounts received in redemption of preferred shares through the operation of the sinking funds or to amounts received upon the sale of such shares in anticipation of a redemption through the operation of the sinking fund, since such dispositions fall within the exception provided by section 306(b)(4).

Advice has been requested as to the status, under section 306 of the Internal Revenue Code of 1954, of amounts paid by a corporation to its shareholders under its sinking fund provisions in redemption of preferred shares previously issued pursuant to a nontaxable reorganization.

Pursuant to a merger agreement, corporation *B* was merged into corporation *C* under the nontaxable provisions of sections 368(a)(1)(A), 361(a) and 354(a) of the Code. Both corporations were large publicly owned corporations. Under the terms of the merger agreement, each share of corporation *B* common stock (the only class of stock outstanding) was converted into one share of first preferred stock, one-half share of second preferred stock, and three shares of common stock of corporation *C*.

Under its amended certificate of incorporation, as set out in the merger agreement, corporation *C* is required, so long as any of the shares of first preferred stock are outstanding, to set apart in each year on specified dates cash in amounts equal to three percent of the greatest aggregate par value of shares of first preferred stock outstanding at any time after the effective date of the merger. In lieu of cash, corporation *C* may set aside at the par value thereof shares of first preferred stock acquired by it, other than through the operation of the sinking fund. Any cash set aside is to be applied to the purchase of shares of preferred stock at a price not exceeding their par value or in redemption of such shares at par value.

Each of the three classes of outstanding shares of corporation *C* is widely held and is listed and traded extensively on the New York Stock Exchange. Since the first preferred stock has been selling on the New York Stock Exchange at a price in excess of its par value, cash set aside in the sinking fund has not been applied to the purchase of any such shares in the open market, but has been applied to the redemption, by lot, of sufficient first preferred shares to satisfy the sinking fund requirements.

In Revenue Ruling 56–116, C. B. 1956–1, 164, it was held that preferred stock issued (together with common stock) by the surviving corporation in exchange for common stock of the merging corporation in connection with a nontaxable statutory merger was section 306 stock as defined in section 306(c)(1)(B) of the Code. However, in view of the exception provided by section 306(b)(4), since the stocks of the two corporations were widely held by the public, it was held that section 306(a)(1) shall not be applicable to the proceeds of the disposition of the preferred stock issued in the merger, unless such disposition is in anticipation of a redemption after the issuance of the stock. Therefore, the issue presented in the instant case is whether the exception provided by section 306(b)(4), which otherwise would appear to be applicable under the above-cited Revenue Ruling, is rendered inapplicable by the operation of the sinking fund provisions.

In view of the facts presented, the Internal Revenue Service holds that the distribution of the first preferred stock at the time of the merger and the subsequent redemption of portions thereof under the sinking fund provisions are not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax within the meaning of section 306(b)(4). Therefore, the provisions of section 306(a)(1) will not be applicable to the proceeds of a sale of such shares (whether or not in anticipation of a redemption through the operation of the sinking fund), and the provisions of section 306(a)(2) will not be applicable to amounts distributed by corporation *C* in redemption of such first preferred shares to meet the requirements of its sinking fund provisions.

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26 CFR 1.306–3: Section 306 stock defined. Rev. Rul. 57–132

Pursuant to a plan of reorganization (recapitalization) under section 368(a)(1)(E) of the Internal Revenue Code of 1954, a corporation issued shares of new "Voting Common Stock" and new "Non-Voting Common Stock" on a pro rata basis to its shareholders in exchange for its outstanding common stock. The "Non-Voting Common Stock" has no voting rights and is redeemable at the discretion of the corporation at a price equal to 110 percent of its book value. In all other respects, the two classes of the new stock are identical. *Held*, The "Non-Voting Common Stock" constitutes section 306 stock within the meaning of sectoin 306(c)(1)(B) of the Code, since such stock, being redeemable, is not considered common stock for purposes of that sub-section.

SUBPART C.—DEFINITIONS; CONSTRUCTIVE OWNERSHIP OF STOCK

SECTION 316.—DIVIDEND DEFINED

26 CFR 1.316–1: Dividends.

Distribution in liquidation of a domestic building and loan association. See Rev. Rul. 57–39, page 198.

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 liquidations.

Distribution in liquidation of a domestic building and loan association. See Rev. Rul. 57–39, page 198.

A liquidating distribution to a parent corporation in exchange for the subsidiary's stock. See Rev. Rul. 57–243, below.

SUBPART B.—EFFECTS ON CORPORATION

SECTION 337.—GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

26 CFR 1.337–1: General. Rev. Rul. 57–243
(Also Sections 331, 1231; 1.331–1.)

Where a liquidating distribution is made by a subsidiary corporation to its parent corporation which is also undergoing liquidation, the surrender by the parent of its stock interest in the subsidiary for the liquidating distribution by the latter is deemed a "sale or exchange" for the purposes of section 337 of the Internal Revenue Code of 1954.

Revenue Ruling 56–372, C. B. 1956–2, 187, distinguished.

Advice has been requested whether a gain of a parent corporation from the liquidation of its subsidiary corporation is a gain from the "sale or exchange" of its subsidiary's stock within the meaning of section 337 of the Internal Revenue Code of 1954. That section provides that if a corporation adopts a plan of complete liquidation and, within 12 months after the date on which the plan is adopted, distributes all of its assets, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property wihin such 12-month period.

A personal holding company, owned entirely by a single shareholder, had assets consisting solely of 60 percent of the stock of its subsidiary corporation and cash. In the current year, the subsidiary entered into a contract to sell all of its assets to an unrelated corporation for cash. Before consummating the sale to the latter, the subsidiary corporation adopted a plan of liquidation requiring complete liquidation within one year from the date of the adoption of the plan. Prior to the receipt of any liquidating dividend from the subsidiary, the parent also adopted a plan of complete liquidation. Within 12 months from the adoption of this plan, the parent corporation received all the cash and property to which it was entitled on the liquidation of the subsidiary and distributed all this, as well

as all the rest of its cash and property, in redemption of all its own stock in complete liquidation.

At issue in Revenue Ruling 56–372, C. B. 1956–2, 187. There, the Service held that the receipt of fire insurance proceeds from the complete destruction of a building by fire, resulting in an involuntary conversion, did not constitute a "sale" for the purpose of obtaining nonrecognition of gain or loss benefits under section 337(a) of the Code, since the provisions of section 1231(a), relating to the determination of capital gains and losses in the case of property used in a trade or business and involuntary conversions, were not effective to characterize the transaction as a sale or exchange under section 337 of the Code.

Section 331(a) of the Code provides that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. The application of this section is not limited to any particular section of the Code. Therefore, it pertains to section 1222 of the Code which defines various types of capital transaction as resulting from the "sale or exchange" of a capital asset. This has been the historic application of section 331 of the 1954 Code and its predecessor, section 115(c) of the 1939 Code, ever since this concept was first introduced as section 201(c) of the Revenue Act of 1924. At that time the Senate Report No. 398, Sixty-eighth Congress, First Session, C. B. 1939–1 (Part 2), at page 274 stated:

"* * * The existing law has no provision similar to subdivision (c) of the bill, but the Treasury has construed the existing law as taxing liquidating dividends, not as capital gains, but as dividends subject to the surtax rates. The bill treats a liquidating dividend as a sale of the stock, with the result that the gain to the taxpayer is treated not as a dividend subject only to the surtax but as a gain from the sale of property which may be treated as a capital gain. The treatment of liquidating dividends under the bill is substantially the same as provided for in the Revenue Act of 1918. A liquidating dividend is, in effect, a sale by the stockholder of his stock to the corporation; he surrenders his interest in the corporation and receives money in place thereof. Treating such a transaction as a sale and within the capital gain provisions is consistent with the entire theory of the Act and, furthermore, is the only method of treating such distributions which can be easily administered."

Since 1924, liquidations of corporations have been treated as exchanges of stock resulting in capital gains or losses. See *Harold T. White, Exr. (Alexander M. White, Est.)* v. *United States*, 305 U. S. 281, Ct. D. 1372, C. B. 1938–2, 238; *Helvering* v. *Chester N. Weaver*, 305 U. S. 293, Ct. D. 1371, C. B. 1938–2, 220; and compare *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U. S. 247, Ct. D. 1510, C. B. 1941–1, 324.

Section 337 adopts the phrase, "sale or exchange" of property, in the 1954 Code, and is identical to the language used in section 1222 of the Code to define a capital transaction. There is a valid distinction between the involuntary conversion which was the subject of Revenue Ruling 56–372, *supra*, and the liquidation in the instant case. Section 1231 of the Code has been characterized as a computation section in that it takes certain transactions and provides that when the net results of such transactions during the course of a year is a gain, then the gain or loss on each transaction shall be considered as a gain or loss from the sale or exchange of a capital asset held for more than six months. Correspondingly, if the net result of those transactions is a loss, then each gain or loss shall not be considered as a gain or loss

from the sale or exchange of a capital asset. However, section 331 of the Code does not in itself specify the tax treatment of a liquidation, but instead characterizes the transaction as an exchange. Thus, section 1231 must be confined to the problem of capital gains and losses because that section by its own language pertains specifically to that problem, whereas section 331 is not similarly restricted.

Therefore, property received by a corporation in exchange for the stock of a corporation which is being completely liquidated is treated as property received in an exchange for purposes of section 337 of the Code.

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26 CFR 1.337–2: Sales or exchanges within the scope of Section 337. Rev. Rul. 57–140

A publicly-owned corporation was engaged in diversified activities operating two of its businesses as separate divisions. One business was sold in 1954 at a loss. In 1955, directors of the corporation, after unsuccessful attempts to aquire additional businesses, entered into a conditional agreement with an unrelated corporation to sell the other operating business, a sale which would result in a substantial gain to the corporation. Prior to the sale, the stockholders adopted a plan of complete liquidation and approved the plan to sell pursuant to the conditional agreement. Thereafter, the sale was consummated and liquidation of the corporation was completed within 12 months from the date the stockholders adopted the plan of liquidation. The evidence with respect to the 1954 sale clearly showed that there was no intention, plan, or decision at that time to sell the other business and that a liquidation of the corporation was not then contemplated. *Held*, for the purposes of section 337 of the Internal Revenue Code of 1954 and based on the facts submitted, the date of adoption of the plan of liquidation is the date on which the stockholders approved the directors' resolution for such liquidation. Consequently, under the provisions of section 337, no gain or loss is recognized to the corporation with respect to the 1956 sale.

Advice has been requested as to the effects for, Federal income tax purposes, of a sale by a corporation of a part of its assets and business at a time when liquidation was not contemplated, followed by the complete liquidation of the corporation pursuant to the decision reached some time after such sale, under the circumstances described below.

Prior to September 1954, *M*, a corporation, was engaged in operating two businesses as separate divisions. It also had a financial division not directly attributable to either of the two operating divisions. Its capital stock was widely held.

In November 1954, for certain sufficient business purposes, *M* sold one of its operating businesses, namely, *B*, to *N*, an unrelated corporation, at a price which resulted in a substantial loss. The consideration received was cash and debenture bonds of *N*. At the time of this sale, *M*'s directors did not seek the approval of their stockholders, since the corporation did not contemplate selling its remaining assets and business, nor was there any plan to effect a complete liquidation. However, sometime after the 1954 sale, *M* considered for a time a plan of partial liquidation pursuant to which the proceeds of the 1954 sale would have been distributed to *M*'s stockholders, but this plan was eventually abandoned. In connection with the contract of sale, the

agreement provided that the remaining assets of the corporation and its business were not to be terminated.

During 1955, the officers and directors of *M* explored the possibilities of acquiring additional operating businesses for *M*, but their efforts were unsatisfactory and they reached the conclusion that the best plan would be to dispose of the remaining assets and business and liquidate the corporation completely. However, because of the first contract, it was necessary for the corporation to enter into special arrangements with the purchaser in order to complete the second sale.

Relative to the bona fides of the transaction during the period between the first and second sale showing that the two sales were not connected, the following factors were in evidence:

(a) Extensive plans for the improvement of the remaining business were made.

(b) Sales negotiations were conducted, directed to the acquisition and mergers of other business, all of which failed.

(c) One small business was purchased.

(d) The corporation continued to pay its regular dividend.

(e) The corporation undertook the study of a pension plan.

(f) The purchasing corporation in the summer of 1955 made a study in connection with the construction of a possible plant, similar to *M* corporation. (No such study would have been made had the purchasing corporation been certain that it was able to acquire the plant of the instant corporation.)

(g) The principal stockholder of the selling corporation had no intention of retiring from business activity.

On December 5, 1955, the directors adopted a resolution to effect the complete liquidation of *M*. The following day they adopted a resolution to authorize the sale of the remaining operating division, namely *C*, and the *N* debentures, and on December 8 they entered into a conditional agreement to sell to *O*, an unrelated corporation, the operating division *C* and the *N* debentures for a cash consideration that would result in a substantial gain to *M*. The directors' resolutions and the conditional agreement were subject to the approval of *M*'s stockholders. It was also decided to dispose of the assets of the financial division and to distribute the proceeds to *M*'s stockholders under the plan of complete liquidation.

At a special meeting of *M*'s stockholders on April 3, 1956, the directors' resolutions to effect a complete liquidation of *M* and to sell the operating division *C* and the *N* debentures to *O* were approved. The sale was consummated on April 16, 1956.

Under the plan of complete liquidation, *M* intends to distribute all of its assets, other than those required to meet claims, to its stockholders within the 12-month period beginning on the date of adoption of the plan. *M's* Capital stock is traded on public stock exchanges and it has several thousand stockholders; therefore, it may not be possible to locate all of them and complete the liquidation within the 12-month period. If this proves true, *M* will transfer, before the expiration of the 12-month period, the amounts distributable to any unlocated stockholders to a state official, trustee, or other person authorized by law to receive distributions for the benefit of such stockholders.

In view of the facts presented, indicating that there was no intention, plan, or decision to liquidate *M* at the time of the loss sale in 1954, the Internal Revenue Service holds as follows:

(1) For purposes of section 337 of the Internal Revenue Code of 1954, the date of adoption of the plan of complete liquidation of *M* is the date on which its stockholders approved the resolution completely to liquidate the corporation, namely April 3, 1956.

(2) If *M* distributes all of its assets, other than those necessarily retained to meet claims, in complete liquidation within 12 months from the date of adoption of the plan of complete liquidation, within the meaning of section 337, no gain or loss will be recognized to *M* from the sale of its property to *O* pursuant to the agreement of December 8, 1955.

(3) If there are stockholders who cannot be located within the 12-month period and *M* within that period transfers the amounts distributable to such stockholders in redemption of their stock to a state official, trustee, or other person authorized by law to receive distributions for the benefit of such stockholders, such transfer will be considered a distribution in complete liquidation.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

SUBPART A.—CORPORATE ORGANIZATIONS

SECTION 351.—TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR

26 CFR 1.351–1: Transfer to corporation controlled by transferor.

A transfer of net assets of one busines to a new corporation in exchange for stock. See Rev. Rul. 57–190, page 121.

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.

A certain shareholder receiving stock of another corporation, not a party to the reorganization. See Rev. Rul. 57–114, page 122.

SECTION 355.—DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION

26 CFR 1.355-1: Distribution of stock and securities of controlled corporation. (Also Section 351; 1.351.1.) Rev. Rul. 57–190

A certain corporation has been engaged under a dealer franchise in the sale and service of brand *X* automobiles since 1946. For over five years prior to 1954, these operations had been carried on in two buildings (*B* and *C*) which the corporation owned and which were located some distance apart in the same city. In 1954 the corporation acquired a franchise for the sale and service of brand *Y* automobiles and purchased the inventories, equipment, and leasehold of a former brand *Y* dealer who had been operating in a building adjoining the corporation's building *B*. Shortly thereafter, the inventories of brand *X* automobiles and certain shop equipment located in building *B* were moved to building *C*, and from that time all brand *X* sales and service operations have been conducted from the location in building *C*. At the same time a portion of the activities of the new dealership were moved into building *B*, and thereafter building *B*, together with the adjoining leased building, has been used for connection with the brand *Y* sales and service operations. In 1956 and for bona fide business reasons, the corporation transferred all of the assets (including building *C*) and liabilities of the brand *X* business to a new corporation in exchange for the stock of the new corporation, and distributed such stock pro rata to its stockholders. It is contended that, since the corporation had been engaged in the sales and servicing of automobiles in two locations for more than five years, the activities at the two locations constituted separate businesses conducted for over five years. *Held*, no gain or loss is recognized to the corporation as a result of the transfer of a portion of its properties to the new corporation in exchange for the stock of the latter, in view of the provisions of section 351 of the Internal Revenue Code of 1954. However, the distribution of the stock of the new corporation is not within the purview of the non-taxable provisions of section 355 of the Code. The activities of the brand *X* business, which formerly were conducted at two locations, were amalgamated into one integrated business in 1954 when the inventories of brand *X* automobiles located in building *B* and the shop equipment theretofore used in the *X* business at that location were moved to building *C*. This business, which was the one transferred to the new corporation, had been actively conducted throughout the five-year period ending on the date of the distribution of the stock of the new corporation. However, the brand *Y* business retained by the corporation had not been actively conducted by the corporation for five years within the meaning of section 355(b) of the Code, inasmuch as the brand *Y* franchise, inventories, equipment, and leasehold were not acquired until 1954. Therefore, the active business requirements of section 355(b) are not met, and the distributions of the stock of the new corporation constitutes a distribution of property to which section 301 applies.

26 CFR 1.355–2: Limitations. Rev. Rul. 57–114
(Also Section 354; 1.354–1.)

An individual, *A*, owned one-half of the stock of a parent corporation, *M*, which owned all of the stock of its subsidiary corporation, *S*. Individual *A* also owned one-half of the stock of corporation *O*. Pursuant to a plan of reorganization, a statutory merger of corporation *O* into corporation *M* was effected, and individual *A* received additional stock of parent corporation *M* in exchange for his stock of the merged corporation *O*. Immediately thereafter, parent corporation *M* distributed all of the stock of its subsidiary corporation *S* to individual *A* in exchange for all of his stock in the parent corporation *M*. *Held*, the exchanges of stock made by individual *A* are not within the terms of section 354(a)(1) or section 355(a)(1) of the Internal Revenue Code of 1954 since, in effect, he exchanged all his stock of the merged corporation *O* for some of the stock of subsidiary corporation *S* and exchanged all of his stock of the parent corporation *M* for the remaining stock of subsidiary corporation *S*.

Advice has been requested as to the tax effect of a transaction in which corporation *O* was merged into parent corporation *M*, after which *M* distributed the stock of its wholly-owned subsidiary, *S*, to one of its stockholders in exchange for all of his stock of the parent corporation *M* issued to him in the merger.

An individual, *A*, owned one-half of the capital stock of a parent corporation, *M*, worth $10x$ dollars and one-half of the capital stock of corporation *O* worth $5x$ dollars. *B*, another individual, owned the other half of the parent corporation *M* stock and *B*'s mother owned the other half of the *O* corporation stock. Corporation *M* was the parent of corporation *S* and owned all of its stock, which is worth $15x$ dollars.

For bona fide business reasons, corporation *O* was merged into corporation *M* in pursuance of a plan of statutory merger, and additional shares of *M* stock were issued to the stockholders of the merged corporation *O* in exchange for their *O* stock. Individual *A* then owned one-half of the parent corporation *M* stock, worth $15x$ dollars. Immediately after the merger, the parent corporation distributed all of the stock of its subsidiary corporation *S* to individual *A* in exchange for all of the stock of the parent corporation *M* then owned by him.

Since, immediately after the exchange by individual *A* of his stock of the merged corporation *O* for new stock of the parent corporation *M*, he surrendered all of his newly acquired stock of the parent corporation back to it, such exchange is disregarded for Federal income tax purposes. In effect, therefore, the parent corporation *M* transferred one-third of the stock of its subsidiary corporation *S* to individual *A* in exchange for his stock of the merged corporation *O* and distributed the remaining two-thirds of the stock of its subsidiary *S* to *A* in exchange for his original holding of stock in the parent corporation *M*.

In view of the foregoing, the Internal Revenue Service holds as follows:

(1) Gain or loss is recognized to both individual *A* and the parent corporation *M* on the exchange of all of the stock of the merged corporation *O* for one-third of the stock of the subsidiary corporation *S*. See section 1002 of the Internal Revenue Code of 1954.

(2) The distribution by the parent corporation *M* of two-thirds of its subsidiary *S* stock to individual *A* in exchange for his orig-

inal stock of the parent corporation *M* does not qualify as a nontaxable distribution under section 355(a)(1) of the Code, since the shares of the subsidiary *S* so distributed do not constitute control within the meaning of section 368(c). Therefore, the distribution is treated as full payment in exchange for individual *A*'s stock of the parent corporation *M* under section 302(b)(3) and 302(a) of the Code, and gain or loss is recognized to him under section 1002 of the Code. No gain or loss is recognized to the parent corporation *M* as a result of the distribution, by virtue of section 311(a) of the Code.

(3) No gain or loss is recognized to either the merged corporation *O* or the parent corporation *M* as a result of the merger of *O* into *M*. See sections 361(a) and 1032 of the Code.

(4) Under the provisions of section 354(a)(1) of the Code, no gain or loss is recognized to *B*'s mother upon the exchange, pursuant to the merger, or her stock in the merged corporation *O* for stock of the parent corporation *M*. Likewise, no gain or loss is recognized to individual *B* as a result of the merger.

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26 CFR 1.355–4: Active conduct of a trade or business. Rev. Rul. 57–126

A taxable cooperative marketing association was engaged originally in the business of marketing fresh fruits for and on behalf of its members. In the years 1949 and 1951, due to a series of disastrous freezes, a substantial portion of the groves of the members was severely damaged or wiped out. As a result of this disaster, the association transacted very little fruit business from 1951 to 1956. However, in order to offset the high fixed overhead costs and in order to partially utilize existing plant and warehouse facilities, the association installed and operated a cotton compressing business in the year 1951. For bona fide reasons in the current year, the association transferred to a new corporation all the assets and liabilities pertaining to the cotton compressing business, including the building in which the entire office force of the association was housed, in exchange for stock of the new corporation, and distributed such stock to its members. Such limited office facilities as are needed by the association for its marketing facilities were leased to it on a fair market value basis by the spin-off corporation. *Held*, the transfer, exchange, and distribution (spin-off) constitute nontaxable transactions within the purview of sections 351 and 355 of the Internal Revenue Code of 1954. The fresh fruit business, though relatively dormant from 1951 to 1956, constituted the active conduct of a trade or business during those years within the meaning of section 355(b)(2)(B) of the Code, since the association maintained the separate identity of the fresh fruit division in all respect and resumed full scale operations.

Rev. Rul. 57–144

A parent corporation qualifying as a personal holding company owned 82 percent and 83 percent of the capital stock of two operating subsidiaries, corporations *A* and *B*, respectively. In order to simplify

the corporate structure and to eliminate the existence of the parent corporation as a personal holding company, the management of the parent corporation distributed pro rata the stock of corporation *A* to its (the parent's) stockholders. After the distribution of such stock, corporation *B* was merged with the parent corporation. The parent corporation obtained control (80 percent of the stock) of corporation *B* during the five-year period preceeding the date of distribution as the result of the latter's redeeming a portion of the minority interest, which at that time exceeded 20 percent. *Held*, the distribution of corporation *A*'s stock does not qualify as a tax-free "spin-off" transaction under section 355(a)(1) of the Internal Revenue Code of 1954, since after the distribution the parent corporation owned only the stock of corporation *B*, control of which was acquired in a taxable transaction less than five years prior to the date of the distribution. See section 355(b)(2)(D)(i) of such Code. The result would be the same whether the stock of corporation *A* was distributed before or after the merger of corporation *B* into the parent corporation. Therefore, such distribution should be treated as a dividend, to the extent of the parent corporation's earning and profits available under sections 301 and 316 of the Code.

SUBPART D.—SPECIAL RULE; DEFINITIONS

SECTION 368.—DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS

26 CFR 1.368-2: Definition of terms. Rev. Rul. 57-278

A transaction whereby (directly or indirectly) a corporation acquires substantially all of the properties of another corporation, in exchange solely for voting stock of a corporation which is in control of the acquiring corporation, may qualify as a section 368(a)(1)(C) reorganization under the Internal Revenue Code of 1954 despite the fact that the corporation whose stock is used to effect the acquisition already owns part of the stock of the transferor corporation. Revenue Ruling 54-396, infra, is applicable only in those cases in which the ultimate transferee acquires some of the assets through liquidation.

Revenue Ruling 54-396, C. B. 1954-2, 147, distinguished.

Advice has been requested whether the reorganization plan herein described qualifies for tax-free treatment under section 368(a)(1)(C) of the Internal Revenue Code of 1954 in view of the principle set forth in Revenue Ruling 54-396, C. B. 1954-2, 147.

In the instant case, two existing corporations and a newly formed corporation were involved in the plan of reorganization. Originally, the parent corporation owned 72 percent of the outstanding capital stock of corporation *M*. The remaining 28 percent of *M*'s outstanding stock was widely held by the public. For valid business reasons, the parent desired to eliminate the minority interest of corporation *M* and operate it as a wholly-owned subsidiary.

In order to achieve the desired result, the parent organized a new corporation in a different state and issued to the new corporation a block of its voting stock in exchange for all the stock of the new corporation. In turn, and pursuant to an agreement with the princi-

pal minority stockholders of corporation *M*, the new corporation acquired all of the assets of corporation *M* in exchange for the stock of the parent corporation. Following this transaction, corporation *M* distributed to its shareholders the stock of the parent corporation on the basis of one share of the parent corporation's stock for each two share of *M* corporation's stock.

Corporation *M* exchanged with the parent 72 percent of that portion of the stock of the parent corporation issued to the new corporation upon organization, the total of which was received by it in exchange for all of its assets, for 72 percent of its own capital stock held by the parent corporation. Corporation *M* exchanged the remaining 28 percent of the parent company stock held by it with its minority stockholders for the 28 percent of its stock held by them. As a result of all these transactions, the new corporation became a wholly owned subsidiary and corporation *M* was dissolved.

Section 368(a)(1)(C) of the Internal Revenue Code of 1954, relating to corporate reorganizations, defines a reorganization as "* * * * the acquisition by one corporation, in exchange solely for all or part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation * * *."

Revenue Ruling 54–396, *supra*, holds that a transaction between two corporations, wherein one, the majority stockholder (but owning less than 80 percent) of the second, acquires all of the assets of the second in exchange for its common stock, is not a nontaxable reorganization within the purview of section 112(g)(1)(C) of the Internal Revenue Code of 1939 (now embodied in section 368(a)(1)(C) of the 1954 Code, since the first corporation, which already owned 79 percent of the second corporation's stock, acquired only 21 percent of the assets of the second corporation through the exchange of stock. The remaining 79 percent of the assets were acquired by the first corporation as a liquidating dividend in exchange for the stock of the second corporation.

The question here involved is whether the principle of Revenue Ruling 54–396 should be extended to the new forms of "C" reorganizations allowed under the Internal Revenue Code of 1954, *i. e.*, where a subsidiary acquires substantially all of the properties of another corporation solely in exchange for its parent's voting stock.

It will be noted that in the instant case the same result would have been achieved if the parent corporation had acquired all of the stock of corporation *M* solely for its own voting stock in a "B" reorganization (meaning reorganizations under section 368(a)(1)(B) of the 1954 Code) and then caused corporation *M* to be reincorporated in another state. Under the 1954 Code, a "B" reorganization may occur even though the acquiring corporation already owns a large block of stock of the other corporation. It, therefore, seems that the new form of "C" reorganization acquisition is tax free in a case in which a "B" reorganization acquisition, in a slightly different form, but having almost the same ultimate effect, would be tax free under the statute. Accordingly, Revenue Ruling 54–396, *supra*, will be restricted to those cases in which the ultimate transferee acquires some of the assets through a liquidation. The transitory ownership

of assets by a corporation in a "C" reorganization is in effect to be disregarded. See *Helvering* v. *Raymond I. Bashford*, 302 U. S. 454, Ct. D. 1299, C. B. 1938–1, 286; *Anheuser-Busch, Inc. et al.* v. *Helvering*, 115 Fed. (2d) 662, cert. denied 312 U. S. 699. In each of these cases, it was held that a transaction was not a tax-free reorganization despite a transitory ownership which would have qualified it as such under the then existing law.

In view of the foregoing, the Internal Revenue Service holds that the acquisition by the new corporation of all the assets of corporation *M* in exchange solely for stock of the parent corporation constitutes a reorganization within the meaning of section 368(a)(1)(C) of the Internal Revenue Code of 1954. No gain or loss is recognized to the parent, the liquidating corporation, or the new corporation as a result of the exchanges made pursuant to the plan of reorganization. As provided by section 354(a)(1) of the Code, no gain or loss is recognized to the shareholders of corporation *M* upon the exchange of their stock for stock of the parent corporation. Under section 358, the basis of the parent corporation's stock in the hands of corporation *M*'s shareholders is the same as the basis of corporation *M*'s stock exchanged therefor and, under section 362(b), the basis of the properties of corporation *M* acquired by the new corporation is the same as that of *M* corporation. In accordance with section 381(c)(2) of the Code, the earnings and profits of corporation *M* for the taxable year involved are deemed to have been received by the new corporation as of the closing date of the transfer of the properties of the *M* corporation.

Taxable year in the case of a corporate reorganization coming within the provisions of section 368(a)(1)(F) and 381(b) of the 1954 Code. See Rev. Rul. 57–276, below.

PART V.—CARRYOVERS

SECTION 381.—CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS

(Also Sections 368, 1502; 26 CFR 1.368–2, 1.1502–11.) Rev. Rul. 57–276

Where a corporate reorganization comes within the provisions of section 368(a)(1)(F) of the Internal Revenue Code of 1954, pursuant to the provisions of section 381(b) of the Code, 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, notwithstanding the fact that such reorganization also qualifies under another provision of section 368(a)(1) of the Code. An income tax return for the full taxable year is required to be filed by the acquiring corporation. The transferor corporation is not required to file an income tax return for any portion of such year. In the case of an affiliated group of corporations, if the transferor corporation was the parent corporation of an affiliated group which filed consolidated income tax returns, the same affiliated group with the acquiring corporation as parent remains in existence for the purpose of filing a consolidated return for the taxable year in which the reorganization occurred.

Advice has been requested regarding the requirements for filing Federal income tax returns in cases involving corporate reorganizations which qualify under section 368(a)(1)(F) of the Internal Revenue Code of 1954, and which also qualify as reorganizations under subparagraph (A), (C), or (D) of section 368(a)(1) of the Code.

The instant situations involve two existing corporations which reincorporated under the laws of a state other than that of original incorporation. Each corporation organized a new corporation in the other state, and each corporation then merged into its newly organized corporation under applicable merger statutes of the states concerned. The first of the existing corporations was a single corporation with no subsidiaries. The second of the existing corporations was the parent corporation of an affiliated group of corporations which had filed consolidated income tax returns. Each merger qualified as a reorganization under both section 368(a)(1)(A) and section 368(a)(1)(F) of the Code.

Section 381(b) of the Code, relating to carryovers in certain corporate acquisitions, provides, in part, as follows:

> (b) OPERATING RULES.—*Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)*— (Italics supplied.)
>
> (1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

Section 368(a)(1)(F) of the Code provides that the term "reorganization" means:

> (F) a mere change in identity, form or place of organization, however effected.

Section 1.1502–11(c) of the Income Tax Regulations provides as follows:

> (c) *When affiliated group remains in existence.*—For the purpose of the regulations under section 1502, an affiliated group shall be considered as remaining in existence if the common parent corporation remains as a common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have become subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

Prior to the enactment of section 381 of the 1954 Code, which has no counterpart in the Internal Revenue Code of 1939, the treatment of carryovers in taxable years was determined by various court decisions and administrative rules. Often a reorganization under section 368(a)(1)(F) of the Code will meet the requirements of subparagraphs (A), (C), or (D) of section 368(a)(1). It is believed that it was not the intention of Congress in enacting section 368(a)(1) of the Code to hold that just because a reorganization meets some other provision of section 368(a)(1) the provisions of subparagraph (F) of that section are not complied with even though the transaction also qualifies under subparagraph (F). Taking a contrary view under the 1954 Code would, for all practical purposes, defeat the provisions of section 381(b) of the Code, since many section 368(a)(1)(F) reorganizations meet some other provisions of section 368(a)(1).

Accordingly, it is held that where a corporate reorganization comes within the provisions of section 368(a)(1)(F) of the Code, pursuant to the provisions of section 381(b) of the Code, that part of the tax-

able year before the reorganization and that part of the taxable year after the reorganization constitute a single taxable year of the acquiring corporation, notwithstanding the fact that such reorganization also qualifies under another provision of section 368(a)(1) of the Code. An income tax return for the full taxable year is required to be filed by the acquiring corporation. The transferor corporation is not required to file an income tax return for any portion of such year. In the case of an affiliated group of corporations, if the transferor corporation was the parent corporation of an affiliated group which filed consolidated income tax returns, the same affiliated group with the acquiring corporation as parent remains in existence for the purpose of filing a consolidated return for the taxable year in which the reorganization occurred.

SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

PART I.—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

SECTION 401.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

26 CFR 1.401–1: Qualified pension, profit-sharing and stock bonus plans. Rev. Rul. 57–163

Compilation of guides applicable to the qualification of stock bonus, pension, profit-sharing, and annuity plans under section 401 (a) of the Internal Revenue Code of 1954.

SUMMARY

Part 3.—Impossibility of diversion under the trust instrument

(a) Trust instrument must make prohibited diversion impossible.
(b) Erroneous actuarial computation.
(c) No reversion in stock bonus or profit-sharing plans.
(d) Application of dividends and other credits under group annuity contracts.
  (1) Restriction on payment of credits or returns to employer.
  (2) Application of dividends or other returns or credits.
  (3) Surrender or cancellation credits after discontinuance of plan.
  (4) Dividends or experience credits after discontinuance of contributions.

Part 4.—Requirements as to coverage

(a) Plan must benefit employees in general.
(b) Continuing participation in the event of leave of absence.
(c) Percentage coverage requirements.
(d) Classification of employees.
(e) Immediate and deferred profit-sharing plans.
(f) Different eligibility requirements for present and future employees.
(g) Burdensome contributions.
(h) Classification within purview of statute but discriminatory in operation.
(i) Integration.
  (1) Integration rules.
  (2) Death benefits involved in integration under mimeograph 5539.
  (3) Death benefits under Mimeograph 6641 and integration of profit-sharing plans.
(j) Coverage requirements must be met on at least one day in each quarter.
(k) Denial of participation for failure to enter plan upon becoming eligible.
(l) Reentry into plan after discontinuance of participation.
(m) Delay in purchasing insurance contracts.
(n) Benefits based on compensation received from more than one employer.

Part 5.—Discrimination as to contributions or benefits

(a) Nondiscriminatory contributions or benefits.
  (1) Application of forfeitures.
  (2) Variations in contributions or benefits.
(b) Vested rights in employer's contributions.
  (1) Determination as to provision for vesting.
  (2) Requirement for ultimate vesting.
  (3) Distribution of funds upon termination.
  (4) Suspension or discontinuance of contributions.
(c) Topheaviness.
(d) Termination rule.
(e) Normal retirement age.
(f) Optional retirement prior to normal retirement.
(g) Participation after normal retirement age.
  (1) Additional benefit for service after normal retirement age.
  (2) Continued participation under a profit-sharing or stock bonus plan.
(h) Basis of compensation on which benefits are computed.
(i) Adjustment of benefits due to increases or decreases in compensation.
(j) Discretion as to payment of benefits under basic options.
(k) Provisions for disability and hardship cases.
(l) Provision that benefits be based on cash surrender value in insured plans.
(m) Loan privileges.
(n) Past service benefits in plans which contain a minimum age or service requirement for eligibility.
(o) Right of trustee to borrow on insurance contracts.
(p) Earmarked investments under a profit-sharing plan.

PART 1.—INTRODUCTION

(a) BACKGROUND.—An employees' trust which is qualified under section 401(a) of the Internal Revenue Code of 1954 is exempt from tax under section 501(a) unless such exemption is denied under section 502 (relating to feeder organizations) or 503 (relating to prohibited transactions). Further, section 511 imposes a tax on the unrelated

business taxable income of an exempt organization. A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries constitutes a qualified trust under section 401(a) if the requirements set forth in such section are met. Nontrusteed annuity plans with respect to which amounts received by employees and their beneficiaries are taxable under section 403(a), and with respect to which deductions claimed for contributions are allowable in accordance with section 404(a)(2), must, except as otherwise provided in section 403(a)(1), also meet the requirements of paragraphs (3) through (6) of section 401(a).

(b) PURPOSE.—It is the purpose of this Revenue Ruling to set forth the guides which have been developed as a result of the determination of various issues relative to the qualification of plans and trusts, to correlate such rules with the applicable requirements of the Internal Revenue Code of 1954, and to codify various individual releases, except in cases where to do so would merely be repetitious or cumulative, and, in such cases, reference is made to the specific release in point. The issues discussed here are not all-inclusive but are those which have been found to be present in many plans. As new issues of general import arise supplemental releases will be issued. See, however, P. S. 35 revised, November 16, 1944, and Rev. Rul. 54–172, C. B. 1954–1, 394.

(c) RULES PREVIOUSLY PROMULGATED.—Revenue Ruling No. 33, C. B. 1953–1, 267, sets forth rules which have been developed with respect to the qualification of plans under section 165(a) of the Internal Revenue Code of 1939. Such rules are accordingly modified to the extent of any inconsistencies with the views here expressed.

(d) REFERENCES.—Certain issues are common to all types of plans while others are applicable to pension and annuity plans, or profit-sharing and stock bonus plans. The various issues are discussed in their relationship to the applicable provisions of the Internal Revenue Code of 1954 and corresponding regulations. Rulings listed in the appendix are incorporated by reference and made a part hereof, with appropriate modifications to conform to the 1954 Code. The omission of certain rulings from the appendix is not to be construed as a revocation or modification of any such rulings. Only those rulings which are appropriate to the particular textual material are referred to. Internal Revenue Bulletin citations are furnished with respect to material published in the Bulletin. P. S. releases have also been made public although not published in the Bulletin. Copies are available in the respective offices of District Directors of Internal Revenue and the National Office in Washington. The present status of such releases is shown in the appendix.

PART 2.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

SECTION 401(a) OF THE INTERNAL REVENUE CODE OF 1954—REGULATIONS SECTION 1.401–1

(a) WRITTEN DOCUMENTS.—A qualified plan must be a definite written program setting forth all provisions essential for qualification. See section 1.401–1(a)(2) of Income Tax Regulations. In the case of a trusteed plan, there must be a valid existing trust, recognized as such under the local law, under a plan in effect. See Mimeo-

graph 5985, C. B. 1946–1, 72. The trust must be evidenced by an executed written document setting forth the terms thereof. See Mimeograph 6394, C. B. 1949–1, 118, and Revenue Ruling 56–673, C. B. 1956–2, 281. In the case of a nontrusteed annuity plan which is evidenced by contracts with an insurance company, the plan is not in effect until such contracts are executed and issued. See Mimeograph 6020, C. B. 1946–1, 74.

(b) COMMUNICATION TO EMPLOYEES.—Employees are to be apprised of the establishment of a plan and the salient provisions thereof. The most effective way of doing so is to furnish each employee with a copy of the plan. It may not be feasible, however, to do so in all cases. Various substitutes may therefore be used. For example, it will be sufficient that a booklet summarizing the plan in all its essential features be furnished the employees, or that a notice be posted on the company's bulletin board, which must be in conspicuous view, that a plan has been established, setting forth the type thereof, the eligibility requirements, a synopsis of all benefits provided thereunder, whether employees are to contribute and, if so, the amount of contributions, vesting provisions, and, if a profit-sharing or stock bonus plan, the employer contribution commitment if any, and that a copy of the complete plan may be inspected at a designated place on the company's premises during stated times.

(c) STOCK BONUS, PENSION, OR PROFIT-SHARING PLAN.—The provisions of section 401(a) of the Code are applicable to a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries. See section 1.401–1(b) of the Income Tax Regulations for definitions of the various types of plans. Certain principles within the purview of such section of the Code relate to plans generally while others pertain to pension (including annuity) plans or profit-sharing and stock bonus plans.

(1) *Plans generally.*—Several employers may join in maintaining a single plan but each must meet all applicable requirements. See section 1.401–1(d) of the Income Tax Regulations and P. S. No. 14, dated August 24, 1944. A qualified plan cannot be maintained when there are no employees, active or retired, who are covered thereunder. See Revenue Ruling 55–629, C. B. 1955–2, 588. An arrangement cannot qualify as a pension, profit-sharing, or stock bonus plan under section 401(a) if the benefits thereunder are not payable to the employee but only to his beneficiary upon his death. See Revenue Ruling 56–656, C. B. 1956–2, 280.

(2) *Pension and annuity plans.*—An employer may establish a qualified pension plan under which current contributions are made by employees only, but under which he is obligated to pay the full amount of the stipulated retirement benefits to each retired employee participant after the funds in the trust which forms a part of such plan have been fully exhausted. See Revenue Ruling 54–152, C. B. 1954–1, 149. A pension plan, within the purview of section 401(a), does not provide for the payment of benefits not customarily included in that type of plan, such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses. See the last sentence of section 1.401–1(b)(1)(i) of the Income Tax Regulations. However, the annuity portion of a contract with an insurance company, by means of which an employees'

nontrusteed annuity plan is funded, may, if otherwise satisfactory, meet the applicable requirements for qualification, even though the contract also provides separate group term life insurance and accident and health insurance. See Revenue Ruling 56–633, C. B. 1956–2, 279. A pension plan may provide incidental benefits prior to normal retirement, such as disability and death benefits, but if it permits participants, prior to severance of employment or termination of the plan, to withdraw all or part of the funds accumulated on their behalf, except their own contributions on discontinuance of participation, in times of financial need or otherwise, it will fail of qualification. A similar provision in a profit-sharing plan, however, may, under appropriate circumstances, be acceptable. See Revenue Ruling 56–693, C. B. 1956–2, 282.

(3) *Profit-sharing and stock bonus plans.*—Funds under a profit-sharing plan must be accumulated for a fixed number of years, or until the attainment of a stated age or prior occurrence of some event, such as layoff, illness, disability, retirement, death, or severance of employment. The term "fixed number of years" is considered to mean at least two years. See Revenue Ruling 54–231, C. B. 1954–1, 150. A stock bonus plan is similar to a profit-sharing plan except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company. Section 1.401–1(b)(1)(iii) of the Income Tax Regulations.

(d) EMPLOYEES' TRUST.—In order to constitute a qualified trust under section 401(a), which is exempt under section 501(a), an employees' trust must be organized or created in the United States and maintained at all times as a domestic trust. If, however, a foreign situs trust meets the requirements of section 401(a) in all other respects, employers making contributions thereunder are allowed deductions within the applicable limits, in accordance with section 404(a)(4) of the Code, and beneficiaries of such trust are granted the same tax treatment under section 402(c) of the Code as is applicable to beneficiaries of a domestic trust, except in the case of a nonresident alien individual. See sections 871 and 1441 of the Code and the regulations thereunder. Where, under specified conditions, separate qualified and exempt trusts pool their funds in a group trust created to provide diversification of investments, the group trust may also be exempt and the status for exemption of the separate trusts will not be adversely affected. See Revenue Ruling 56–267, C. B. 1956–1, 206.

(e) PROFIT-SHARING AND STOCK BONUS PLANS OF AFFILIATED COMPANIES.—In the case of a profit-sharing plan, or stock bonus plan in which contributions are determined with reference to profits, of an affiliated group within the purview of section 1504 of the Code, contributions may be made by other members of the group for the benefit of employees of a member which is prevented from making a contribution because it lacks or has insufficient current or accumulated earnings or profits, to the extent and in the manner provided in section 404(a)(3)(B) of the Code and section 1.404(a)–10 of the Income Tax Regulations.

(f) FEEDER PLAN.—A stock bonus or profit-sharing plan which provides that the funds therein may be used to meet the costs of a pension

or annuity plan operated concurrently and covering the same employees, if and when the employer suspends contributions to such latter plan, is generally called a "feeder" plan and cannot be a qualified plan since it relieves the employer from contributing to the pension or annuity plan and is therefore not for the exclusive benefit of employees or their beneficiaries. See section 1.401–1(b)(3) of the Income Tax Regulations. An employee who has a vested right under a stock bonus or profit-sharing plan may, however, if the plan so provides, authorize a transfer of all or part of his vested interest to make up for a deficiency in the employer's contribution under a pension or annuity plan. In such case, he will be taxable on the transfer as though a distribution of such interest had been made. See P. S. No. 37, dated October 7, 1944. It should also be observed that a feeder plan is different from a feeder organization. In the latter respect, see section 502 of the Code which denies exemption under section 501 to an organization which is operated for the primary purpose of carrying on a trade or business for profit even though all of its profits are payable to one or more organizations exempt under section 501.

(g) DEFINITELY DETERMINABLE BENEFITS.—Benefits under a qualified pension plan must be definitely determinable. See section 1.401–1(b)(1)(i) of the Income Tax Regulations. Benefits are not definitely determinable if they may be suspended after retirement, without cause. The plan may provide, however, that benefits shall be suspended for any period of time during which primary insurance benefits under the Federal Social Security Act are discontinued because of employment after retirement date. See Revenue Ruling 82, C. B. 1953–1, 288. Benefits which vary with the increase or decrease in the market value of the assets from which such benefits are payable, or which vary with the fluctuations of a specified and generally recognized cost-of-living index, will be recognized as a plan providing for definitely determinable benefits. See Revenue Ruling 185, C. B. 1953–2, 202.

(h) PERMANENCY.—A plan within the meaning of section 401(a) of the Code is a permanent and continuing program. A plan which is set up during years of high tax rates and is abandoned within a few years without a valid business reason when profits fall off is not within the intent of such section. Also, especially in the case of a pension plan under which benefits are funded at a higher rate for employees in whose favor discrimination is prohibited than for other employees, if the plan is discontinued before ample provision is made for comparable benefits for such other employees, it will be deemed not to have been a bona fide program from its inception for the exclusive benefit of employees in general. As for profit-sharing, merely making a single or occasional contribution out of profits for employees does not establish a qualified profit-sharing plan. Under such a plan there must be recurring and substantial contributions. See section 1.401–1(b)(2) of the Income Tax Regulations. For a more detailed discussion of the applicable principles and illustrative cases, see Mimeograph No. 6136, C. B. 1947–1, 58, as modified by Revenue Ruling 55–60, C. B. 1955–1, 37. See also Exhibit "A" of Revenue Procedure 56–12, C. B. 1956–1, 1029, for information to be filed for a determination as to the effect of a curtailment or termination of a plan on its prior qualification; P. S. No. 56, dated June 27, 1946, as to notice by the trustee as to

termination of a plan; P. S. No. 57, dated August 5, 1946, as modified by Revenue Ruling 56–596, C. B. 1956–2, 288, as to the effect of a suspension of contributions; and P. S. Nos. 64 and 67, dated November 9, 1950 and April 26, 1951, respectively, and Revenue Ruling 55–681, C. B. 1955–2, 585, as to union negotiated plans. A qualified profit-sharing plan may, under applicable circumstances, provide that an employee may elect each year to participate in the trust forming a part of such plan or to accept his share in cash. See, however, parts 4(e) and 5(a) hereof as to meeting the requirements for coverage and nondiscrimination in contributions or benefits. A profit-sharing plan which does not contain a definite contribution formula may qualify if all other applicable requirements are met. See section 1.401–1(b)(1)(ii) of the Income Tax Regulations and Revenue Procedure 56–22, C. B. 1956–2, 1380.

(i) EXCLUSIVE BENEFIT OF EMPLOYEES OR THEIR BENEFICIARIES.—The plan must be for the exclusive benefit of employees or their beneficiaries.

(1) *Partners.*—Partners are not employees and therefore are not eligible to participate in the plan. See I. T. 3350, C. B. 1940–1, 64, and PS 23, dated September 2, 1944. Neither are they to be credited for services as partners prior to becoming employees in a successor corporation, both for prior service benefits and for meeting the eligibility requirements. See also section 1361(d) of the Code which provides that a partner or proprietor of an unincorporated business enterprise electing to be taxed as a corporation shall not be considered an employee for the purpose of participating in a qualified plan. Where a group of doctors adopt the form of an association in order to obtain the benefits of corporate status for purposes of section 401(a) of the Code, it is in substance a partnership and the doctor-members are employers and therefore not eligible to participate in a qualified plan as employees. Furthermore, any period of service as members of a prior partnership will not be credited as a period of employment for purposes of such section of the Code. See Revenue Ruling 56–23, C. B. 1956–1, 598.

(2) *Stockholder participants.*—Stockholders who are bona fide employees of a corporation may participate in the corporation's plan to the same extent as other employees. If, however, the plan is designed as a subterfuge for the distribution of profits to stockholders, even if it includes other employees who are not stockholders, it will not qualify as a plan for the exclusive benefit of employees. The plan must not be weighted in favor of stockholder employees either with respect to eligibility requirements or with respect to contributions, or benefits. See section 1.40–1(b)(3) of the Income Tax Regulations and I. T. 4020, C. B. 1950–2, 61.

(3) *Attorneys and other practitioners.*—An attorney, or other professional person, may be a bona fide employee, and, as such, eligible to participate in a qualified plan. The mere fact that a practitioner also has an independent income from the practice of his profession will not necessarily preclude him from participating in such a plan. He must, however, be an employee for all purposes, including coverage as an employee for social security or similar public program, if applicable to other employees, and

for income tax withholding purposes. Thus, if his actual employment for such purposes commences as of a certain date, he is not entitled to credit for services prior thereto, such as, for example, for the purpose of meeting the years of service requirement to be eligible to participate in the plan or to be entitled to past service credits.

(4) *Insurance agents.*—Section 7701(a)(20) of the Code provides that for the purpose of contributions to, and distributions from, a stock bonus, pension, or profit-sharing plan or trust, or under an annuity plan, the term "employee" shall include a full-time life insurance salesman who is considered an employee for the purpose of the Federal Insurance Contribution Act, or in the case of services performed before January 1, 1951, who would be considered an employee if his services were performed during 1951. Thus, the same rules apply with respect to treating full-time life insurance salesmen as employees for inclusion in a plan described in section 401(a) as are applicable to taxability for old-age and survivors' insurance purposes. This inclusion does not, however, extend to insurance brokers and others who are not full-time life insurance agents within the purview of section 3121(d)(3)(B) of the Code.

(j) DESIGNATION OF BENEFICIARIES.—Beneficiaries of employees under a qualified plan may be designated by the respective participants without restriction, or they may be restricted under the plan to specified persons, or to a group of persons, who are the natural objects of the employees' bounty, his estate, or his dependents. See Revenue Ruling No. 54–398, C. B. 1954–2, 239.

(k) INVESTMENT OF TRUST FUNDS.—Trust investments must be for the exclusive benefit of employees or their beneficiaries. While an incidental benefit may also inure to other, the primary purpose of benefiting employees or their beneficiaries must be maintained. For example, a sale of securities to the trust may benefit the vendor in that it may have resulted in a profit to him but, essentially, the purchase by the trustee must have been for the best interests of the trust; *i. e.*, the cost must not exceed fair market value at the time of purchase, a fair return commensurate with the prevailing rate must be provided, sufficient liquidity is to be maintained so as to permit distributions in accordance with the terms of the plan, and the safeguards that a prudent investor would look to are to exist.

(1) *Stock or securities of the employer.*—If the trust instrument and local law permit investments in the stock or securities of the employer, and if such investments are consistent with the purpose of benefiting employees or their beneficiaries, they are not otherwise precluded for the purpose of section 401(a) and 501(a) of the Code, unless such investments constitute prohibited transactions under section 503. Notification is to be given if stock or securities of the employer are acquired by the trust so that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees. Such notification is to be made as part of the annual information return, Form 990–P, unless an advance determination is requested and, if so, at the time of making a request

to the appropriate district director for such determination. The notification shall include information certified to by the accounting or other responsible officer as follows:

1. Balance sheets of the employer as at the close of the last accounting period and for the taxable year ended prior thereto.

2. Comparative statements of income and profit and loss for the last and four prior taxable years.

3. An analysis of the surplus account for the last five years, specifically showing the amount and rate of dividends paid on each class of stock.

4. A statement accounting for all material changes from the latest dates of the aforesaid statements to the date of filing the information.

5. A schedule showing the nature and amounts of the various assets in the trust fund.

6. A statement showing the amount of the investment, the type of investment, the present rate of return, the security if a loan is involved, and the reasons for the investment. (The information called for under items 1, 2, and 6 above, and related data, may be submitted in composite form as set forth in Exhibit "B–1" of Revenue Procedure 56–12, C. B. 1956–1, 1029.)

(2) *Life Insurance contracts.*—An exempt employees' trust may provide for investment of part of its funds in life insurance contracts without adversely affecting its status for exemption and the qualification of the plan, merely because of such provision. Where, however, in a pension plan the life insurance benefits are applied to reduce subsequent contributions by the employer, employer contributions attributable to such insurance may not be currently deductible. See Revenue Ruling 55–748, C. B. 1955–2, 234. If amounts allocated to the respective participants in any type of qualified plan are to be used to provide such participants with life insurance protection, the life insurance feature must be incidental and subordinate to the primary purpose of the plan which is to permit the employees or their beneficiaries to participate in a plan of deferred compensation. See section 1.401–1(b)(1)(i) and (ii) of the Income Tax Regulations. If the plan is used to provide employees only such benefits as are afforded through ordinary life insurance contracts, it is not a plan which can qualify under section 401(a), notwithstanding the fact that the contracts are convertible to life annuities at the normal retirement date. See Revenue Ruling 54–67, C. B. 1954–1, 149. An investment by a profit-sharing trust in an ordinary life insurance contract for the purpose of providing death benefits for each insurable participant under the trust will be considered incidental and subordinate to the primary purpose of a qualified profit-sharing plan where (1) the aggregate premiums for life insurance in the case of each participant is less than one-half of the aggregate of the contributions allocated to him at any particular time; and (2) the plan shall require the trustee to convert the entire value of the life insurance contract at or before retirement into cash or to provide periodic income so that no portion of such

value may be used to continue life insurance protection beyond retirement. Under such circumstances the investment will not disqualify the plan under section 401(a). See Revenue Ruling 54–51, C. B. 1954–1, 147.

(3) *Unrelated business income.*—An exempt employees' trust is taxable under section 511 of the Code on its unrelated business taxable income, as defined in section 512, derived from any unrelated trade or business, as defined in section 513. Special rules are set forth in section 514 with respect to business leases. If business lease indebtedness is incurred, rental income is includible in gross income in the ratio that the business lease indebtedness, at the close of the taxable year, bears to the adjusted basis of the property.

(l) VALUATION OF SECURITIES ON INVENTORY DATE.—Any type of qualified plan which provides for distributions in accordance with amounts, stated or ascertainable, credited to participants (*i. e.*, profit-sharing, stock bonus, and some self-administered trusteed money purchase pension plans) must provide for a valuation of securities held by the trust, at least once a year, on a specified inventory date, in accordance with a method consistently followed and uniformly applied. The fair market value on the inventory date is to be used for this purpose. The respective accounts of participants are to be adjusted in accordance with the valuation. For example, if as a result of a valuation on the inventory date, John Doe's account, which previously showed a balance of $1,000 is to be increased by one-tenth of one percent of the increase in the value of the trust securities, and such increase is $50,000, his interest is to be increased by $50.

(m) ALLOCATION OF STOCK BONUS AND PROFIT-SHARING FUNDS.—All funds in an exempt profit-sharing or stock bonus trust must be allocated to participants in accordance with a definite formula. Thus, no reserves are to be provided for by withholding allocations from participants. If suspense accounts are maintained, provision should be made for ascertaining the respective shares of participants in such accounts and such shares are to be included in the distributions.

PART 3.—IMPOSSIBILITY OF DIVERSION UNDER THE TRUST INSTRUMENT

SECTION 401(a)(2) OF THE INTERNAL REVENUE CODE OF 1954—REGULATIONS SECTION 1.401–2

(a) TRUST INSTRUMENT MUST MAKE PROHIBITED DIVERSION IMPOSSIBLE.—Under section 401(a)(2) of the code the *trust instrument* must make it impossible, "* * * at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries * * *." The term "trust instrument" means a written agreement. Although an oral trust may be effective within the purview of the applicable local law, for the purposes of paragraph (2) of section 401(a) of the Code, there must be a *written* trust instrument. It must also constitute a valid trust under the law prevailing in the jurisdiction to which it is subject. In addition, it must definitely and affirm-

atively make it impossible for the nonexempt diversion or use to occur. See Mimeograph 5985, C. B. 1946–1, 72, as to the requisites for the existence of a valid trust and a plan in effect and, also Mimeograph 6394, C. B. 1949–1, 118, as to the requirements for compliance with the provisions of section 401(a)(2) of the Code. A plan will not fail to qualify merely because it contains a provision whereby, except as to claims of the employer, the rights of the employee under the plan are not subject to the claims of creditors. See Revenue Ruling 56–432, C. B. 1956–2, 284.

(b) Erroneous Actuarial Computation.—Trust funds must not be used for purposes other than for the exclusive benefit of employees or their beneficiaries prior to the termination of the trust and the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, and, only then, may recovery be had in the case of a pension trust to the extent of any surplus existing because of an actuarial error. In determining whether any surplus exists on termination of a trust, and the amount thereof, all liabilities, contingent as well as fixed, with respect to employees and their beneficiaries under the trust must be taken into account. Fixed liabilities are the benefits payable to those who have become entitled to them. Contingent liabilities are the benefit credits accrued up to the time of termination of the trust for employees (and their beneficiaries) who might have become entitled to benefits if the trust had been continued indefinitely. If such liabilities are to be discharged by commuting the payments (other than through the purchase of insurance company contracts), the value thereof at the time of termination of the trust must be determined for this purpose by use of assumptions no less conservative in any respect than were used in determining costs during the previous life of the trust, and no discount for severances other than death may be assumed.

(c) No Reversion in Profit-sharing or Stock Bonus Plans.—Allocations under profit-sharing and stock bonus plans are not predicated upon amounts actuarially necessary to provide stipulated retirement benefits. See I. T. 3660, C. B. 1944, 136. See also section 1.401–1(b)(1)(i) of the Income Tax Regulations to the effect that a plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 401 (a) of the Code, be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or, as in the case of money purchase pension plans, such contributions are fixed without being geared to profits. Consequently, in profit-sharing and stock bonus plans there can be no reversion of any kind since such plans do not provide benefits which are predicated on actuarial assumptions or computations.

(d) Application of Dividends and Other Credits Under Group Annuity Contracts.—Provisions analogous to that set forth in section 401(a)(2) of the Code, prohibiting diversion of funds from exempt trusts, are contained in section 404(a)(2) of the Code, relating to deductions of contributions under non-trusteed annuity plans, and in section 403(a)(2)(A)(ii) of the Code, relating to the capital gains treatment for certain distributions under non-trusteed annuity plans. Section 404(a)(2), for example, requires that, where retire-

ment annuities are purchased, refunds of premiums, if any, must be applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities. To satisfy this requirement, there must be a definite written arrangement between the employer and the insurer, either as part of the annuity contract or by separate written direction from the employer to the insurer, or partly in one form and partly in the other, providing that:

(1) No credits or returns, other than those arising from corrections of errors in records or computations, such as misstated ages or similar corrections, may be paid to the employer prior to permanent discontinuance of contributions.

(2) All dividends, experience rating credits, or employer surrender or cancellation credits ascertained prior to permanent discontinuance or contributions are to be applied regularly as they are determined toward the premiums next due for purchase of annuities under the plan before any further employer contributions are so applied.

(3) If surrender or cancellation credits may be made after discontinuance of the plan but before all retirement annuities with respect to service prior to discontinuance of the plan have been purchased, such credits will be applied regularly as they are determined to purchase such retirement annuities by a procedure which does not contravene the conditions of section 401(a)(4) of the Code.

(4) Any dividends or experience credits similar to dividends made after permanent discontinuance of contributions or any surrender or cancellation credits made after permanent discontinuance of contributions and after all retirement annuities with respect to service prior to discontinuance of the plan have been purchased may be paid to the employer provided they are paid as nearly as practicable as they are determined so that no substantial accumulation results. (It may be noted that this possibility of return to the employer after discontinuance is analogous to the provision permitting return to the employer, on termination of an exempt pension trust of any surplus arising from erroneous actuarial computations.)

PART 4.—REQUIREMENTS AS TO COVERAGE

SECTION 401(a)(3)(A) AND (B), (5), AND (6) OF THE INTERNAL REVENUE CODE OF 1954—REGULATIONS SECTION 1.401-3

(a) PLAN MUST BENEFIT EMPLOYEES IN GENERAL.—Section 401(a)(3) of the Code permits an employer to designate several pension, stock bonus, profit-sharing, and annuity plans as constituting parts of a plan which he intends to qualify under such section. If all of the plans so designated cover a sufficient portion of all employees, there is no requirement that a definite proportion of the employees be included in any one plan. The plan, or plans, must benefit employees in general and, towards this end, must cover either a number which is at least equal to that determined under the percentage provisions of section 401(a)(3)(A) of the Code, or such employees as qualify under a nondiscriminatory classification within the purview of section 401(a)(3)(B) of the Code. A plan will not necessarily fail of qualifica-

tion merely because it covers only the employer's one employee, provided, however, that it is not designed, or is not operated, as a means of siphoning profits to a shareholder-employee or otherwise limiting participation to an employee of a class in whose favor discrimination is prohibited under section 401(a)(3)(B) and (4) of the Code. See Revenue Ruling 55–81, C. B. 1955–1, 392.

(b) CONTINUING PARTICIPATION IN THE EVENT OF LEAVE OF ABSENCE.—Plans may provide for continued participation in the event of leave of absence for a specified purpose, such as service in the Armed Forces, sickness, or disability. All participants under similar circumstances, however, must be treated alike.

(c) PERCENTAGE COVERAGE REQUIREMENTS.—The percentage coverage requirements of section 401(a)(3)(A) of the Code may be met by including in the plan a number of employees at least equal to that determined by applying either of the alternative percentage provisions. The percentages are applied after excluding certain short service, seasonal, and part-time employees. For example, if out of a total of 1,200 employees, 100 have less than three years of service (the minimum period prescribed by the plan), 25 do not customarily work for more than 20 hours in any one week, and 75 are employees whose customary employment is for not more than five in any calendar year, the percentages are applied to the balance of 1,000. The alternative percentage provisions are:

1. Seventy percent or more of all employees (70% of 1,000 in the above example) must be covered under the plan.

2. Seventy percent or more of all employees (70% of 1,000 in the above example) must be eligible to benefit under the plan, and, if so, at least 80 percent of all eligible employees must actually be covered.

Under the first alternative, on the basis of the figures used, if at least 700 employees are covered, the requirements of section 401(a)(3)(A) of the Code are satisfied. Under the second alternative, on the same basis, 700 or more employees must be eligible to participate and at least 80 percent of those eligible must actually participate. For example, if employees are also required to contribute five percent of compensation in order to participate, and, say, 750 of them are eligible to do so, then if at least 600 actually do contribute and are covered under the plan, the requirements of section 401(a)(3)(A) of the Code are also met.

(d) CLASSIFICATION OF EMPLOYEES.—In lieu of meeting the percentage requirements of section 401(a)(3)(A) of the Code, an employer may set up a classification of employees which, if found by the Commissioner not to discriminate in favor of officers, shareholders, supervisors, or highly compensated employees, will satisfy the requirements of section 401(a)(3)(B) of the Code. Under such section, plans may qualify which are limited to employees who are within a prescribed age group, have been employed for a stated number of years, have been employed in certain designated departments, or are in other classifications, provided that the effect of covering only such employees does not discriminate in favor of employees within the enumerations with respect to which discrimination is prohibited. See section 1.401–3(d) of the Income Tax Regulations.

(e) IMMEDIATE AND DEFERRED PROFIT-SHARING PLANS.—A profit-sharing plan which is qualified under section 401(a) of the Code is a plan of deferred compensation and, as such, provides for distributing the funds accumulated thereunder after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as illness, disability, retirement, death, layoff, or severance of employment. Thus, employees who receive the amounts allocated to their accounts before the expiration of such period of time or the occurrence of such contingency are not considered covered under the plan for the purposes of section 401(a)(3)(A) and (B). See section 1.401–3(c) of the Income Tax Regulations. If the employee has a right of election to receive his share of the profits in cash or to have it deferred through payment into a trust for his benefit, qualification of the plan is made by reference only to those employees who participate in the trust. See Revenue Ruling 56–497, C. B. 1956–2, 284. See also the last sentence of part 5(a), below.

(f) DIFFERENT ELIGIBILITY REQUIREMENTS FOR PRESENT AND FUTURE EMPLOYEES.—A provision for different eligibility requirements for present and future employees is not necessarily discriminatory within the purview of section 401(a)(3)(B) of the Code. If present employees who are officers, shareholders, supervisors, or highly compensated can meet the requirements for new employees there is no objection to the dual requirements. For example, if all present employees regardless of age are eligible and only those new employees who are at least 30 years old may participate, but all present employees who fall within one or more of the categories enumerated in section 401(a)(3)(B) of the Code are at least 30 years of age, the eligibility provision is not objectionable, even though there are other present employees who are under 30 years of age. Similarly, if all present employees are eligible regardless of years of service but only those future employees who will complete five years of service will be eligible, but all present employees who are officers, shareholders, supervisors, or highly compensated have at least five years of service, although there are other present employees who have less than five years, the eligibility provision is acceptable. If however, in the above illustrations, there are employees within the enumerated categories who are under 30 years of age or have less than five years of service, the prohibited discrimination is likely to arise in operation when new employees are added, and, therefore, in such a case such a provision would not be acceptable as a basis for a favorable advance ruling.

(g) BURDENSOME CONTRIBUTIONS.—Section 1.401–3(d) of the Income Tax Regulations provides in part: "* * * if a contributory plan is offered to all of the employees, but the contributions required of the employee participants are so burdensome as to make the plan acceptable only to the highly paid employees, the classification will be considered discriminatory in favor of such highly paid employees." For example, if the plan requires employee contributions of ten percent of compensation, it will be necessary to determine whether lower paid employees are kept out of the plan because of such requirement. If it is found that lower paid employees are not participating because of the contribution requirement, the classification may be held to discriminate in favor of a group enumerated in section 401(a)(3)(B)

and (4) of the Code. As a general rule, however, employee contributions of six percent or less are not deemed to be burdensome. In cases where the plan provides for optional rates of contribution by employees, and employer contributions or the benefits are geared to the employee contributions in such a way that a higher rate of employee contributions will result in larger benefits from employer contributions, the employee contributions may similarly be found to be burdensome and result in discrimination in contributions or benefits in contravention of section 401(a)(4) of the Code, but generally only if the highest rate of employee contribution permitted is in excess of six percent of compensation. The test is whether the contribution provisions operate to deprive lower paid employees of benefits at least as high in proportion to compensation as are provided for higher paid employees, after taking into account differentials permitted under the requirements for integration with social security benefits. See subparagraph (i) below.

(h) CLASSIFICATION WITHIN PURVIEW OF STATUTE BUT DISCRIMINATORY IN OPERATION.—A classification may appear to be satisfactory on paper but if in actual operation of the plan it discriminates in favor of employees who are highly compensated, etc., the plan will fail of qualification. For example, a plan ostensibly covers all employees regardless of service but nonforfeitable rights are provided only for those who have at least 15 years of service and stay on until normal retirement age 65. Except for a handful of executives who are shareholders and officers, employees are migratory workers who stay on a job for a relatively short time and then move elsewhere. Although the coverage provisions on paper seem satisfactory, in actual operation only the executive employees will benefit. Accordingly, both paragraphs (3)(B) and (4) of section 401(a) of the Code are considered together in determining whether the requirements of each are met. It is possible in the illustration used that the plan may qualify if satisfactory provisions for vesting are incorporated therein. See part 5(b) hereof. In the case of a profit-sharing plan under which employees may elect to receive their shares in cash or to participate in a trust, the trust must include enough lower paid employees to demonstrate that in the operation of the plan there is no discrimination in favor of higher paid employees. See Revenue Ruling 56–497, *supra*.

(i) INTEGRATION.—Plans which exclude employees who earn less than a specified amount or provide proportionately lesser benefits for such employees may qualify if the benefits under the plan integrate with those provided under the social security or similar (e. g., Railroad Retirement Act) program. The total benefits, inclusive of those under the social security or similar program, are used for comparative purposes. If a plan is properly integrated, a classification which excludes all employees who are compensated below the compensation level used for integration purposes will not be considered discriminatory solely because the contributions or benefits based on that part of excluded remuneration differ from contributions or benefits based on that part of remuneration which is not so excluded.

(1) *Integration rules.*—The rules for integrating benefits under a plan with those provided under the Social Security Act, prior to the 1950 amendments, are set forth in Commissioner's

Mimeograph 5539, C. B. 1943, 499. Supporting rulings under that mimeograph are contained in I. T.'s 3613, 3614, and 3615, C. B. 1943, 475, 476 and 477, respectively, and in P. S. Nos. 5, 13, and 30, dated July 29, 1944, August 24, 1944, and September 16, 1944, respectively. Rules as to integration of deferred benefit plans of employers with the old-age and survivors insurance benefits provided by the Social Security Act Amendment of 1950 are contained in Mimeograph 6641, C. B. 1951–1, 41, and the modification effected as a result of amendments to the Social Security Act by Public Law 590, 82d Congress, 2d Session, approved July 18, 1952, are set forth in Revenue Ruling 13, C. B. 1953–1, 294. P. S. No. 34, dated September 23, 1944, sets forth the rules applicable to integrating benefits under a plan with those under the Railroad Retirement Act, as in effect as of September 23, 1944, and Revenue Ruling 12, C. B. 1953–1, 290 prescribed the applicable integration rules as effected by amendments to the Railroad Retirement Act through October 1951. Section 1.401–3 (e) of the Income Tax Regulations establishes the general basis for integrating pension, annuity, profit-sharing, and stock bonus plans which limit coverage to employees earning in excess of $4,200 a year, or which base contributions or benefits only on compensation in excess of that amount, with the benefits provided by the Social Security Act as amended through 1956. Revenue Ruling 56–692, C. B. 1956–2, 287, extends the provisions of Mim. 6641, *supra*, except paragraphs 11 and 15 thereof, to plans which are integrated at $4,200 a year and gives effect to the more liberal definition of "average annual compensation," as provided by section 1.401-3 (e) (2) (i) of the Regulations.

(2) *Death benefits involved in integration under Mimeograph 5539.*—In applying integration tests under Mimeograph 5539, *supra*, any benefits payable in the event an employee dies before retirement (or before normal retirement age) may be disregarded to the extent that such benefits do not exceed the reserve or the accumulated prior contributions. In the event employees contribute under a plan, the increase in limits provided by paragraph 9 of Mimeograph 5539, *supra*, applies only to employee contributions which are exclusive of those applicable to the current cost of insurance or death benefits in excess of the reserve or cash value. Where integration is required and the normal form of benefits beginning at retirement (or at normal retirement age) include death benefits provided by employer contributions and payable on behalf of the employee which are more valuable than a life annuity with a ten year certain provision, it must be shown that the equivalent benefits of a life annuity ten year certain basis satisfy the integration requirements. For the purpose of demonstrating such equivalence there may be used the factors in the insurance or annuity contract involved or, where normal retirement age is 65 and the normal form of benefit is one of those indicated below, there may be used the corresponding factor shown:

Normal form of benefit	*Reduction factor to basis of life annuity 10 year certain*
Life annuity, 15 years certain	90 percent.
Life annuity, 20 years certain	80 percent.
Installment refund life annuity	90 percent.
Cash refund life annuity	85 percent.

Thus, for example, if in a particular case integration required that benefits be not more than 25 percent of average salary in excess of $3,000 a year and the normal form of retirement benefits is a cash refund life annuity at age 65, income benefits of 21¼ percent of average salary in excess of $3,000 a year would be acceptable. These forms of benefits are commonly found in plans insured by individual insurance or annuity contracts but are not often used as the normal form. Optional forms of income other than the normal form which determines the actual value of the benefits should be disregarded for the purposes hereof.

(*3*) *Death benefits under Mimeograph 6641 and Integration of profit-sharing plans.*—Death benefits within the purview of Mimeograph 6641, *supra*, and integration of profit-sharing plans are discussed in such mimeograph.

(j) COVERAGE REQUIREMENTS MUST BE MET ON AT LEAST ONE DAY IN EACH QUARTER.—The coverage requirements of section 401(a)(3) of the Code, either on the percentage basis under subparagraph (A) or on the basis of a nondiscriminatory classification under subparagraph (B), may be satisfied for an entire taxable year if such requirements are met on at least one day in each quarter of the taxable year. For example, assuming that the taxable year coincides with the calendar year, if the percentage basis is applicable and on the first day of the taxable year 1,000 employees have at least the minimum service requirements prescribed by subparagraph (A), it is sufficient if not less than 700 employees are eligible to participate and not less than 80 percent of those eligible are actually participating on that day even though employee turnover changes the percentages to less than 70 and 80 on all other days prior to April 1 of the same year. The percentage requirements will again have to be met on at least one day during the quarter commencing with April 1, and so on for the other quarters during the year.

(k) DENIAL OF PARTICIPATION FOR FAILURE TO ENTER PLAN UPON BECOMING ELIGIBLE.—Plans may provide for denial of participation for failure to enter plan upon becoming eligible provided that participation requires something substantially more than mere consent on the part of the employee. For example, under an employee contributory plan, if the employee refuses to sign a prescribed form for participation authorizing salary deductions in accordance with the plan, the plan may provide for the denial of participation at any other time or for a limited time. Similarly, under an insured plan which requires a physical examination and information as to condition of health, the plan may provide that refusal to take the examination or furnish the information will bar the employee from participation. Adequate notice, however, must be given the employee and the consequences of his failure to comply must be clearly presented to him after which, if he refuses to join, the exclusion provisions of the plan become operative as to such employee. Such provisions must be uniformly applied so as not to result in the prohibited discrimination.

(l) REENTRY INTO PLAN AFTER DISCONTINUANCE OF PARTICIPATION.—Plans may provide for reentry after discontinuance of original participation upon severance of employment or for other reasons, such as failure to continue contributions on the part of the employee. Such

provisions, however, must be uniformly applied and in no event should they permit a duplication of benefits.

(m) DELAY IN PURCHASING INSURANCE CONTRACTS.—Generally, a statement in a plan exonerating the trustee from liability in the event of a reasonable delay in the purchase of insurance contracts for participants will not adversely affect the qualification of the plan, provided, however, that the benefits are calculated from the effective date of participation.

(n) BENEFITS BASED ON COMPENSATION RECEIVED FROM MORE THAN ONE EMPLOYER.—In the case of a pension plan maintained by more than one employer, where employees covered by the plan may receive compensation from more than one of the participating employers, the aggregate compensation may be used in determining the employee's eligibility for benefits in the plan. See Revenue Ruling 55–276, C. B. 1955–1, 401.

PART 5.—DISCRIMINATION AS TO CONTRIBUTIONS OR BENEFITS

SECTION 401(a)(4) OF THE INTERNAL REVENUE CODE OF 1954—REGULATIONS SECTION 1.401–4

(a) Nondiscriminatory contributions or benefits.—In order for a plan to qualify under section 401(a) of the Code, there must, among other things, be no discrimination in contributions or benefits in favor of officers, shareholders, supervisors, or highly compensated employees as against other employees either within or without the plan. Thus, for example a profit-sharing plan which provides employer allocations of 20 percent of compensation for participants who are within a group in whose favor discrimination is prohibited, and only 10 percent for all other participants, fails to meet the requirements of section 401(a)(4) of the Code. See I. T. 3678, C. B. 1944, 321. Similar considerations apply to contributions and benefits in a pension or annuity plan, except that certain differences in favor of higher paid employees may be acceptable if integration rules are satisfied. See part 4(i) hereof. Also, as provided in section 1.401–4(a)(1)(ii) of the Income Tax Regulations, any amount allocated to an employee which is withdrawn before the expiration of the time or the occurrence of the contingency required by section 1.401–1(b)(1)(ii) of the Income Tax Regulations is not considered in determining whether the contributions under the plan discriminate in favor of employees who are officers, etc. See also Revenue Ruling 56–497, *supra*.

(1) *Application of forfeitures.*—Funds under a qualified plan arising from forfeitures because of termination of service, or other reason, must not be allocated to the remaining participants in a manner that will effect the prohibited discrimination. In a pension plan, this requirement is met by complying with the rule under section 1.401–1(b)(1)(i) of the Income Tax Regulations, regarding definitely determinable benefits, to wit: "Benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants instead of being used to reduce the amount of contributions by the employer." This provision is equally applicable to so-called "money purchase" pension plans. See Revenue Ruling 109, C. B. 1953–1, 288.

Similarly, in a stock bonus or profit-sharing plan the contribution formula may provide that forfeitures be used to reduce the employer contributions which would otherwise be required by the formula, but such application of forfeitures is not mandatory in such plans. Nevertheless, it should be observed that whatever provision is made for absorbing forfeitures under a stock bonus or profit-sharing plan the prohibited discrimination must not result.

(2) *Variations in contributions or benefits.*—Contributions or benefits for the respective participants may vary provided that the plan in its over-all operations does not discriminate in favor of officers, etc. In some cases, benefits in a profit-sharing plan may vary by reason of a distribution formula which takes into consideration years of service. See I. T.'s 3685 and 3686, C. B. 1944, 324 and 326, respectively, and P. S. No. 28, dated September 2, 1944. While the case covered in I. T. 3685, *supra*, illustrates the result, in that case, of the addition of units of compensation and units of service as not creating the prohibited discrimination and the case mentioned in I. T. 3686, *supra*, illustrates the result, in that case, of the multiplication of units of compensation by units of service as creating such discrimination, it was not intended to imply, by the promulgation of those rulings, that any formula using the method shown in I. T. 3685, *supra*, would be acceptable and any formula using the method shown in I. T. 3686, *supra*, would not be acceptable. The result of the operation of the formula is controlling in each case. If the application of either type of formula is found to result in the prohibited discrimination, as measured by the ratio of benefits to compensation, then the formula is objectionable.

(b) VESTED RIGHTS IN EMPLOYER'S CONTRIBUTIONS.—The Code does not require that an employee be granted immediate vested rights in his employer's contributions as a condition for qualification of a plan. Various provisions for vesting are in use, ranging from complete and immediate vesting through different forms of graduated vesting, upon completion of stated service or participation requirements, to no vesting until attainment of normal or stated retirement age.

(1) *Determination as to provisions for vesting.*—A determination as to satisfactory vesting provisions will of necessity depend on the facts in the particular case involved. For example, a company which ordinarily employs few people obtains a defense contract, engages a larger number of employees to work on such contract, establishes a plan under which all employees are eligible to participate, makes contributions on the basis of all employees, but vested rights are not granted until normal retirement age, and it has no need for the additional employees except for work on the defense contract. It is apparent that upon termination of the defense contract, if another contract is not obtained, the additional employees will be released and whatever credits may have inured to them under the plan will be forfeited. A favorable ruling on such a plan is not warranted unless satisfactory provision is made for effectuating benefits to all covered employees. This may be accomplished, for example, by granting fully vested rights after a reasonable waiting period. See P. S. No. 22, dated September 2, 1944.

(2) *Requirement for ultimate vesting.*—A plan will not be acceptable as to qualification unless an employee who has reached the normal retirement age (in a pension or annuity plan) or the stated age (or other definitely determinable event has transpired, in a profit-sharing or stock bonus plan), and has satisfied any reasonable and uniformly applicable requirements as to length of service or participation, is vested in the benefits received under the plan. This, however, does not preclude a provision for discontinuance of benefits to a retired employee for cause, which must be distinctly specified, such as, for example, taking a position with a competitor of the employer or divulging the employer's trade secrets to competitors. Similarly, provision may be made for the granting of less liberal rights under such circumstances. Provisions for the vesting of rights in employees, however, must not discriminate in favor of officers, shareholders, supervisors, or highly compensated employees.

(3) *Distribution of funds upon termination.*—Qualified plans are to provide for distribution of funds upon termination. At such time the rights of all participants are to be fully vested. Any provision for distribution is acceptable if it specifies the method to be used and (1) is not in conflict with the restrictions set forth in Mimeograph 5717, C. B. 1944, 321 (see paragraph (d) below), and (2) cannot otherwise discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated. See section 1.401–4 (c) of the Income Tax Regulations. The distribution of unallocated funds may be in cash or in the form of other benefits provided under the plan. The distribution among employees, other than those whose benefits have been restricted in accordance with the provisions of Mimeograph 5717, *supra*, need not necessarily benefit all such other employees. For example, a distribution which benefits only the employees over the age of 50 at the time of termination of the plan, or only those who then have at least ten years of service, or only those who meet both such age and service requirements may be acceptable if there is no possibility of discrimination in favor of employees who are highly compensated, etc. Such a situation may exist in a plan covering only wage and hourly rated employees. Upon termination, again provided that there is no possibility of the prohibited discrimination, the funds may be used first to continue benefits to retired employees, then for employees who have met the requirements for retirement but have not actually retired, then for employees over age 60, and so on until the funds are fully exhausted.

(4) *Discontinuance or Suspension of Contributions.*—A discontinuance of contributions is in effect a termination of the plan except that the formal steps to accomplish such result are not taken. Employees who become eligible to enter the plan subsequent to the discontinuance receive no benefits, and no additional benefits attributable to employer contributions accrue to any of the participants, unless contributions are resumed. The same requisites which pertain to a termination, therefore, are applicable to a discontinuance. In such case, vesting of employees' rights is required. See sub-paragraph (3) hereof and Revenue

Ruling 55–186, C. B. 1955–1, 39, as modified by Revenue Ruling 56–596, C. B. 1956–2, 288. A suspension is a temporary cessation of contributions which may ripen into a discontinuance. In the case of a pension or annuity plan, however, a suspension of contributions will not necessitate vesting of employees' rights, merely because of the existence of such situation, and the applicability of a prior ruling as to the qualification of the plan under section 401(a) of the Code will not be affected thereby if the following conditions are met, namely: (1) the benefits to be paid or made available under the plan are not affected at any time by the suspension, and (2) the unfunded past service cost at any time (which includes any unfunded prior normal cost and unfunded interest on any unfunded cost) does not exceed the unfunded past service cost as of the date of establishment of the plan (plus any additional past service or supplemental costs added by amendment). See P. S. No. 57, as modified by Revenue Ruling 56–596, *supra*. In the case of a profit-sharing plan, contributions must be recurring and substantial. See section 1.401–1(b)(2) of the Income Tax Regulations. A determination as to whether a suspension of contributions under a profit-sharing plan constitutes a discontinuance will be made upon the basis of all the relevant facts and circumstances of the particular case. If under the terms of a profit-sharing plan, authority is specifically reserved to discontinue contributions without terminating the trust, the plan must also contain an appropriate provision for the purpose of granting fully vested rights to participants upon discontinuance of contributions by the employer, similar to a case in which actual termination of the trust occurs. See Revenue Ruling 56–596, *supra*.

(c) TOPHEAVINESS.—Paragraph (5) of section 401(a) of the Code provides, in part, that a plan shall not be considered discriminatory within the meaning of paragraphs (3)(B) or (4) of such section merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees. However, in the case of pension and annuity plans which are based on a salary classification, i. e., exclusion of employees earning less than a specified amount, such as $3,600 or $4,200 per annum, the benefits under the plan must integrate with those provided under the Social Security Act or similar public retirement plan. See part 4(i) hereof. If under the benefit formula of a pension or annuity plan benefits are provided which bear a uniform relationship to compensation or which do not discriminate in favor of the group with respect to which discrimination is prohibited when social security or similar Federal or State retirement benefits are taken into account, the benefits and contributions are not discriminatory provided the plan contains adequate safeguards against discrimination in the event of termination of the plan or failure to meet the current costs during the first ten years. See paragraph (d) hereof. A pension or annuity plan which is not in conformance with the aforesaid does not comply with the requirements of paragraph (4) of section 401(a) of the Code, with respect to nondiscrimination as to contributions or benefits. A ceiling or similar limitation on the amount of benefits is not required

in view of the provisions of section 401(a)(5) of the Code but a plan under which benefits are limited may satisfy the applicable requirements whereas otherwise certain essential requirements may not be fully met.

(d) TERMINATION RULE.—If benefits for employees who are officers, etc., are funded, or substantially so, because of their nearness to retirement, and benefits for other employees are not similarly funded prior to termination of the plan, the prohibited discrimination will result. Consequently, under the applicable circumstances, an advance favorable determination letter as to the qualification of a pension or annuity plan will not be issued unless the plan contains satisfactory provisions limiting the benefits from officers, etc., in the event of early termination of the plan. The rules for this purpose are set forth in Mimeograph 5717, C. B. 1944, 321. Explanatory releases consist of P. S. Nos. 8, 25, 29, 31, 38, 42, 50, and 52 as modified by Revenue Ruling 55–60, C. B. 1955–1, 37. Similar rules are not applicable to stock bonus and profit-sharing plans since acceptable allocation formulae under such plans are designed to preclude the prohibited discrimination under comparable circumstances. The requirements pertaining to permanency, however, are applicable to all types of plans. See part 2(h) hereof.

(e) NORMAL RETIREMENT AGE.—The normal retirement age in a pension or annuity plan is the lowest age specified in the plan at which the employee has the right to retire without the consent of the employer and receive retirement benefits based on service to date of retirement at the full rate set forth in the plan (*i. e.* without actuarial or similar reduction because of retirement before some later specified age). Ordinarily, the normal retirement age under pension and annuity plans is 65, the same as the retirement age under the old-age and survivors' insurance provisions of the Social Security Act. A different age may be specified, provided that if it is lower than 65 it represents the age at which employees customarily retire in the particular company or industry and is not a device to accelerate funding. In profit-sharing or stock bonus plans, where there is a stated retirement age it is merely one of several events which may be designated as fixing the time for making distributions. Since the amount of the distributions is dependent upon profits, there is no definitely stated rate of benefits payable at such age. Consequently, the stated retirement age in a profit-sharing or stock bonus plan does not have the same significance as "normal retirement age" in a pension plan.

(f) OPTIONAL RETIREMENT PRIOR TO NORMAL RETIREMENT AGE.—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. See, however, paragraph (k) below as to retirement for disability. If the optional early retirement age is earlier than 65 (60 for women), and if integration with Old Age and Survivors Insurance or Railroad Retirement benefits is involved (see part 4 (i), the benefits which depend on integration must be appropriately limited. See paragraph 9 of Mimeograph 6641, as extended by Revenue Ruling 56–692, C. B. 1956–2, 287, or paragraph 7 of Revenue Ruling 12, C. B. 1953–1, 290, 292, whichever is applicable.

(g) PARTICIPATION AFTER NORMAL RETIREMENT AGE.—The normal

retirement age is the time from which definitely determinable benefits under a pension plan become fixed and payable. Accordingly, an employee who has reached such age and has fulfilled the service requirement and other uniformly applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable thereunder. Arrangements, however, may be mutually made for continued employment beyond normal retirement age. In such event, provision may be made with respect to the treatment of the pension benefits such as, for example, payment as though the employee had actually retired, deferment to actual retirement without increment for the interval between normal retirement date and actual retirement, or actuarial equivalent on actual retirement of the benefit at normal retirement age. Whatever provisions are made, however, must be uniformly applied to all participants.

(1) *Additional benefits for service after normal retirement age.*—Provision may be made for additional benefits on account of service after normal retirement age provided such provision is uniformly applicable to all employees under similar circumstances and does not result in the prohibited discrimination. In a unit benefit plan, the units may be continued during the time of the extended service and the total computed to the time of actual retirement. Under a money purchase plan, the regular rate of contributions may continue to actual retirement. Under a fixed benefit plan the benefits payable at actual retirement may be the actuarial equivalent of those payable at normal retirement age.

(2) *Continued participation under a profit-sharing or stock bonus plan.*—A provision for continued participation under a profit-sharing or stock bonus plan and for contributions to provide additional benefits for employees who remain in employment beyond the stated age does not adversely affect the qualification of the plan, provided, however, that such provision is uniformly applied to all employees under similar circumstances and does not result in the prohibited discrimination.

(h) BASIS OF COMPENSATION ON WHICH BENEFITS ARE COMPUTED.—Section 401(a)(5) of the Code provides in part: "Neither shall a plan be considered discriminatory * * * merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the *total compensation, or the basic or regular rate of compensation*, of such employees * * *." [Italics supplied.] Thus, total compensation (which may include bonuses, commissions, or overtime pay), basic compensation, or regular rate of compensation may be used, provided that whatever is used is consistently and uniformly applicable to all participants. In this respect, attention is invited to section 1.401–1(b)(3) of the Income Tax Regulations which provides in part:

"* * * a plan is not for the exclusive benefit of employees in general if, by any device whatever, it discriminates either in eligibility requirements, contributions, or benefits in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees. See section 401(a)(3), (4), and (5)." Thus, benefits computed at a uniform rate of compensation for all participants may be nondiscriminatory but if compensation is adjusted to favor one or a

select few the plan may become discriminatory in operation. See section 401(a)(5) of the Code. For example, under a 50 percent fixed benefit plan, a $10,000 a year officer who fulfills all requirements for retirement would be entitled to an annuity of $5,000, but if shortly before retirement his compensation is increased to $20,000 per annum his retirement annuity computed on final salary would be $10,000, or 100 percent of compensation before the increase, whereas others would only be receiving 50 percent. Section 1.401–1(b)(3) of the Income Tax Regulations also points out: "The law is concerned not only with the form of a plan but also with its effects in operation. For example, section 401(a)(5) specifies certain provisions which of themselves are not discriminatory. However, this does not mean that a plan containing these provisions may not be discriminatory in actual operation." Accordingly, in any case where increases in compensation during the last five years of employment are taken into account for the purpose of computing benefits, provision is generally made that such benefits are to be based on compensation averaged over a period of at least five years. In a pension plan which provides both past and future service credits the past service credits may be computed on the average compensation for the five-year period immediately preceding the establishment of the plan.

(i) ADJUSTMENT OF BENEFITS DUE TO INCREASES OR DECREASES IN COMPENSATION.—Consistent and uniform bases of compensation for determining benefits under a plan are essential in order to preclude the prohibited discrimination. If benefits are based on compensation at the time the plan is established, and if certain highly compensated employees are within a few years of retirement, their benefits will be based on the highest, or nearly the highest, compensation, while lower paid employees who entered the service of the employer shortly before the plan was established will receive benefits based on the lowest, or nearly the lowest, compensation. To eliminate discrimination, a consistent and uniform application should prevail as between both groups, *e. g.* where compensation within a few years before retirement, which includes salary increments since original employment, is used for the highly compensated employees, similar compensation should be used for the lower paid employees. Therefore, provision is to be made for increases in benefits when compensation on which benefits are computed is increased. (See Mimeograph 5677, C. B. 1944, 320.) Plans may also provide for decreases in benefits because of decreases in compensation but since the aforesaid reason is not applicable such provision is not required.

(j) DISCRETION AS TO PAYMENT OF BENEFITS UNDER BASIC OPTIONS.—Plans may include various modes of settlement for payment of benefits thereunder if under each mode of settlement the distribution has the same value as a distribution determined under any other mode of settlement provided for under the plan, and further, if, upon retirement (or event calling for a distribution in a profit-sharing plan) each participant is entitled to a fully vested right in the amount which has been accumulated for his benefit. In an insured plan, any type of benefit which is provided under the options contained in the insurance contract is the actuarial equivalent of any other option. Consequently, discretion in the trustee to determine under which option bene-

fits will be paid does not result in the prohibited discrimination. Similar discretion may be provided for in a profit-sharing plan which, for example, permits the trustee to determine whether lump-sum or periodic distributions are to be made in particular cases. The amounts distributable must be fully vested in the employee in either situation, and, if periodic distributions are to be made to some as against lump-sum payments to others, the present value of all such periodic amounts payable to any employee is to be equal to the immediate lump-sum otherwise distributable to him.

(k) PROVISIONS FOR DISABILITY AND HARDSHIP CASES.—Pension plans may contain provisions for early retirement because of disability provided that the term "disability" is defined and the rules with respect thereto are uniformly and consistently applied to all employees in similar circumstances. Provisions may also be made in stock bonus and profit-sharing plans for accelerated distributions because of hardship provided that the term "hardship" is defined, the rules with respect thereto are uniformly and consistently applied, and the distributable portion does not exceed the employee's vested interest. Similar provisions, however, are not permissible under a pension plan, since, as provided for in section 1.401–1(b)(1)(i) of the Income Tax Regulations, such a plan is established and maintained "primarily to provide systematically for the payment of definitely determinable benefits to * * * employees over a period of years, usually for life, after retirement." See Revenue Ruling 56–693, C. B. 1956–2, 282.

(l) *Provision that benefits be based on cash surrender value in insured plans.*—If an insured plan provides that benefits shall be based on cash surrender values, all contracts purchased must provide uniform cash surrender values with respect to all employees under similar circumstances.

(m) LOAN PRIVILEGES.—Provision may be made for the granting of loans to participants up to the extent of their vested interests subject to the application of specified uniform rules consistently followed. (It should be noted that so-called "loans" may constitute "distributions" if there is tacit understanding between the parties that collection is not intended.)

(n) PAST SERVICE BENEFITS IN PLANS WHICH CONTAIN A MINIMUM AGE OR SERVICE REQUIREMENT FOR ELIGIBILITY.—A plan which contains a minimum age or service requirement for eligibility and provides for past service credits for all prior service of original, but not subsequent, participants will generally be considered objectionable within the purview of section 401(a)(3)(B) and (4) of the Code unless it can be demonstrated that such credits do not result in the prohibited discrimination. (Where the difference is only one year, however, *e. g.*, if there is a one-year waiting period for eligibility, but original participants are given credit for all prior service, including the one-year waiting period, and new participants do not receive credit based on the one year, such a provision may be acceptable.) Provision may, however, be made for credits on account of past services rendered after attainment of a specified age or completion of minimum service, if applied to original as well as subsequent participants.

(o) RIGHT OF TRUSTEE TO BORROW ON INSURANCE CONTRACTS.—Provision may be made granting the trustee the right to borrow against

the loan values of insurance contracts provided that in doing so the remaining interest of employees who are officers, etc., is proportionately no greater than the interest of other employees.

(p) EARMARKED INVESTMENTS.—Where amounts to be distributed to participants under a profit-sharing trust are measured by investments which have been earmarked for their respective accounts, the trustee is to invest each participant's interest proportionately, unless all participants have the right to direct the trustee to select the type of investment with respect to their individual shares.

APPENDIX

RULINGS INCORPORATED BY REFERENCE

COMMISSIONER'S MIMEOGRAPHS

Number	*Reference*
5539	C. B. 1943, 499
5677	C. B. 1944, 320
5717	C. B. 1944, 321
5985	C. B. 1946-1, 72
6020	C. B. 1946-1, 74
6136 (modified by Revenue Ruling 55-60)	C. B. 1947-1, 58
6394	C. B. 1949-1, 118
6641 (extended to cover integration at $4,200 by Revenue Ruling 56-692).	C. B. 1951-1, 41

I. T. RULINGS

3350	C. B. 1940-1, 64
3613	C. B. 1943, 475
3614	C. B. 1943, 476
3615	C. B. 1943, 477
3660	C. B. 1944, 136
3678	C. B. 1944, 321
3685	C. B. 1944, 324
3686	C. B. 1944, 326
4020	C. B. 1950-2, 61

REVENUE RULINGS

12	C. B. 1953-1, 290
13	C. B. 1953-1, 294
33 (modified by the instant ruling)	C. B. 1953-1, 267
82	C. B. 1953-1, 288
109	C. B. 1953-1, 288
185	C. B. 1953-2, 202
54-51	C. B. 1954-1, 147
54-67	C. B. 1954-1, 149
54-152	C. B. 1954-1, 149
54-172	C. B. 1954-1, 394
54-231	C. B. 1954-1, 150
54-398	C. B. 1954-2, 239
55-60	C. B. 1955-1, 37
55-186 (modified by Revenue Ruling 56-596)	C. B. 1955-1, 39
55-81	C. B. 1955-1, 392
55-276	C. B. 1955-1, 401
55-629	C. B. 1955-2, 588
55-748	C. B. 1955-2, 234
56-23	C. B. 1956-1, 598
56-267	C. B. 1956-1, 206
56-497	C. B. 1956-2, 284
56-432	C. B. 1956-2, 284
56-596	C. B. 1956-2, 288
56-633	C. B. 1956-2, 279
56-656	C. B. 1956-2, 280
56-673	C. B. 1956-2, 281
56-692	C. B. 1956-2, 287
56-693	C. B. 1956-2, 282

REVENUE PROCEDURES

56–12 ..... C. B. 1956–1, 1029
56–22 ..... C. B. 1956–2, 1380

STATUS OF P. S. RELEASES

The following list is designed to give current information as to the status of P. S. Releases issued under the Internal Revenue Code of 1939, which, to the extent consistent with the Internal Revenue Code of 1954 and the regulations thereunder, remain effective except as indicated.

STATUS

P. S. No.

1 ..... Administrative—inapplicable as a result of action taken on P. S. No. 2 by Rev. Rul. 2, C. B. 1953–1, 484, 488.
2 ..... Administrative—revoked by Rev. Rul. 2, C. B. 1953–1, 484, 488.
3 ..... Outstanding.
4 ..... Outstanding.
5 ..... Applicable under Mim. 5539, C. B. 1943, 499.
6 ..... Revoked by Rev. Rul. 55–748, C. B. 1955–2, 234.
7 ..... Outstanding; see, however, Mim. 6136, C. B. 1947–1, 58, as modified by Rev. Rul. 55–60, C. B. 1955–1, 37.
8 ..... Outstanding; see, however, P. S. No. 38, Oct. 7, 1944, for more detailed provisions.
9 ..... Outstanding, except for provision as to wartime restriction which is no longer applicable.
10 ..... Obsolete as a result of issuance of I. T. 4020, C. B. 1950–2, 61.
11 ..... Outstanding; see, however, instant ruling, Part 5(p).
12 ..... Obsolete as a result of *Saalfield Publishing Co., Inc.*, 11 T. C. 756; Acquiescence, C. B. 1952–2, 3.
13 ..... Outstanding under prior law; as to current position see Income Tax Regulations, section 1.401–3(e).
14 ..... Outstanding; see also Income Tax Regulations, section 1.401–1(d).
15 ..... Modified; see instant ruling, Part 2(i)(3).
16 ..... Obsolete as a result of new definition of "profit-sharing plan", Income Tax Regulations, section 1.401–1(b)(1)(ii).
17 ..... Modified by Rev. Rul. 55–758, C. B. 1955–2, 587. See also Income Tax Regulations section 1.401–1(e).
18 ..... Outstanding.
19 ..... Revoked by Rev. Rul. 54–398, C. B. 1954–2, 239.
20 ..... Obsolete as a result of issuance of I. T. 4020, C. B. 1950–2, 61.
21 ..... Obsolete as a result of new definition of "profit-sharing plan", Income Tax Regulations, section 1.401–1(b)(1)(ii).
22 ..... Outstanding; but see instant ruling, Part 5(b).
23 ..... Outstanding; but see instant ruling, Part 2(i)(1).
24 ..... Outstanding except as to provision for definite formula—see I. T. Regulations section 1.401–1(b)(1)(ii).
25 ..... Outstanding.
26 ..... Outstanding; subject, however, to P. S. No. 57 minimum.
27 ..... Outstanding.
28 ..... Outstanding. See also Rev. Rul. 57–77, page — of this Bulletin.
29 ..... Outstanding.
30 ..... Outstanding; see also I. T. 3615, C. B. 1943, 477, and current integration rules, Income Tax Regulations section 1.401–3(e).
31 ..... Outstanding.
32 ..... Outstanding.
33 ..... Obsolete as a result of new definition of "profit-sharing plan", Income Tax Regulations, section 1.401–(b)(1)(ii).
34 ..... Outstanding under prior law; see, however, Rev. Rul. 12, C. B. 1953–1, 290.
35 ..... Revised November 16, 1944.
35 Revised ... Modified by Rev. Rul. 54–172, C. B. 1954–1, 394.
36 ..... Outstanding.
37 ..... Outstanding; see also Income Tax Regulations, section 1.401–1(b)(3).

P. S. No.	
38	Outstanding; see also P. S. No. 8, Aug. 4, 1944.
39	Obsolete as a result of issuance of I. T. 4020, C. B. 1950–2, 61.
40	Obsolete as a result of new definition of "profit-sharing plan", Income Tax Regulations, section 1.401–1(b)(1)(ii).
41	Obsolete as a result of issuance of I. T. 4020, C. B. 1950–2, 61.
42	Outstanding.
43	Outstanding. The second paragraph of P. S. No. 43 is obsolete in view of section 1.403(a)–1(a) of the Income Tax Regulations.
44	Outstanding, except for Salary Stabilization provisions which are no longer applicable.
45	Outstanding.
46	Obsolete as a result of new definition of "profit-sharing plan", Income Tax Regulations, section 1.401–1(b)(1)(ii).
47	Outstanding, but in part superseded by *Meldrum & Fewsmith*, 20 T. C. 790, 806; Acq., C. B. 1954–2, 5.
48	See Income Tax Regulations, section 1.6033–1(a)(3) as to provisions under Internal Revenue Code of 1954.
49	See Rev. Proc. 56–12, Exhibit "B", C. B. 1956–1, 1029; modified, part 2(k) hereof.
50	Outstanding.
51-Part A	Outstanding.
51-Part B	Outstanding under prior law; see, however, Internal Revenue Code of 1954, Sec. 404(a)(3)(B).
52	Modified by Rev. Rul. 55–60, C. B. 1955–1, 37.
53	Outstanding under prior law.
54	Applicable to calendar year 1942 or a fiscal year which commenced in 1942.
55	Not retroactive to year ending on or prior to Feb. 28, 1946; Mim. 5985, C. B. 1946–1, 72; see also Rev. Rul. 55–640, C. B. 1955–2, 231
56	Outstanding.
57	Outstanding, except penultimate paragraph modified by Rev. Rul. 56–596, C. B. 1956–2, 288.
58	Revised March 7, 1947.
58 Revised	Reissued as Rev. Rul. 55–747, C. B. 1955–2, 228.
59	Also published as I. T. 3847, C. B. 1947–1, 65. See also Income Tax Regulations section 1.402(a)–1(a)(6)(ii).
60	See Rev. Proc. 56–12, Exhibit "A", C. B. 1956–1, 1029.
61	See GCM 25358, C. B. 1947–2, 9; inapplicable under Internal Revenue Code of 1954, Sec. 403(a)(2).
62	Outstanding under prior law; See Sec. 381(c)(11) and (20) as to principle under 1954 Code.
63	Outstanding; see also Income Tax Regulations, section 1.402(a)–1(a)(5).
64	Outstanding, supplemented by Rev. Rul. 55–681, C. B. 1955–2, 585.
65	Last paragraph obsolete as a result of Income Tax Regulations, section 1.403(a)–1(d).
66	Obsolete as to distributions after Oct. 26, 1956; Income Tax Regulations, section 1.402(a)–1(a)(2).
67	Outstanding.
68	Outstanding under prior law; principle modified as a result of *Meldrum & Fewsmith*, 20 T. C. 790, 806; Acquiescence, C. B. 1954–2, 5.

Rev. Rul. 57–199

A domestic trust, governed by state laws and forming part of an employees' pension, profit-sharing or stock bonus plan, which otherwise meets the qualifications of section 401(a) of the Internal Revenue Code of 1954, will not be denied the exemption from tax provided by section 501(a) of the Code merely because a portion of the trust assets are situated in a foreign country, if the trustee of the domestic trust has the exclusive management and control of the entire trust fund and is required to withhold tax from distributions in accordance with sections 871 and 1441 of the Code.

The Internal Revenue Service has been asked whether a domestic trust, forming part of an employees' pension, profit-sharing, or stock bonus plan, which otherwise meets the requirements of section 401(a) of the Internal Revenue Code of 1954, will be denied the exemption from tax provided by section 501(a) of the Code if a portion of the trust assets are situated in a foreign country.

A domestic corporation established a contributory pension plan for the benefit of its employees. The trust forming a part of the plan was established under the laws of the state in which it is located and a domestic trust company was named as the trustee.

The corporation also operates sales branches and warehouses in a foreign country where almost all of the employees are natives of that country and are all included in the employees' pension plan. The government of the foreign country requires that all contributions to the pension plan, with respect to employees in such country, must be deposited and maintained in that country. Accordingly, the trustee of the domestic trust opened a trust account with a trust company in that country. This trust account is in the name of the domestic trust company as trustee of the employees' pension trust and the foreign trust company acts merely as an agent in handling the funds.

All contributions to the plan with regard to the foreign employees, together with interest earned thereon, are paid into and held in this foreign trust account. The domestic trust issues instructions for the purpose of investment of the funds in the foreign trust account and also with regard to the payment of monthly pensions to retired employees of the corporation who are residents of the foreign country. No amount is paid out of the trust account without instructions from the trustee of the domestic trust. Pension checks for the retired foreign employees are issued by the foreign trust company and drawn from the funds it holds as agent. These funds held in the foreign trust account are deemed a part of the domestic trust for all purposes, including actuarial computations, United States income tax reports, and the withholding of tax on distributions in accordance with sections 871 and 1441 of the Code.

In order for a trust, forming part of an employees' pension, profit-sharing, or stock bonus plan, to be exempt from tax as provided by section 501(a) of the Code, it must, in addition to other qualifications provided by section 401(a) of the Code, be created or organized in the United States and it must be maintained at all times as a domestic trust in the United States. See section 1.401-1(a)(3)(i) of the Income Tax Regulations.

From the foregoing statement of facts, it is concluded that the domestic trust company is trustee under the employees' pension trust agreement with the domestic corporation, which provides that it shall be governed by the laws of the state in which it is located. Title to all assets of the trust fund is, at all times, vested in the domestic trust company as the trustee who has the exclusive management and control of the entire trust fund, even though a portion of the trust assets are situated in a foreign country.

Accordingly, it is held that a domestic trust, forming part of an employees' pension, profit-sharing, or stock bonus plan which otherwise meets the qualifications of section 401(a) of the Code, will not be denied the exemption from tax provided by section 501(a) of the Code merely because a portion of the trust assets are situated in a foreign

country, if title to such assets at all times is vested in the trustee of the domestic trust which has the exclusive management and control of the entire trust fund and is required to withhold tax from distributions in accordance with sections 871 and 1441 of the Code.

Rev. Rul. 57–213

A trust will not fail of qualification under section 401(a) of the 1954 Code, if the use of any funds of a profit-sharing trust to purchase ordinary life insurance is limited by an amount which, when added to the total amount of the contributions and forfeitures previously allocated to the purchase of ordinary life insurance for the participant, is less than one-half of the total contributions and forfeitures allocated to the account of the employee. Since the test enunciated in Revenue Ruling 54–51, *infra*, is in terms of the contributions and not the trust fund, earnings, capital gains and losses of the trust are not taken into account in determining the amount of trust funds which may be used to pay premiums on ordinary life insurance contracts. Also, the program of providing current life insurance protection in a qualified employee's profit-sharing plan may be continued after normal retirement date, upon continuation of employment by a participant who elects not to retire, if the above-stated limitation as to the proportion of funds so expendable is applied.

Rev. Rul. 54–51, C. B. 1954–1, 147, amplified.

Advice has been requested whether the trustees of an employees' qualified profit-sharing trust which was intended to comply with Revenue Ruling 54–51, C. B. 1954–1, 147, may use trust funds attributable to earnings, capital gains, and forfeitures in the payment of premiums on life insurance contracts; and whether the program of providing current life insurance protection may be continued after normal retirement date, upon continuation of employment by a participant who elects not to retire, if the limitation as to the proportion of trust funds so expendable is applied.

Revenue Ruling 54–51, *supra*, holds that an investment by a profit-sharing trust in an ordinary life insurance contract for each insurable participant under the trust will be considered incidental and subordinate to the primary purpose of an employees' qualified profit-sharing plan where (1) the aggregate premiums for the life insurance contract in the case of each participant is less than one-half of the aggregate of the contributions allocated to him at any particular time, and (2) the plan shall require the trustee to convert the entire value of the life insurance contract at or before retirement to provide periodic income so that no portion of such value may be used to continue life insurance protection beyond retirement.

Conversely, the use of 50 percent or more of the aggregate accumulated credits of participants for the purchase of the life insurance contract would have the effect of the plan's primarily providing life insurance benefiits, which would cause the trust to fail of qualification under section 401(a) of the Internal Revenue Code of 1954.

Accordingly, it is held that a trust will not fail of qualification under section 401(a) of the Code if the use of any funds of a profit-sharing trust to purchase ordinary life insurance is limited by an amount which, when added to the total amount of the contributions and forfeitures previously allocated to the purchase of ordinary life insurance for the participant, is less than one-half of the total contributions and forfeitures allocated to the account of the employee. Since the test

enunciated in Revenue Ruling 54–51, supra, is in terms of the contributions and not the trust fund, earnings, capital gains and losses of the trust are not taken into account in determining the amount of trust funds which may be used to pay premiums on ordinary life insurance contracts. It is also held that the program of providing current life insurance protection in a qualified employees' profit-sharing plan may be continued after normal retirement date, during the period of continued employment of a participant who elects not to retire, if the above stated limitation as to the proportion of funds so expendable is applied.

Revenue Ruling 54–51, *supra*, is accordingly amplified.

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26 CFR 1.401–4: Discrimination as to contributions or benefits. Rev. Rul. 57–77

A favorable advance determination will not be rendered in the case of a trust forming part of an employees' profit-sharing plan which provides that contributions to the trust will be used to provide benefits allocated in proportion to the cost of providing units of retirement annuities in proportion to annual compensation where the costs of such units are dependent upon the sex and age of the respective employee participants in the year of allocation and purchase.

Advice has been requested whether a trust forming part of an employees' profit-sharing plan will meet the qualifications of section 401(a) of the Internal Revenue Code of 1954, where the employer's contribution to the trust will be used to provide benefits allocated in proportion to the cost of providing units of retirement annuities in proportion to annual compensation and where the costs of such units are dependent upon the sex and age of the respective employee participants in the year of allocation and purchase, under a deposit administration group annuity contract.

An employer established a trusteed profit-sharing plan for the benefit of his employees. Contributions to the trust are made by the employer in an amount equal to ten percent of profits annually but limited to the amount deductible under Code. No contributions are made by the employees. Trust funds are invested by the trustee with an insurer under a deposit administration group annuity contract. Forfeitures and dividends are allocated among the remaining participants in accordance with the allocation formula.

The allocation formula provides two priorities as applied to each year independently. Under the first priority, there is allocated to each participant's account that proportion of the contribution which the cost of providing him with a monthly retirement benefit of one percent of the first $350 of his average monthly earnings, plus two percent of his average monthly earnings in excess of $350, bears to the total cost of providing such benefits for all participants, provided, however, if the annual contribution is more than sufficient to provide all participants with such benefits, only that part of the annual contribution necessary to provide such benefits shall be allocated as provided in the first priority. Second, the remainder of the annual contribution shall be allocated to each participant in the same proportion as the cost of providing such participant's account with a monthly retirement benefit of one percent of his average monthly earnings bears

to the total cost of providing such benefits for all participants. The costs of all retirements benefits are dependent upon the sex and age of the respective employee participants in the year of allocation.

Section 401(a) of the Code provides, among other qualifications, that a trust created or organized in the United States and forming part of a profit-sharing plan of an employer for the exclusive benefit of his employees, or their beneficiaries, shall constitute a qualified trust if the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated employees. A plan shall not be considered discriminatory merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation of such employees.

While there is nothing in the law, or regulations prescribed thereunder, requiring any particular formula or method or allocating trust funds among the participating employees, and formula, the operation of which results in the prohibited discrimination, will cause the plan to fail of qualification.

Section 1.401–4(a) (2) (iii) of the Income Tax Regulations states, in part, that benefits in a profit-sharing plan which vary by reason of an allocation formula which takes into consideration years of service, or other factors, are not prohibited unless they discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated. This principal is recognized in I. T. 3685, C. B. 1944, 324, which indicates a type of allocation formula which does not discriminate, and I. T. 3686, C. B. 1944, 326, which demonstrates a type of formula which does discriminate in favor of those employees for whom discremination should not exist. These rulings make clear that, in testing whether the nondiscrimination requirement is met in a profit-sharing plan, the criterion is the ratio which the employer contributions allocated to each group of employees bears to the compensation of the group, where the groupings are based upon compensation range.

In the instant case, since the allocation formula provides for an apportionment of the employer contributions, forfeitures, dividends, etc., in proportion to the cost of providing units of retirement annuities in proportion to compensation each year, where the costs of such units are dependent upon the age and sex of the respective employee participants, the result is that larger proportionate allocations, measured by current compensation, are made for older employees than for younger employees of the same sex.

In the pension plan, in which contributions are allocated in accordance with the cost of proportionate benefits, the employer undertakes to provide definite retirement benefits in proportion to compensation and/or service for each employee. If contributions to the plan are contined as intended, each employee who fulfills the requirements will receive his contemplated benefits. If the plan or contributions to it should terminate prematurely, resulting in discrimination in favor of the original older group of participants, a reallocation may be required in accordance with the provisions of Mimeograph 5717, C. B. 1944, 321, wherein the benefits of employees who are officers, shareholders, supervisors, or highly compensated, are restricted so as to limit the possibility of discrimination.

On the other hand, in a profit-sharing plan, since the employer contributions are geared to profits, there is no assurance that contributions will be continued. Therefore, there is no way of measuring what the ultimate retirement benefits will be. Also, there is no practical device, similar to Mimeograph 5717, *supra*, to correct discrimination in event of early termination or discontinuance of contributions. It may be argued, in the instant case, that each employee is provided with a retirement annuity in proportion to his average monthly compensation for each year that a contribution is made. However, the value of the retirement annuity purchased for the older employees is greatly in excess of the value to the younger employees. Only if the same relative contributions are continued fairly evenly each year is there any assurance that the ultimate benefits will take account of changes in compensation.

In a pension plan in which benefits are proportionate to compensation, failure to recognize increases in compensation in providing benefits will cause the plan to fail of qualification for the reasons given in Part 5(i) of Revenue Ruling 33, C. B. 1953–1, 267, at page 284. Since, in the type of profit-sharing plan here considered, there is no assurance that increases in compensation will be recognized in providing benefits, the benefits actually provided cannot be recognized as an acceptable criterion of nondiscrimination. Therefore, the alternative criterion, ratio of contributions to compensation, must be used.

Since the purpose of a profit-sharing plan is to provide for the participation in the employer's profits by his employees or their beneficiaries, it is the position of the Internal Revenue Service that the proper measure of discrimination is the allocation of the employer's contributions from profits, even though such allocated contributions may be accumulated for varying periods of years for employees of different ages. In making such tests, total regular compensation is used. Bonuses are includible if they are a part of the regular compensation.

Such a plan as here set out may qualify for a particular year but, in its operation, may fail to qualify in future years. Accordingly, it is held that a favorable advance determination will not be rendered in the case of a trust forming part of an employees' profit-sharing plan which provides that contributions to the trust will be used to provide benefits allocated in proportion to the cost of providing units of retirement annuities in proportion to annual compensation where the costs of such units are dependent upon the sex and age of the respective employee participants in the year of allocation and purchase.

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. 57–115

A lump-sum distribution from an employees' qualified profit-sharing plan, terminated by reason of a corporation's change in business activity, is held to be taxable at ordinary income tax rates in the case of a corporate officer participant who, although uncompensated, continued to act in the capacity of an officer and director for limited service.

Advice has been requested as to the taxability of a lump-sum distribution from a trust forming part of an employees' profit-sharing plan, constituting a qualified trust under section 401(a) of the Internal Revenue Code of 1954, in the case of an officer-employee participant who, although uncompensated, continued to act in the capacity of an officer for limited service.

Because a corporation effected a sale of the assets used in the conduct of its business, discontinued all former activities, and invested its funds in investment securities, the employment of all employees of the corporation was terminated, and the employees' qualified profit-sharing plan was terminated. However, an officer-employee of the corporation, who is also a participant in the profit-sharing plan, will continue to act as an uncompensated officer and director of the corporation, with his services limited to attendance at director's meetings, and other services not of a substantial nature. The corporation was advised, by the District Director of Internal Revenue, that the prior qualification of the plan was not adversely affected by such termination. A lump-sum distribution has been made of the amounts standing to the credit of each participant in the trust.

Beneficiaries of a qualified employees' trust are taxable in accordance with the provisions of section 402(a) of the Code. This section of the Code provides, in part, that amounts actually distributed or made available shall be taxable as annuities in the year in which received or made available, under section 72 of the Code except that section 72(e)(3) of the Code shall not apply. Section 402(a)(2) of the Code provides that if the total distributions payable under a qualified plan, 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, then the amount of such payment shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

It is the position of the Internal Revenue Service that capital gains treatment of lump sum distributions from qualified profit-sharing plans is available only upon the complete termination of the employment relationship. See *Estate of Frank B. Fry* v. *Commissioner*, 19 T. C. 461, affirmed 205 Fed. (2d) 517 and Revenue Ruling 56-214, C. B. 1956-1, 196. Thus, there must be a complete severance of all relationships between the employer and the employee, as such. Rendition of services or being employed to render services and not the element of compensation is the determinative factor in seeking to establish whether or not there has been a separation from the service. The rendition of uncompensated services by the officer-employee in the instant case is sufficient to continue the employment relationship for purposes of section 402(a)(2) of the Code since there has not been a "separation from service" within the meaning of that section.

Accordingly, it is held that a lump-sum distribution from an employees' qualified profit-sharing plan, terminated by reason of a corporation's change in business activity, is taxable at ordinary income tax rates in the case of a corporate officer-employee who, although uncompensated, continued to act in the capacity of an officer and director for limited service.

(Also Section 403, 1.403(a)-1.) Rev. Rul. 57-191

Application of the provisions of the Income Tax Regulations, under section 402 and section 403 of the Internal Revenue Code of 1954, relating to the taxability of an employee for distributions made by a qualified trust after October 26, 1956, of individual contracts which provide life insurance protection and for premiums paid by an employee after October 26, 1956, for such contracts under a qualified nontrusteed annuity plan.

Advice has been requested whether, under a nontrusteed annuity plan meeting the qualifications of section 401(a) of the Internal Revenue Code of 1954 and exempt under section 501(a) of the Code, premiums paid for individual contracts providing life insurance protection are taxable to the employees according to their nonforfeitable rights therein. Advice has also been requested as to the tax consequences of a distribution of life insurance contracts from a similarly qualified plan.

Section 1.402(a)-1(a)(2) of the Income Tax Regulations, relating to the tax consequences of the distribution of an annuity contract or of a life insurance contract by a trust which meets the requirements of section 401(a) of the Code, states that if such a trust purchases an annuity contract for an employee and distributes it to the employee in a year for which the trust is exempt under section 501(a) of the Code, the contract containing a cash surrender value which may be available to an employee by surrendering the contract, such cash surrender value will not be conisdered income to the employee unless and until the contract is surrendered. If, however, the contract distributed by such an exempt trust is a retirement income, endowment, or other life insurance contract and is distributed after October 26, 1956, the entire cash value of such contract at the time of distribution must be included in the distributee's income in accordance with the provisions of section 402(a), except to the extent that, within 60 days after the distribution of such contract, all or any portion of such value is irrevocably converted into a contract under which no part of any proceeds payable on death at any time would be excludable under section 101(a) of the Code (relating to life insurance proceeds).

Section 1.403(a)-1(d) of the regulations, relating to the taxability of a beneficiary under a qualified nontrusteed annuity plan, by reason of the purchase of contracts providing life insurance protection, states that if, under a qualified annuity plan, a group contract providing permanent life insurance protection is purchased for the employees, the same rules which are applicable when contracts providing life insurance protection are purchased by a trust described in section 401(a) and exempt under section 501(a) of the Code, shall be applicable in the case of such a contract. For such rules, see section 1.402(a)-1(a)(2), (3), and (4) of the regulations. Section 403(a) of the Code is not applicable to premiums paid after October 26, 1956, for individual contracts providing life insurance protection for employees.

The application of these provisions of the regulations requires that a distinction be made between (1) an annuity contract and (2) a life insurance contract, *i. e.*, a contract which provides pure life insurance protection at any time.

The definition of an annuity contract, within the meaning of section 402 and section 403 of the Code, is set forth in Revenue Ruling 55–639, C. B. 1955–2, 230, as a contract which provides primarily for periodic installment payments to the annuitant named therein and under which the death benefits at any time cannot exceed the larger of the reserve or the total premiums paid for the annuity benefits. Thus, in any annuity contract, there is no pure insurance protection at any time. The fact that the contract may provide for return of total premiums paid for the annuity benefits in case of death, and such total premiums may exceed the reserve in the early years, will not be considered as providing insurance protection.

Any other type of contract which involves life contingencies is a life insurance contract. This includes any type of contract which provides pure insurance protection, *i. e.*, a death benefit which at any time may exceed the larger of the reserve or the aggregate premiums paid to such time, such as a retirement income contract, or an endowment contract, as well as an ordinary life insurance contract. The mere fact that such a contract may contain provisions permitting the application or the conversion of its reserve, or its cash value, or its maturity value, to provide annuity benefits does not make such a contract an annuity contract, unless, and until, such conversion takes place. Thus, while a life insurance contract may be converted into an annuity contract, a contract is never both at the same time. Although such terms as "life insurance—annuity," "life insurance with annuity," "annuity with life insurance," may be used to describe contracts issued by life insurance companies, such contracts will be considered life insurance contracts for the purposes of section 402 and 403 of the Code if they provide pure insurance protection.

Section 1.402(a)–1(a)(2) of the regulations, and corresponding provisions of the regulations under the 1939 Code, grant a deferment of the inclusion in income of the value of an annuity contract distributed by an employees' exempt trust. A similar deferment does not apply in the case of the distribution of an insurance contract, unless, within 60 days after the distribution of such contract, it is irrevocably converted into an annuity. The tax consequences of the distribution of an insurance contract by an exempt employees' trust before October 27, 1956, are set forth in Mimeograph 6461, C. B. 1950–1, 73. The tax treatment of such a distribution made after October 26, 1956, is governed by the second sentence of section 1.402(a)–1(a)(2) of the regulations. This sentence makes Mimeograph 6461, *supra*, and P. S. 66,[1] dated November 10, 1950, inapplicable to distributions of an insurance contract after October 26, 1956.

The circumstances under which a distribution is made from a trust of a retirement income, endowment, or other life insurance contract after October 26, 1956, govern whether such distribution will be taxed as ordinary income or as a gain from the sale or exchange on an capital asset. The regulations state that the entire cash value of such contract at the time of distribution must be included in the distributee's income in accordance with the provisions of section 402(a) of the Code. Thus, under some circumstances, the amount includible in the distributee's income in accordance with this provi-

[1] Not published in the Bulletin.

sion of the regulations would be entitled to capital gains treatment under section 402(a)(2) of the Code. See section 1.402(a)-1(a)(6) of the regulations.

Under the provisions of section 403(a) of the Code and section 1.403(a)-1 of the regulations, relating to the taxability of a beneficiary under a nontrusted qualified annuity plan, when an annuity contract is purchased by an employer for an employee under a nontrusteed qualified annuity plan, the employee is not required to include in income the amount paid for the contract at the time such amount is paid, but the amounts received or made available under such annuity contract shall be included in income for the taxable year in which received or made available. The first sentence of section 1.403(a)-1(d) of the regulations indicates the similar deferred tax treatment of the portion of the premiums not applicable to current life insurance protection, when the employer pays premiums for a group permanent life insurance contract under a qualified nontrusteed annuity plan for his employees; however, as in the case of a trusteed plan where contracts containing life insurance protection are purchased, the deferment ceases when there is a distribution of a contract or certificate providing life insurance protection.

As indicated in section 1.403(a)-1(d) of the regulations, there is no deferred tax treatment under section 403(a) of the Code when individual contracts providing life insurance protection for employees are purchased by the employer without an intervening trust. The reason for this is that when an employee has a nonforfeitable interest is an individual insurance contract, and thus has ownership rights in the contract, the payment of a premium by the employer is tantamount to an immediate distribution to the employee-owner of the contract. This provision of the regulations has the effect of revoking the last paragraph of PS No. 65,[2] dated November 10, 1950, with respect to premiums paid after October 26, 1956, for individual contracts providing life insurance protection for employees. Also, this provision has no reference to annuity contracts, since section 403(a) of the Code is specifically applicable to the purchase of annuity contracts under a qualified annuity plan.

Thus, premiums paid by an employer after October 26, 1956, for individual contracts providing life insurance protection for employees are includible in the employee's income to the extent of each employee's nonforfeitable interest therein, where there is no intervening trust.

Rev. Rul. 57-260

If a participant in an employees' qualified pension plan continues to work beyond the normal retirement age specified in the plan and, prior to such specified age, makes an irrevocable election to receive the total amount credited to his account under the plan only upon the termination of his services with his employer, the amount of his credits will not be deemed to have been made available to him until such time as he actually terminates his services, at which time he will be entitled to treat the total distribution as a long-term capital gain.

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[2] Not published in the Bulletin.

Advice has been requested as to the taxability of a distribution from an employees' qualified pension plan where an employee continues to work beyond the normal retirement age and prior to reaching such age makes an irrevocable election to accept the total amount credited to his account under the plan only upon the termination of his services with his employer.

Under the employees' noncontributory trusteed pension plan in the instant case, which has been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954, the employer's contributions are used to purchase a life insurance policy for insurable employees, or an annuity for those employees who are not insurable. The policies mature at the normal retirement age specified in the plan, but the plan does not provide for compulsory retirement. When the policies mature, the employees must elect to accept a monthly annuity or receive a lump sum payment representing the total cash surrender value. In the instant case, an employee, who desired to continue working beyond the normal retirement age, made an irrevocable election, prior to reaching such age, to receive his total distributions payable, in a lump sum, only upon the termination of his services with his employer.

Section 402(a) of the Code provides that the amount distributed or made available from a trust, described under section 401(a) as being exempt under section 501(a) of the Code, shall be taxable to the distributee in the year in which so distributed or made available. Where total distributions payable 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 death of the employee after separation from service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than six months.

Revenue Ruling 55–423, C. B. 1955–1, 41, holds that a participant's interest in an employees' qualified trust described in section 401(a) of the Code is not made available to him within the purview of section 402(a) of the Code where there are substantial conditions or restrictions on his right of withdrawal.

Accordingly, it is held that in the case of an employees' qualified noncontributory trusteed pension plan, where the distribution of benefits under the plan is made at the normal retirement age specified in the plan, but an employee continues to work beyond the specified retirement age and, prior to such age, makes an irrevocable election to receive, upon the termination of his service with his employer, and only then, the total amount credited to his account under the plan, the amount of his credits will not be deemed to have been made available to him until such time as he actually terminates his services. At such time, he will be entitled to treat the total distribution as a gain from the sale or exchange of a capital asset held for more than six months.

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SECTION 403.—TAXATION OF EMPLOYEE ANNUITIES

26 CFR 1.403(a)-1: Taxability of beneficiary under a qualified annuity plan.

Application of the provisions of the Income Tax Regulations, relating to the taxability of an employee for premiums paid by an employer, after October 26, 1956, for individual contracts providing life insurance protection. See Rev. Rul. 57-191, page 162.

SECTION 404.—DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

Contributions by an employer to separate and individual trusts each providing certain nonforfeitable unemployment and other benefits to a designated employee. See Rev. Rul. 57-37, page 18.

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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. (Also Sections 61, 162.) Rev. Rul. 57-104

> The amount paid by a taxpayer to an independent contractor as reimbursement for the costs of a union negotiated qualified pension plan for the contractor's employees constitutes ordinary and necessary business expense, deductible under the provisions of section 162(a) of the Internal Revenue Code of 1954. The contractor will be required to include in gross income, under section 61(a) of the Code, the amount received as reimbursement for contributions paid by him to the pension trust and will be entitled to a deduction, within the applicable limits of section 404(a) of the Code, with respect to amounts actually paid into the trust.

Advice has been requested relative to the deductibility of amounts contributed to fund pension benefits when the independent contractor who makes the contribution to the pension trust for his employees is reimbursed therefor by the taxpayer for whom the independent contractor performs services.

A shipowner had a contract with a stevedore contractor under which the stevedore contractor discharged and loaded cargoes for the shipowner. Pursuant to a collective bargaining agreement, a pension plan and trust was established for employees of the stevedore contractor. The contract between the shipowner and the stevedore contractor provided, among other things, that the shipowner reimburse the stevedore contractor for the amount required to be contributed by the stevedore contractor to the pension trust.

The pension plan and the trust forming a part thereof have been held as meeting the requirements of section 401(a) of the Internal Revenue Code of 1954, and the trust to be exempt from tax under section 501(a) of the Code.

Section 61(a) of the Code provides that, except as otherwise provided in subtitle A of the Code, gross income means all income from

whatever souce derived, including, among other items, gross income derived from business.

In the computation of taxable income, section 162(a) of the Code provides for a deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 404(a) of the Code provides, in part, that contributions paid by an employer to a pension trust which is exempt under section 501(a) shall be deductible to the extent and in the manner provided in section 404.

Accordingly, it is held that the amount paid pursuant to contract by a shipowner to a stevedore contractor as reimbursement for the costs of a union negotiated qualified pension plan for employees of the stevedore contractor constitutes a part of the cost of the services rendered, and, as such, is deductible under section 162 of the 1954 Code as an ordinary and necessary business expense. Also, the stevedore contractor will be required to include in gross income, under section 61(a) of the Code, amounts received as reimbursement for contributions paid by him to the pension trust, but will be entitled to a deduction, within the applicable limits of section 404(a) of the Code, with respect to amounts actually paid into the trust.

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26 CFR 1.404(a)–3: Contributions of an employer to or under an employee's pension trust or annuity plan that meets the requirements of section 401(a); application of section 404(a)(1). Rev. Rul. 57–165

A transfer of property to a collective investment fund qualified as a section 401(a) trust by a participating trust forming part of a qualified employees' pension plan, in exchange for units of the fund, constitutes an "exchange" of the property by the participating trust. Gain or loss will result at the time the exchange takes place and must be taken into account by the participating trust and its grantor in determining, under the cost method of valuing the assets of the trust, (1) the extent to which benefits under the plan are then funded and (2) the limitation, at that time, upon currently deductible employer contributions to such trust.

Advice has been requested whether a qualified employees' pension trust, which is a participant in a collective investment fund, qualified as a section 401(a) trust, will be deemed to have realized a gain or loss, insofar as employer contributions for Federal income tax purposes are concerned, when the trust transfers its assets to the fund and receives a credit in units of the fund at the time of such transfer.

A collective investment fund is created as a trust solely for the purpose of providing, only to other trusts which are held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 and are exempt under section 501(a) of the Code, a means of diversifying investments to a greater extent than would otherwise be possible with only the funds of a single trust. The trust agreements creating the participating trusts and the collective investment trust meet the requiremens of Revenue Ruling 56–267, C. B. 1956–1, 206.

The declaration of trust creating the investment fund, and each trust agreement creating a participating trust, provide, in part, that the trustee of the investment fund, at the time each participating trust first deposits money in the fund, may acquire for the fund any property of such participating trust which would then be appropriate for purchase by the fund. Each such acquisition shall be made at the then fair value of the property. Any property or asset of a participating trust so acquired shall be exclusively owned by the trustee of the fund, and no participating trust shall have any individual ownership thereof. A trust asset when once acquired by the investment trust is under no circumstances required thereafter to be transferred, as such, or otherwise distributed, to the same participating trust.

The declaration of trust also provides that the trustee shall credit to the account of each participating trust which deposits money or property (taken into account at its fair market value) in the fund, the number of units in the fund which its deposit will purchase at the then fair market value of each unit and that the interests of the several participating trusts in the fund, and in the net earnings, profits, and losses of the fund, shall be proportionate to the number of units standing to their respective credits.

The investment trust declaration also provides that, at the inception of the fund, the fair market value of each unit of the fund shall be deemed to be $100. Annually, at a specified valuation date, the trustee of the fund shall determine the then fair market value of each unit of the fund by dividing the then fair market value of the fund as a whole by the number of units of the fund then allocated to participating trusts. Units owned by a participating trust may be withdrawn from the fund annually and only on a valuation date.

The employees' trusts, which have become participating trusts in the collective investment fund, value assets at cost for purposes of determining unfunded costs of the respective plans and employer contribution limits.

An employer's contributions under a qualified employees' pension plan are deductible for Federal income tax purposes as provided by section 404 of the Code. Subsection (a)(1) of that section imposes alternative limitations as to the amount deductible in any taxable year which depend in whole or in part upon the amount necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan. Sections 1.404(a)-3 to 1.404(a)-6, inclusive, of the Income Tax Regulations prescribe the manner and extent to which an employer's contributions may be deducted and require that all pertinent factors must be reasonably recognized.

A collective investment fund, qualified as a section 401 (a) trust under Revenue Ruling 56-267, *supra*, must be recognized as an entity separate from the participating trust. But for such qualification and except as it might qualify as a common trust fund under section 584 of the Code, such an investment fund would constitute an association taxable as a corporation. *Brooklyn Trust Co.* v. *Commissioner*, 80 Fed. (2d) 865; *Commissioner* v. *North American Bond Trust*, 122 Fed. (2d) 545. Thus, determination of gain or loss in the transaction discussed above is the same as in the case of a sale or exchange of assets by the participating trust to any other entity for purpose of the cost method of valuing assets.

Accordingly, it is held that a transfer of property to a collective investment fund, qualified as a section 401 (a) trust, by a participating trust forming part of a qualified employees' pension plan, in exchange for units of the fund, constitutes an "exchange" of the property by the participating trust. Gain or loss will result at the time the exchange takes place and must be taken into account by the participating trust and its grantor in determining, under the cost method of valuing the assets of the trust, (1) the extent to which benefits under the plan are then funded and (2) the limitation, at that time, upon currently deductible employer contributions to such trust.

Also, where it has been the administrative practice of a praticipating trust and its grantor, with either the express or the clearly implied approval of the Internal Revenue Service, to consistently value the assets of such trust at cost for purposes of determining the extent to which (1) the benefits to be provided by the trust have been funded and (2) the employer can make further contributions to the trust which are currently deductible under the authority of section 404 (a) of the Code, there will be no objection to the continued use by such trust and its grantor of the same method of valuing assets of the trust, including those units of the investment fund acquired in exchange for assets of the participating trust. In such case, the units of the collective investment fund acquired by the participating trust may, from the time they are acquired until withdrawn, be treated as having a cost basis equivalent to the fair value, at the time of the exchange, of the asset or assets exchanged for such units. However, every withdrawal by a participating trust of a unit in the fund will constitute a disposition for cash. The cash amount thus considered to be obtained will then take the place of the cost basis of the unit for purposes of determining (1) the gain or loss on such transactions and the extent to which benefits payable or to be paid by such trust are funded and (2) the extent to which the employer-grantor may make further currently deductible contributions to the trust.

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26 CFR 1.404(a)–4: Pension and annuity plans; limitations under section 404(a)(1)(A). Rev. Rul. 57–89

> The limitation of deductions for contributions, to a qualified employees' pension plan, to five percent of the nondeferred compensation of all employees who are under the trust in the taxable year, under the trust in the taxable year, under subparagraph (A) of section 404(a)(1) of the Internal Revenue Code of 1954, may be applied even where it exceeds the limitation under subparagraph (C) of that section, provided it does not exceed the unfunded cost of past service credits as of the beginning of the year plus the normal cost of the plan for the year. The application of the limitation under subparagraph (A), where the subparagraph (C) limitation has been used in prior years, is acceptable.

Advice has been requested whether an employer may deduct contributions to a qualified employees' pension plan, to the extent of the applicable limitation under subparagraph (A) of section 404(a)(1) of the Internal Revenue Code of 1954, even though it would result in allowable deductions greater than the limitation under subparagraph (C) of that section.

Subparagraph (A) of section 404(a)(1) of the Code provides, in part, that an employer may deduct contributions paid to a pension plan in an amount not in excess of five percent of the compensation paid or accrued during the taxable year to all the employees under the trust. However, the amount deductible is subject to reduction upon specific findings by the Commissioner.

Alternatively, subparagraph (C) of section 404(a)(1) of the Code provides, in part, that the amount deductible shall be limited to the sum of the normal cost of the plan plus an amount not in excess of ten percent of the cost which would be required to completely fund or purchase the past service pension or annuity credits as of the date when they are included in the plan.

Section 1.404(a)-4 of the Income Tax Regulations states that the five percent limitation, provided by section 404(a)(1)(A) of the Code, applies to the initial year and to each subsequent year for which the five percent figure is not reduced as provided below. For years to which the initial five percent limitation applies, no adjustment on account of prior experience is required. If the contributions do not exceed the initial five percent limitation in the first taxable year to which this limitation applies, the taxpayer need not submit actuarial data for such year. For the first taxable year following the first year to which the initial five percent limitation applies, and for every fifth year thereafter, or more frequently where preferable to the taxpayer, the taxpayer shall submit with his return an actuarial certification of the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan with a statement explaining all the methods, factors, and assumptions used in determining such amount. The District Director of Internal Revenue will make periodical examinations of such data at not less than five year intervals. Based upon such examinations, the Commissioner will reduce the limitation under section 404(a)(1)(A) of the Code below the five percent limitation for the years with respect to which he finds that the five percent limitation exceeds the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan. It is also stated that deductions are allowable to the extent of the applicable limitations under section 404(a)(1)(A) of the Code even where these are greater than the applicable limitations under section 404(a)(1)(B) or section 404(a)(1)(C) of the Code.

Accordingly, the limitation of deductions under subparagraph (A) of section 404(a)(1) of the Code to five percent of the nondeferred compensation of all employees, who are under the trust in the taxable year, may be applied even where it may exceed the limitation under subparagraph (C) of that section, provided it does not exceed the unfunded past service cost as of the beginning of the year plus the normal cost of the plan for the year. In applying this limitation, the compensation of any employee who is not a potential beneficiary of the plan may not be included. Thus, if the effect of offset provisions in the benefit formula would, on the basis of projecting the employee's earning rate to his retirement date, eliminate any net benefits under the plan for him, or if, because of the circumstances of his age and service, it would be impossible for him to qualify for benefits under the plan, his compensation cannot be included for the purpose of applying the

limitation. In no event are deductions allowable for contributions to the extent that they, together with other assets of the fund, result in overfunding the cost of service credits up to the end of the taxable year, since to such extent they do not constitute ordinary and necessary expenses under section 162 of the Code.

It is also held that the application of the limitation under subparagraph (A) of section 404(a)(1) of the Code, where the subparagraph (C) limitation of that section has been used in prior years, is acceptable. This ruling shall not be construed as authorizing or approving increased deductions under the limitation of subparagraph (A) for any year for which the employer's income tax return has been filed and for which the deduction has been computed under the limitation of subparagraph (C). See section 1.404(a)-3(c) of the regulations.

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26 CFR 1.404(a)-10: Profit-sharing plan of an affiliated group; application of section 404(a)(3)(B).

Deductibility of payments under an employees' cash payment profit-sharing incentive plan of a corporation and its wholly owned subsidiary. See Rev. Rul. 57-88, page 88.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART I.—ACCOUNTING PERIODS

SECTION 441.—PERIOD FOR COMPUTATION OF TAXABLE INCOME

Rev. Rul. 57-51

The trustee of a revocable trust had, since the inception thereof, filed Forms 1041, U. S. Fiduciary Income Tax Return, as information returns on behalf of the trust on a calendar year basis. The grantor reported the income with respect to the trust and paid the tax thereon. Upon the death of the grantor, when the trust became irrevocable, the trustee desired to file returns for the trust on a fiscal year basis. *Held*, upon the death of the grantor the trust became a separate entity for Federal income tax purposes for the first time and hence a *new* taxpayer. Therefore, the trustee may elect to file the *first* return for the trust either on the basis of a calendar year or a fiscal year without the consent of the Commissioner, provided it fulfills the other requirements of a taxpayer filing its first return. For tax purposes, the existence of the trust in this case, prior to the time it became irrevocable, is ignored.

Revenue Ruling 56-374, C. B. 1956-2, 296, holding that an employee trust, having an established fiscal year of accounting for filing its required annual return, must obtain prior approval to change its accounting period is distinguishable in that such trust

was a taxable entity and was a taxpayer because it was subject to tax. Although a taxable entity, it was exempt from taxation by other provisions of the Code.

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26 CFR 1.441: Statutory provisions; period for computation of taxable income. (Also Sections 442, 443; 1.442, 1.443.) T. D. 6226[1]

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

Regulations under sections 441, 442, and 443 of the Internal Revenue Code of 1954.

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

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

On October 12, 1956, notice of proposed rulemaking with respect to regulations under subchapter E, part I (relating to accounting periods), of the Internal Revenue Code of 1954, was published in the Federal Register (21 F. R. 7798). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so published have been modified and are hereby adopted as set forth below:

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AUTHORITY: §§ 1.441 to 1.443–1 incl., issued under sec. 7805, I. R. C. 1954; 68 A Stat. 917; 26 U. S. C. 7805.

The following regulations are hereby prescribed under sections 441, 442, and 443 of the Internal Revenue Code of 1954. Except as otherwise stated in the regulations, the rules are applicable for taxable years beginning after December 31, 1953, and ending after August 16, 1954:

ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

Accounting Periods

§ 1.441 STATUTORY PROVISIONS: PERIOD FOR COMPUTATION OF TAXABLE INCOME.

SEC. 441. PERIOD FOR COMPUTATION OF TAXABLE INCOME.

(a) COMPUTATION OF TAXABLE INCOME.—Taxable income shall be computed on the basis of the taxpayer's taxable year.

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[1] The publication of this Treasury Decision in 22 F. R. 1287, dated March 1, 1957, contains (1) a series of instructions modifying the notice of proposed rule making published in 21 F. R. 7798, dated October 12, 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.

(b) TAXABLE YEAR.—For purposes of this subtitle, the term "taxable year" means—

(1) The taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

(2) The calendar year, if subsection (g) applies; or

(3) The period for which the return is made, if a return is made for a period of less than 12 months.

(c) ANNUAL ACCOUNTING PERIOD.—For purposes of this subtitle, the term "annual accounting period" means the annual period on the basis of which the taxpayer regularly computes his income in keeping his books.

(d) CALENDAR YEAR.—For purposes of this subtitle, the term "calendar year" means a period of 12 months ending on December 31.

(e) FISCAL YEAR.—For purposes of this subtitle, the term "fiscal year" means a period of 12 months ending on the last day of any month other than December. In the case of any taxpayer who has made the election provided by subsection (f), the term means the annual period (varying from 52 to 53 weeks) so elected.

(f) ELECTION OF YEAR CONSISTING OF 52–53 WEEKS—

(1) GENERAL RULE.—A taxpayer who, in keeping his books, regularly computes his income on the basis of an annual period which varies from 52 to 53 weeks and ends always on the same day of the week and ends always—

(A) On whatever date such same day of the week last occurs in a calendar month, or

(B) On whatever date such same day of the week falls which is nearest to the last day of a calendar month,

may (in accordance with the regulations prescribed under paragraph (3)) elect to compute his taxable income for purposes of this subtitle on the basis of such annual period. This paragraph shall apply to taxable years ending after the date of the enactment of this title.

(2) SPECIAL RULES FOR 52–53-WEEK YEAR—

(A) EFFECTIVE DATES.—In any case in which the effective date or the applicability of any provision of this title is expressed in terms of taxable years beginning or ending with reference to a specified date which is the first or last day of a month, a taxable year described in paragraph (1) shall (except for purposes of the computation under section 21) be treated—

(i) As beginning with the first day of the calendar month beginning nearest to the first day of such taxable year, or

(ii) As ending with the last day of the calendar month ending nearest to the last day of such taxable year,

as the case may be.

(B) CHANGE IN ACCOUNTING PERIOD.—In the case of a change from or to a taxable year described in paragraph (1)—

(i) If such change results in a short period (within the meaning of section 443) of 359 days or more, or of less than 7 days, section 443 (b) (relating to alternative tax computation) shall not apply;

(ii) If such change results in a short period of less than 7 days, such short period shall, for purposes of this subtitle, be added to and deemed a part of the following taxable year; and

(iii) If such change results in a short period to which subsection (b) of section 443 applies, the taxable income for such short period shall be placed on an annual basis for purposes of such subsection by multiplying such income by 365 and dividing the result by the number of days in the short period, and the tax shall be the same part of the tax computed on the annual basis as the number of days in the short period is of 365 days.

(3) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary for the application of this subsection.

(g) NO BOOKS KEPT; NO ACCOUNTING PERIODS.—Except as provided in section 443 (relating to returns for periods of less than 12 months), the taxpayer's taxable year shall be the calendar year if—

(1) The taxpayer keeps no books;

(2) The taxpayer does not have an annual accounting period; or

(3) The taxpayer has an annual accounting period, but such period does not qualify as a fiscal year.

§ 1.441–1 PERIOD FOR COMPUTATION OF TAXABLE INCOME.—(a) *Computation of taxable income.*—Taxable income shall be computed and a return shall be made for a period known as the "taxable year." For rules relating to methods of accounting, the taxable year for which items of gross income are included and deductions are taken, inventories, and adjustments, see sections 446 to 482, inclusive, and the regulations thereunder.

(b) *Taxable year.*—(1) The term "taxable year" means—

(i) The taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

(ii) The calendar year, if section 441(g) (relating to taxpayers who keep no books or have no accounting period) applies; or

(iii) The period for which the return is made, if the return is made under section 443 for a period of less than 12 months, referred to as a "short period."

(2) A taxable year may not cover a period of more than 12 calendar months except in the case of a 52–53-week taxable year. See § 1.441–2.

(3) A new taxpayer in his first return may adopt any taxable year which meets the requirements of section 441 and this section without obtaining prior approval. The first taxable year of a new taxpayer must be adopted on or before the time prescribed by law (not including extensions) for the filing of the return for such taxable year. However, for rules applicable to the adoption of a taxable year by a partnership, see § 1.442–1(b)(2), section 706(b), and § 1.706–1(b). For rules applicable to the taxable year of a member of an affiliated group which makes a consolidated return, see § 1.1502–14 and § 1.442–1(d).

(4) After a taxpayer has adopted a calendar or a fiscal year, he must use it in computing his taxable income and making his returns for all subsequent years unless prior approval is obtained from the Commissioner to make a change or unless a change is otherwise permitted under the internal revenue laws or regulations. See section 442 and § 1.442–1. For rules applicable to changes in taxable years of partners and partnerships, see also section 706(b) and § 1.706–1(b).

(c) *Annual accounting period.*—The term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes his income in keeping his books.

(d) *Calendar year.*—The term "calendar year" means a period of 12 months ending on December 31. A taxpayer who has not established a fiscal year must make his return on the basis of a calendar year.

(e) *Fiscal year.*—(1) The term "fiscal year" means—

(i) A period of 12 months ending on the last day of any month other than December, or

(ii) The 52–53-week annual accounting period, if such period has been elected by the taxpayer.

(2) A fiscal year will be recognized only if it is established as the annual accounting period of the taxpayer and only if the books of the taxpayer are kept in accordance with such fiscal year.

(f) *Election of year consisting of 52–53 weeks.*—For rules relating to the 52–53-week taxable year, see § 1.441–2.

(g) *No books kept; no accounting period.*—Except in the case of a short period under section 443, the taxpayer's taxable year shall be the calendar year if—

(1) The taxpayer keeps no books;

(2) The taxpayer does not have an annual accounting period (as defined in section 441(c) and paragraph (c) of this section); or

(3) The taxpayer has an annual accounting period, but such period does not qualify as a fiscal year (as defined in section 441(e) and paragraph (e) of this section).

For the purposes of subparagraph (1) of this paragraph, the keeping of books does not require that records be bound. Records which are sufficient to reflect income adequately and clearly on the basis of an annual accounting period will be regarded as the keeping of books. A taxpayer whose taxable year is required to be a calendar year under section 441(g) and this paragraph may not adopt a fiscal year without obtaining prior approval from the Commissioner since such adoption is treated as a change of annual accounting period. See section 442 and § 1.442–1(a)(2).

§ 1.441–2 Election of Year Consisting of 52–53 Weeks.—(a) *General rule.*—Section 441 (f) provides, in general, that a taxpayer may elect to compute his taxable income on the basis of a fiscal year which—

(1) Varies from 52 to 53 weeks.

(2) Ends always on the same day of the week, and

(3) Ends always on—

(i) Whatever date this same day of the week last occurs in a calendar month, or

(ii) Whatever date this same day of the week falls which is nearest to the last day of the calendar month.

For example, if the taxpayer elects a taxable year ending always on the last Saturday in November, then for the year 1956, the taxable year would end on November 24, 1956. On the other hand, if the taxpayer had elected a taxable year ending always on the Saturday nearest to the end of November, then for the year 1956, the taxable year would end on December 1, 1956. Thus, in the case of a taxable year described in (3)(i), the year will always end within the month and may end on the last day of the month, or as many as six days before the end of the month. In the case of a taxable year described in (3)(ii), the year may end on the last day of the month, or as many as three days before or three days after the last day of the month.

(b) *Application of effective dates.*—(1) For the purpose of determining the effective date for the applicability of any provision of this title which is expressed in terms of taxable years beginning or ending with reference to the first or last day of a specified calendar month, including the time for filing returns and other documents, paying tax,

or performing other acts, a 52–53-week taxable year is deemed to begin on the first day of the calendar month beginning nearest to the first day of the 52–53-week taxable year, and is deemed to end or close on the last day of the calendar month ending nearest to the last day of the 52–53-week taxable year, as the case may be. The preceding sentence does not apply to the computation of tax if subparagraph (2) of this paragraph, relating to the computation under section 21 of the effect of changes in rates of tax during a taxable year, applies. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Assume that an income tax provision is applicable to taxable years beginnig on or after January 1, 1957. For that purpose a 52–53-week taxable year beginning on any day within the period December 26, 1956, to January 4, 1957, inclusive, shall be treated as beginning on January 1, 1957.

Example (2). Assume that an income tax provision requires that a return must be filed on or before the 15th day of the third month following the close of the taxable year. For that purpose, a 52–53-week taxable year ending on any day during the period May 25 to June 3, inclusive, shall be treated as ending on May 31, the last day of the month ending nearest to the last day of the taxable year, and the return, therefore, must be made on or before August 15.

(2) If a change in the rate of tax is effective during a 52–53-week taxable year (other than on the first day of such year as determined under subparagraph (1) of this paragraph), the tax for the 52–53-week taxable year shall be computed in accordance with section 21, relating to effect of changes, and the regulations thereunder. For the purpose of the computation under section 21, the determination of the number of days in the period before the change, and in the period on and after the change is to be made without regard to the provisions of subparagraph (1) of this paragraph. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Assume a change in the rate of tax is effective for taxable years beginning after June 30, 1956. For a 52–53-week taxable year beginning on Wednesday, November 2, 1955, the tax must be computed on the basis of the old rates for the actual number of days, from November 2, 1955, to June 30, 1956, inclusive, and on the basis of the new rates for the actual number of days from July 1, 1956, to Tuesday, October 30, 1956, inclusive.

Example (2). Assume a change in the rate of tax for taxable years beginning after June 30. For this purpose, a 52–53-week taxable year beginning on any of the days from June 25 to July 4, inclusive, is treated as beginning on July 1. Therefore, no computation under section 21 will be required for such year because of the change in rate.

(c) *Adoption of or change to or from 52–53-week taxable year.*— (1) A new taxpayer may adopt the 52–53-week taxable year for his first taxable year if he keeps his books and computes his income on that basis, or if he conforms his books accordingly in closing them. The taxpayer must thereafter keep his books and report his income on the basis of the 52–53-week taxable year so adopted unless prior approval for a change is obtained from the Commissioner. See subparagraph (4) of this paragraph. The taxpayer shall file with his return for his first taxable year a statement containing the informa-

tion required in subparagraph (3) of this paragraph. A newly-formed partnership may adopt a 52–53-week taxable year without the permission of the Commissioner only if such a year ends either with reference to the same month in which the taxable years of all its principal partners end or with reference to the month of December. See § 1.706–1(b)(1).

(2) A taxpayer, including a partnership, may change to a 52–53-week taxable year without the permission of the Commissioner if the 52–53-week taxable year ends with reference to the end of the same calendar month as that in which the former taxable year ended, and if the taxpayer keeps his books and computes his income for the year of change on the basis of such 52–53-week taxable year, or if he conforms his books accordingly in closing them. The taxpayer must continue to keep his books and compute his income on the basis of such 52–53-week taxable year unless prior approval for a change is obtained. See subparagraph (4) of this paragraph. The taxpayer shall indicate his election to change to such 52–53-week taxable year by a statement filed with his return for the first taxable year for which the election is made. This statement shall contain the information required in subparagraph (3) of this paragraph.

(3) The statement referred to in subparagraphs (1) and (2) of this paragraph shall contain the following information:

(i) The calendar month with reference to which the new 52–53-week taxable year ends;

(ii) The day of the week on which the 52–53-week taxable year always will end; and

(iii) Whether the 52–53-week taxable year will always end on (*a*) the date on which such day of the week falls in the calendar month, or (*b*) on the date on which such day of the week falls which is nearest to the last day of such calendar month.

(4) Where a taxpayer wishes to change to a 52–53-week taxable year and, in addition, wishes to change the month with reference to which the taxable year ends, or where a taxpayer wishes to change from a 52–53-week taxable year, he must obtain prior approval from the Commissioner, as provided in section 442 and § 1.442–1.

(5) If a change from or to a 52–53-week taxable year results in a short period (within the meaning of section 443) of 359 days or more, or six days or less, the tax computation under section 443(b) shall not apply. If the short period is 359 days or more, it shall be treated as a full taxable year. If the short period is six days or less, such short period is not a separate taxable year but shall be added to and deemed a part of the following taxable year. (In the case of a change from or to a 52–53-week taxable year not involving a change of the month with reference to which the taxable year ends, the tax computation under section 443(b) does not apply since the short period will always be 359 days or more, or six days or less.) In the case of a short period which is more than six days, but less than 359 days, taxable income for the short period shall be placed on an annual basis for the purpose of section 443(b) by multiplying such income by 365 and dividing the result by the number of days in the short period. In such case, the tax for the short period shall be the same part of the tax computed on such income placed on an annual basis as the number of days in the short period is of 365 days (unless section 443(b)(2) and § 1.443–1(b)(2),

relating to the alternative tax computation, apply). For adjustment in deduction for personal exemption, see section 443(c) and § 1.443-1(b)(1)(v).

(6) The provisions of subparagraph (5) are illustrated by the following examples:

Example (1). A taxpayer having a fiscal year ending April 30 elects for years beginning after April 30, 1955, a 52–53-week taxable year ending on the last Saturday in April. This election involves a short period of 364 days, from May 1, 1955, to April 28, 1956, inclusive. Since this short period is 359 days or more, it is not placed on an annual basis and is treated as a full taxable year.

Example (2). Assume the same conditions as in example (1), except that the taxpayer elects for years beginning after April 30, 1955, a taxable year ending on the Tuesday nearest to April 30. This election involves a short period of three days, from May 1 to May 3, 1955. Since this short period is less than seven days, tax is not separately computed for it. This short period is added to and deemed part of the following 52-week taxable year which would otherwise begin on May 4, 1955, and end on May 1, 1956. Thus, that taxable year is deemed to begin on May 1, 1955, and end on May 1, 1956.

(d) *Computation of taxable income.*—The principles of section 451, relating to the taxable year for inclusion of items of gross income, and section 461, relating to the taxable year for taking deductions, are generally applicable to 52–53-week taxable years. Thus, items of income and deductions are determined on the basis of a 52–53-week taxable year, except that such items may be determined as though the 52–53-week taxable year were a taxable year consisting of 12 calendar months if such practice is consistently followed by the taxpayer and if income is clearly reflected thereby. In the case of depreciation, unless some other practice is consistently followed, the allowance shall be determined as though the 52–53-week year were a taxable year consisting of 12 calendar months. Amortization deductions for the taxable year shall be determined as though the 52–53-week year were a taxable year consisting of 12 calendar months.

(e) *Taxable years beginning before January 1, 1954, and ending after August 16, 1954.*—Pursuant to section 7851(a)(1)(C), the regulations prescribed in this section relating to taxable years consisting of 52–53 weeks shall also apply to taxable years beginning before January 1, 1954, and ending after August 16, 1954, which years are subject to the Internal Revenue Code of 1939.

§ 1.442 Statutory Provisions; Change of Annual Accounting Period.

SEC. 442. CHANGE OF ANNUAL ACCOUNTING PERIOD.

If a taxpayer changes his annual accounting period, the new accounting period shall become the taxpayer's taxable year only if the change is approved by the Secretary or his delegate. For purposes of this subtitle, if a taxpayer to whom section 441(g) applies adopts an annual accounting period (as defined in section 441(c)) other than a calendar year, the taxpayer shall be treated as having changed his annual accounting period.

§ 1.442-1(a) Change of annual accounting period.—(1) *In general.*—If a taxpayer wishes to change his annual accounting period (as defined in section 441(c)) and adopt a new taxable year (as defined in section 441(b)), he must obtain prior approval from the Com-

missioner by application, as provided in paragraph (b) of this section, or the change must be authorized under the Income Tax Regulations. A new taxpayer who adopts an annual accounting period as provided in section 441 and §§ 1.441–1 or 1.441–2 need not secure the permission of the Commissioner under section 442 and this section. However, see subparagraph (2) of this paragraph. For adoption of and changes to or from a 52–53-week taxable year, see section 441(f) and § 1.441–2; for adoption of and changes in the taxable years of partners and partnerships, see paragraph (b) (2) of this section, section 706(b), and § 1.706–1(b); for special rules relating to certain corporations, subsidiary corporations, and newly married couples, see paragraphs (c), (d), and (e), respectively, of this section.

(2) *Taxpayers to whom section 441(g) applies.*—Section 441(g) provides that if a taxpayer keeps no books, does not have an annual accounting period, or has an accounting period which does not meet the requirements for a fiscal year, his taxable year shall be the calendar year. If section 441(g) applies to a taxpayer, the adoption of a fiscal year will be treated as a change in his annual accounting period under section 442. Therefore, such fiscal year can become the taxpayer's taxable year only with the approval of the Commissioner. Approval of any such change will be denied unless the taxpayer agrees in his application to establish and maintain accurate records of his taxable income for the short period involved in the change and for the fiscal year proposed. The keeping of records which adequately and clearly reflect income for the taxable year constitutes the keeping of books within the meaning of section 441(g) and § 1.441–1 (g).

(b) *Prior approval of the Commissioner.*—(1) *In general.*—In order to secure prior approval of a change of a taxpayer's annual accounting period, the taxpayer must file an application on Form 1128 with the Commissioner of Internal Revenue, Washington 25, D. C., on or before the last day of the month following the close of the short period for which a return is required to effect the change of accounting period. In general, a change of annual accounting period will be approved where the taxpayer establishes a substantial business purpose for making the change. In determining whether a taxpayer has established a substantial business purpose for making the change, consideration will be given to all the facts and circumstances relating to the change, including the tax consequences resulting thereform. If the effect of the change is to defer a substantial portion of the taxpayer's income, or to shift a substantial portion of deductions, from one year to another so as to reduce substantially the tax liability of the taxpayer, the change will ordinarily not be approved. Further, approval will ordinarily be denied if the effect of the change is to cause a similar deferral or shifting in the case of another taxpayer, such as a partner, beneficiary, etc., so as to reduce substantially such other taxpayer's tax liability. In addition, a change will ordinarily not be approved if the short period resulting from the change is one in which there is a net operating loss. Among the non-tax factors that will be considered in determining whether a substantial business purpose has been established is the effect of the change on the taxpayer's annual cycle of business activity. However, even though a substantial business purpose is not established, the Commissioner in appropriate cases may permit a husband and wife to change his or her taxable year in order to secure the benefits of section 2 (relating to tax in

case of joint return). See paragraph (e) of this section for special rule for newly married couples.

(2) *Partnerships and partners.*—(i) A newly formed partnership may adopt a taxable year which is the same as the taxable year of all its principal partners (or is the same taxable year to which its principal partners who do not have such taxable year concurrently change) without securing prior approval from the Commissioner. If all its principal partners are not on the same taxable year, a newly formed partnership may adopt a calendar year without securing prior approval from the Commissioner. If a newly formed partnership wishes to adopt a taxable year that does not qualify under the preceding two sentences, the adoption of such year requires the prior approval of the Commissioner in accordance with section 706(b)(1) and § 1.706–1(b). An existing partnership may change its taxable year without securing prior approval from the Commissioner if all its principal partners have the same taxable year to which the partnership changes, or if all its principal partners who do not have such a taxable year concurrently change to such taxable year. In any other case, an existing partnership may not change its taxable year unless it secures the prior approval of the Commissioner in accordance with paragraph (b)(1) of this section and section 706(b)(1) and § 1.706–1(b).

(ii) A partner may change his taxable year only if he secures the prior approval of the Commissioner in accordance with paragraph (b)(1) of this section.

(c) *Special rule for certain corporations.*—(1) A corporation may change its annual accounting period without the prior approval of the Commissioner if all the conditions in subparagraph (2) of this paragraph are met, and if the corporation files a statement with the district director of internal revenue with whom the returns of the corporation are filed at or before the time (including extensions) for filing the return for the short period required by such change. This statement shall indicate that the corporation is changing its annual accounting period under § 1.442–1(c) and shall contain information indicating that all of the conditions in subparagraph (2) of this paragraph have been met.

(2) The provisions of this paragraph do not apply unless all of the following conditions are met:

(i) The corporation has not changed its annual accounting period at any time within the ten calendar years ending with the calendar year which includes the beginning of the short period required to effect the change of annual accounting period;

(ii) The short period required to effect the change of annual accounting period is not a taxable year in which the corporation has a net operating loss as defined in section 172;

(iii) The taxable income of the corporation for the short period required to effect the change of annual accounting period is, if placed on an annual basis (see § 1,443–1(b)(1)(i) and (ii)), 80 percent or more of the taxable income of the corporation for the taxable year immediately preceding such short period; and

(iv) If a corporation had a special status (described in the following sentence) either for the short period or for the taxable year immediately preceding such short period, it must have the same special status for both the short period and such taxable

year. For the purpose of the preceding sentence, special status includes only: a personal holding company, a foreign personal holding company, a corporation which is an exempt organization, a foreign corporation not engaged in trade or business within the United States, a Western Hemisphere trade corporation, and a China Trade Act corporation.

(3) If the Commissioner finds upon examination of the returns that the corporation, because of subsequent adjustments in establishing tax liability, did not in fact meet all the conditions in subparagraph (2) of this paragraph, the statement filed under subparagraph (1) of this paragraph shall be considered as a timely application for permission to change the corporation's annual accounting period to the taxable year indicated in the statement.

(d) *Special rule for change of annual accounting period by subsidiary corporation.* A subsidiary corporation which is required to change its annual accounting period under § 1.1502–14, relating to the accounting period of an affiliated group which files a consolidated income tax return, may do so by filing Form 1128 with the district director with whom the consolidated return is filed. Such form shall be filed in accordance with that section. See also §§ 1.1502–13(h) and 1.1502–32.

(e) *Special rule for newly married couples.* (1) A newly married husband or wife may change his or her annual accounting period in order to adopt the annual accounting period of the other spouse so that a joint return may be filed for the first or second taxable year of such spouse ending after the date of marriage, provided that the newly married husband or wife adopting the annual accounting period of the other spouse files a return for the short period required by such change on or before the 15th day of the 4th month following the close of such short period. See section 443 and the regulations thereunder. (If the due date for any such short-period return occurs before the date of marriage, the first taxable year of the other spouse ending after the date of marriage cannot be adopted under this paragraph.) The short-period return shall contain a statement that it is filed under authoriy of § 1.442–1(e). For a change of annual accounting period by a husband or wife which does not qualify under this subparagraph, see paragraph (b) of this section.

(2) The provisions of this paragraph may be illustrated by the following example:

Example. H & W marry on September 25, 1956. H is on a fiscal year ending June 30, and W is on a calendar year. H wishes to change to a calendar year in order to file joint returns with W. W's first taxable year after marriage ends on December 31, 1956. H may not change to a calendar year for 1956 since, under § 1.442–1(e), he would have had to file a return for the short period from July 1 to December 31, 1955, by April 15, 1956. Since the date of marriage occurred subsequent to this due date, the return could not be filed under § 1.442–1(e). Therefore, H cannot change to a calendar year for 1956. However, H may change to a calendar year for 1957 by filing a return under § 1.442–1(e) by April 15, 1957, for the short period from July 1 to December 31, 1956. If H files such a return, H and W may file a joint return for calendar year 1957 (which is W's second taxable year ending after the date of marriage).

(f) *Effective date.*—The provisions of this section (other than paragraph (e) thereof) are effective for any change of annual accounting period where the last day of the short period to effect the change ends on or after the date the regulations under section 442 are published in the Federal Register.

§ 1.443 STATUTORY PROVISIONS; RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

SEC. 443. RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

(a) RETURNS FOR SHORT PERIOD.—A return for a period of less than 12 months (referred to in this section as "short period") shall be made under any of the following circumstances:

(1) CHANGE OF ANNUAL ACCOUNTING PERIOD.—When the taxpayer, with the approval of the Secretary or his delegate, changes his annual accounting period. In such a case, the return shall be made for the short period beginning on the day after the close of the former taxable year and ending at the close of the day before the day designated as the first day of the new taxable year.

(2) TAXPAYER NOT IN EXISTENCE FOR ENTIRE TAXABLE YEAR.—When the taxpayer is in existence during only part of what would otherwise be his taxable year.

(3) TERMINATION OF TAXABLE YEAR FOR JEOPARDY.—When the Secretary or his delegate terminates the taxpayer's taxable year under section 6851 (relating to tax in jeopardy).

(b) COMPUTATION OF TAX ON CHANGE OF ANNUAL ACCOUNTING PERIOD—

(1) GENERAL RULE.—If a return is made under paragraph (1) of subsection (a), the taxable income for the short period shall be placed on an annual basis by multiplying such income by 12 and dividing the result by the number of months in the short period. The tax shall be the same part of the tax computed on the annual basis as the number of months in the short period is of 12 months.

(2) EXCEPTION

(A) COMPUTATION BASED ON 12-MONTH PERIOD.—If the taxpayer applies for the benefits of this paragraph and establishes the amount of his taxable income for the 12-month period described in subparagraph (B), computed as if that period were a taxable year and under the law applicable to that year, then the tax for the short period, computed under paragraph (1), shall be reduced to the greater of the following:

(i) An amount which bears the same ratio to the tax computed on the taxable income for the 12-month period as the taxable income computed on the basis of the short period bears to the taxable income for the 12-month period; or

(ii) The tax computed on the taxable income for the short period without placing the taxable income on an annual basis.

The taxpayer (other than a taxpayer to whom subparagraph (B) (ii) applies) shall compute the tax and file his return without the application of this paragraph.

(B) 12-MONTH PERIOD.—The 12-month period referred to in subparagraph (A) shall be—

(i) The period of 12 months beginning on the first day of the short period, or

(ii) The period of 12 months ending at the close of the last day of the short period, if at the end of the 12 months referred to in clause (i) the taxpayer is not in existence or (if a corporation) has theretofore disposed of substantially all of its assets.

(C) APPLICATION FOR BENEFITS.—Application for the benefits of this paragraph shall be made in such manner and at such time as the regulations prescribed under subparagraph (D) may require; except that the time so prescribed shall not be later than the time (including extensions) for filing the return for the first taxable year which ends on or after the day which

is 12 months after the first day of the short period. Such application, in case the return was filed without regard to this paragraph, shall be considered a claim for credit or refund with respect to the amount by which the tax is reduced under this paragraph.

(D) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary for the application of this paragraph.

(c) ADJUSTMENT IN DEDUCTION FOR PERSONAL EXEMPTION.—In the case of a taxpayer other than a corporation, if a return is made for a short period by reason of subsection (a)(1) and if the tax is not computed under subsection (b)(2), then the exemptions allowed as a deduction under section 151 (and any deduction in lieu thereof) shall be reduced to amounts which bear the same ratio to the full exemptions as the number of months in the short period bears to 12.

(d) CROSS REFERENCES.—For inapplicability of subsection (b) in computing—

(1) Accumulated earnings tax, see section 536.

(2) Personal holding company tax, see section 546.

(3) Undistributed foreign personal holding company income, see section 557.

(4) The taxable income of a regulated investment company, see section 852(b)(2)(E).

§ 1.443–1 RETURNS FOR PERIODS OF LESS THAN 12 MONTHS.—(a) *Returns for short period.*—A return for a short period, that is, for a taxable year consisting of a period of less than 12 months, shall be made under any of the following circumstances:

(1) *Change of annual accounting period.*—In the case of a change in the annual accounting period of a taxpayer, a separate return must be filed for the short period of less than 12 months beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year. However, such a return is not required for a short period of six days or less, or 359 days or more, resulting from a change from or to a 52–53-week taxable year. See section 441(f) and § 1.441–2. The computation of the tax for a short period required to effect a change of annual accounting period is described in paragraph (b) of this section. In general, a return for a short period resulting from a change of annual accounting period shall be filed and the tax paid within the time prescribed for filing a return for a taxable year of 12 months ending on the last day of the short period. For a subsidiary corporation required to change its annual accounting period under § 1.1502–14, see §§ 1.1502–13, 1.1502–32, and 1.442–1(d).

(2) *Taxpayer not in existence for entire taxable year.*—If a taxpayer is not in existence for the entire taxable year, a return is required for the short period during which the taxpayer was in existence. For example, a corporation organized on August 1 and adopting the calendar year as its annual accounting period is required to file a return for the short period from August 1 to December 31, and returns for each calendar year thereafter. Similarly, a dissolving corporation which files its returns for the calendar year is required to file a return for the short period from January 1 to the date it goes out of existence. Income for the short period is not required to be annualized if the taxpayer is not in existence for the entire taxable year, and, in the case of a taxpayer other than a corporation, the deduction under section 151 for personal exemptions (or deductions in lieu thereof) need not be reduced under section 443(c). In general, the requirements with

respect to the filing of returns and the payment of tax for a short period where the taxpayer has not been in existence for the taxable year are the same as for the filing of a return and the payment of tax for a taxable year of 12 months ending on the last day of the short period. Although the return of a decedent is a return for the short period beginning with the first day of his last taxable year and ending with the date of his death, the filing of a return and the payment of tax for a decedent may be made as though the decedent had lived throughout his last taxable year.

(3) *Termination of taxable year for jeopardy.*—A return must be filed for a short period resulting from the termination by the Commissioner of a taxpayer's taxable year for jeopardy. See section 6851 and the regulations thereunder.

(b) *Computation of tax for short period on change of annual accounting period.*—(1) *General rule.*—(i) If a return is made for a short period resulting from a change of annual accounting period, the taxable income for the short period shall be placed on an annual basis by multiplying such income by 12 and dividing the result by the number of months in the short period. Unless section 443(b)(2) and subparagraph (2) of this paragraph apply, the tax for the short period shall be the same part of the tax computed on the annual basis as the number of months in the short period is of 12 months.

(ii) If a return is made for a short period of more than 6 days, but less than 359 days, resulting from a change from or to a 52–53-week taxable year, the taxable income for the short period shall be annualized and the tax computed on a daily basis, as provided in section 441(f)(2)(B)(iii) and § 1.441-2(c)(5).

(iii) For method of computation of income for a short period in the case of a subsidiary corporation required to change its annual accounting period to conform to that of its parent, see §§ 1.1502-32 and 1.1502-14.

(iv) An individual taxpayer making a return for a short period resulting from a change of annual accounting period is not allowed to take the standard deduction provided in section 141 in computing his taxable income for the short period. See section 142(b)(3).

(v) In computing the taxable income of a taxpayer other than a corporation for a short period (which income is to be annualized in order to determine the tax under section 443(b)(1)) the personal exemptions allowed individuals under section 151 (and any deductions allowed other taxpayers in lieu thereof, such as the deduction under section 642(b)) shall be reduced to an amount which bears the same ratio to the full amount of the exemptions as the number of months in the short period bears to 12. In the case of the taxable income for a short period resulting from a change from or to a 52–53-week taxable year to which section 441(f)(2)(B)(iii) applies, the computation required by the preceding sentence shall be made on a daily basis, that is, the deduction for personal exemptions (or any deduction in lieu thereof) shall be reduced to an amount which bears the same ratio to the full deduction as the number of days in the short period bears to 365.

(vi) If the amount of a credit against the tax (for example, the credits allowable under sections 34 and 35 for dividends received and for partially tax-exempt interests, respectively) is depednent upon the amount of any item of income or deduction, such credit shall be

computed upon the amount of the item annualized separately in accordance with the foreging rules. The credit so computed shall be treated as a credit against the tax computed on the basis of the annualized taxable income. In any case in which a limitation on the amount of a credit is based upon taxable income, taxable income shall mean the taxable income computed on the annualized basis.

(vii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A taxpayer with one dependent who has been granted permission under section 442 to change his annual accounting period files a return for the short period of 10 months ending October 31, 1956. He has income and deductions as follows:

INCOME	
Interest income	$10,000.00
Partially tax-exempt interest with respect to which a credit is allowable under section 35	500.00
Dividends to which section 34 and 116 are applicable	750.00
	$11,250.00
DEDUCTIONS	
Real estate taxes	200.00
2 personal exemptions at $600 on an annual basis	1,200.00

The tax for the 10-month period is computed as follows:

Total income as above			$11,250.00
Less:			
Exclusion for dividends received	$50.00		
2 personal exemptions ($1,200×10/12)	1,000.00		
Real estate taxes	200.00		
			1,250.00
Taxable income for 10-month period before annualizing			$10,000.00
Taxable income annualized ($10,000×12/10)			$12,000.00
Tax on $12,000 before credits			$3,400.00
Deduct credits:			
Dividends received for 10-month period	$750.00		
Less: Excluded portion	50.00		
Included in gross income	$700.00		
Dividend income annualized ($700×12/10)	840.00		
Credit (4% of $840)		$33.60	
Partially tax-exempt interest included in gross income for 10-month period	$500.00		
Partially tax-exempt interest (annualized) ($500×12/10)	600.00		
Credit (3% of $600)		18.00	
			51.60
Tax on $12,000 (after credits)			$3,348.40
Tax for 10-month period ($3,348.40×10/12)			$2,790.33

Example (2). The X Corporation makes a return for the one-month period ending September 30, 1956, because of a change in annual accounting period permitted under section 442. Income and expenses for the short period are as follows:

Gross operating income	$126,000
Business expenses	130,000
Net loss from operations	$(4,000)
Dividends received from taxable domestic corporations	30,000

Gross income for short period before annualizing		$26,000
Dividends received deduction (85% of $30,000, but not in excess of 85% of $26,000)		22,100
Taxable income for short period before annualizing		$3,900
Taxable income annualized ($3,900×12)		$46,800
Tax on annual basis: $46,800 at 52%	$24,336	
Less surtax exemption	5,500	
		$18,836
Tax for one-month period ($18,836×1/12)		$1,570

Example (*3*). The Y Corporation makes a return for the six-month period ending June 30, 1957, because of a change in annual accounting period permitted under section 442. Income for the short period is as follows:

Taxable income exclusive of net long-term capital gain	$40,000	
Net long-term capital gain	10,000	
Taxable income for short period before annualizing	$50,000	
Taxable income annualized ($50,000×12/6)		$100,000
REGULAR TAX COMPUTATION:		
Taxable income annualized		$100,000
Tax on annual basis:		
$100,000 at 52 percent	$52,000	
Less surtax exemption	5,500	
		$46,500
Tax for 6-month period ($46,500×6/12)		$23,250
ALTERNATIVE TAX COMPUTATION:		
Taxable income annualized		$100,000
Less annualized capital gain ($10,000×12/6)		20,000
Annualized taxable income subject to partial tax		$80,000
PARTIAL TAX ON ANNUAL BASIS:		
$80,000 at 52 percent	$41,600	
Less surtax exemption	5,500	
		$36,100
25% of annualized capital gain ($20,000)		5,000
Alternative tax on annual basis		$41,100
Alternative tax for 6-month period ($41,100×6/12)		$20,550

Since the alternative tax of $20,550 is less than the tax computed in the regular manner ($23,250), the corporation's tax for the 6-month short period is $20,550.

(2) *Exception: computation based on 12-month period.*—(i) A taxpayer whose tax would otherwise be computed under section 443(b)(1) (or section 441(f)(2)(B)(iii) in the case of certain changes from or to a 52–53-week taxable year) for the short period resulting from a change of annual accounting period may apply to the district director to have his tax computed under the provisions of section 443(b)(2) and this subparagraph. If such application is made, as provided in subdivision (v) of this subparagraph, and if the taxpayer

establishes the amount of his taxable income for the 12-month period described in subdivision (ii) of this subparagraph, then the tax for the short period shall be the greater of the following—

(*a*) An amount which bears the same ratio to the tax computed on the taxable income which the taxpayer has established for the 12-month period as the taxable income computed on the basis of the short period bears to the taxable income for such 12-month period; or

(*b*) The tax computed on the taxable income for the short period without placing the taxable income on an annual basis.

However, if the tax computed under section 443(b)(2) and this subparagraph is not less than the tax for the short period computed under section 443(b)(1) (or section 441(f)(2)(B)(iii) in the case of certain changes from or to a 52–53-week taxable year), then section 443(b)(2) and this subparagraph do not apply.

(ii) The term "12-month period" referred to in subdivision (i) of this subparagraph means the 12-month period beginning on the first day of the short period. However, if the taxpayer is not in existence at the end of such 12-month period, or if the taxpayer is a corporation which has disposed of substantially all of its assets before the end of such 12-month period, the term "12-month period" means the 12-month period ending at the close of the last day of the short period. For the purposes of the preceding sentence, a corporation which has ceased business and distributed so much of the assets used in its business that it cannot resume its customary operations with the remaining assets, will be considered to have disposed of substantially all of its assets. In the case of a change from a 52–53-week taxable year, the term "12-month period" means the period of 52 or 53 weeks (depending on the taxpayer's 52–53-week taxable year) beginning on the first day of the short period.

(iii) (*a*) The taxable income for the 12-month period is computed under the same provisions of law as are applicable to the short period and is computed as if the 12-month period were an actual annual accounting period of the taxpayer. All items which fall in such 12-month period must be included even if they are extraordinary in amount or of an unusual nature. If the taxpayer is a member of a partnership, his taxable income for the 12-month period shall include his distributive share of partnership income for any taxable year of the partnership ending within or with such 12-month period, but no amount shall be included with respect to a taxable year of the partnership ending before or after such 12-month period. If any other item partially applicable to such 12-month period can be determined only at the end of a taxable year which includes only part of the 12-month period, the taxpayer, subject to review by the Commissioner, shall apportion such item to the 12-month period in such manner as will most clearly reflect income for the 12-month period.

(*b*) In the case of a taxpayer permitted or required to use inventories, the cost of goods sold during a part of the 12-month period included in a taxable year shall be considered, unless a more exact determination is available, as such part of the cost of goods sold during the entire taxable year as the gross receipts from sales for such part of the 12-month period is of the gross receipts from sales for the entire taxable year. For example, the 12-month period of a

corporation engaged in the sale of merchandise, which has a short period from January 1, 1956, to September 30, 1956, is the calendar year 1956. The three-month period, October 1, 1956, to December 31, 1956, is part of the taxpayer's taxable year ending September 30, 1957. The cost of goods sold during the three-month period, October 1, 1956, to December 31, 1956, is such part of the cost of goods sold during the entire fiscal year ending September 30, 1957, as the gross receipts from sales for such three-month period are of the gross receipts from sales for the entire fiscal year.

(*c*) The Commissioner may, in granting permission to a taxpayer to change his anual accounting period, require, as a condition to permitting the change, that the taxpayer must take a closing inventory upon the last day of the 12-month period if he wishes to obtain the benefits of section 443(b)(2). Such closing inventory will be used only for the purposes of section 443(b)(2), and the taxpayer will not be required to use such inventory in computing the taxable income for the taxable year in which such inventory is taken.

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

Example (1). The taxpayer in example (1) under paragraph (b)(1) establishes his taxable income for the 12-month period from January 1, 1956, to December 31, 1956. The taxpayer has a short period of 10 months, from January 1, 1956, to October 31, 1956. The taxpayer files an application in accordance with subdivision (v) of this subparagraph to compute his tax under section 443(b)(2). The taxpayer's income and deductions for the 12-month period, as so established, follow:

INCOME		
Interest income		$11,000
Partially tax-exempt interest with respect to which a credit is allowable under section 35		600
Dividends to which sections 34 and 116 are applicable		850
		$12,450
DEDUCTIONS		
Real estate taxes		$200
2 personal exemptions at $600		1,200
TAX COMPUTATION FOR SHORT PERIOD UNDER SECTION 443(b)(2)(A)(i)		
Total income as above		$12,450
Less:		
Exclusion for dividends received	$50	
Personal exemptions	1,200	
Deduction for taxes	200	1,450
Taxable income for 12-month period		$11,000
Tax before credits		$3,020
Credit for partially tax-exempt interest (3% of $600)	$18	
Credit for dividends received (4% of ($850—50))	32	50
Tax under section 443(b)(2)(A)(i) for 12-month period		$2,970
Taxable income for 10-month short period from example (1) of paragraph (b)(1) before annualizing		$10,000
Tax for short period under section 443(b)(2)(A)(i) ($2,970×$10,000 (taxable income for short period)/$11,000 (taxable income for 12-month period))		$2,700

TAX COMPUTATION FOR SHORT PERIOD UNDER SECTION 443(b)(2)(A)(ii)		
Total income for 10-month short period		$11,250
Less:		
Exclusion for dividends received	$50	
2 personal exemptions	1,200	
Real estate taxes	200	1,450
Taxable income for short period without annualizing and without proration of personal exemptions		$9,800
Tax before credits		$2,572
Less credits:		
Partially tax-exempt interest (3% of $500)	$15	
Dividends received (4% of ($750—50))	28	43
Tax for short period under section 443(b)(2)(A)(ii)		$2,529

The tax of $2,700 computed under section 443(b)(2)(A)(i) is greater than the tax of $2,529, computed under section 443(b)(2)(A)(ii), and is, therefore, the tax under section 443(b)(2). Since the tax of $2,700 (computed under section 443(b)(2)) is less than the tax of $2,790.33 (computed under section 443(b)(1)) on the annualized income of the short period (see example (1) of paragraph (b)(1)), the taxpayer's tax for the 10-month short period is $2,700.

Example (2). Assume the same facts as in example (1) of this subdivision, except that, during the month of November 1956, the taxpayer suffered a casualty loss of $5,000. The tax computation for the short period under section 443(b)(2) would be as follows:

TAX COMPUTATION FOR SHORT PERIOD UNDER SECTION 443(b)(2)(A)(i)		
Taxable income for 12-month period from example (1)		$11,000
Less: Casualty loss		5,000
Taxable income for 12-month period		$6,000
Tax before credits	$1,360	
Credits from example (1)	50	
Tax under section 443(b)(2)(A)(i) for 12-month period		$1,310
Tax for short period ($1,310 × $10,000/$6,000) under section 443(b)(2)(A)(i)		$2,183

TAX COMPUTATION FOR SHORT PERIOD UNDER SECTION 443(b)(2)(A)(ii)		
Total income for the short period		$11,250
Less:		
Exclusion for dividends received	$50	
2 personal exemptions	1,200	
Real estate taxes	200	1,450
Taxable income for short period without annualizing and without proration of personal exemptions		$9,800
Tax before credits		2,572
Less credits:		
Partially tax-exempt interest (3% of $500)	$15	
Dividends received (4% of ($750—50))	28	43
Tax for short period under section 443(b)(2)(A)(ii)		$2,529

The tax of $2,529, computed under section 443(b)(2)(A)(ii) is greater than the tax of $2,183 computed under section 443(b)(2)(A)(i) and is, therefore, the tax under section 443(b)(2). Since this tax is less than the tax of $2,790.33 computed under section 443(b)(1)

(see example (1) of paragraph (b)(1)), the taxpayer's tax for the 10-month short period is $2,529.

(v) (*a*) A taxpayer who wishes to compute his tax for a short period resulting from a change of annual accounting period under section 443(b)(2) must make an application therefor. Except as provided in subdivision (*b*), the taxpayer shall first file his return for the short period and compute his tax under section 443(b)(1). The application for the benefits of section 443(b)(2) shall subsequently be made in the form of a claim for credit or refund. The claim shall set forth the computation of the taxable income and the tax thereon for the 12-month period and must be filed not later than the time (including extensions) prescribed for filing the return for the taxpayer's first taxable year which ends on or after the day which is 12 months after the beginning of the short period. For example, assume that a taxpayer changes his annual accounting period from the calendar year to a fiscal year ending September 30, and files a return for the short period from January 1, 1956, to September 30, 1956. His application for the benefits of section 443(b)(3) must be filed not later than the time prescribed for filing his return for his first taxable year which ends on or after the last day of December 1956, the twelfth month after the beginning of the short period. Thus, the taxpayer must file his application not later than the time prescribed for filing the return for his fiscal year ending September 30, 1957. If he obtains an extension of time for filing the return for such fiscal year, he may file his application during the period of such extension. If the district director determines that the taxpayer has established the amount of his taxable income for the 12-month period, any excess of the tax paid for the short period over the tax computed under section 443(b)(2) will be credited or refunded to the taxpayer in the same manner as in the case of an overpayment.

(*b*) If at the time the return for the short period is filed, the taxpayer is able to determine that the 12-month period ending with the close of the short period (see section 443(b)(2)(B)(ii) and subparagraph (2)(ii) of this paragraph) will be used in the computations under section 443(b)(2), then the tax on the return for the short period may be determined under the provisions of section 443(b)(2). In such case, a return covering the 12-month period shall be attached to the return for the short period as a part thereof, and the return and attachment will then be considered as an application for the benefits of section 443(b)(2).

(c) *Adjustment in deduction for personal exemption.* For adjustment in the deduction for personal exemptions in computing the tax for a short period resulting from a change of annual accounting period under section 443(b)(1) (or under section 441(f)(2)(B)(iii) in the case of certain changes from or to a 52–53-week taxable year), see paragraph (b)(1)(v) of this section.

(d) *Cross references.*—For inapplicability of section 443(b) and paragraph (b) of this section in computing—

(1) Accumulated earnings tax, see section 536 and the regulations thereunder;

(2) Personal holding company tax, see section 546 and the regulations thereunder;

(3) Undistributed foreign personal holding company income, see section 557 and the regulations thereunder; and

(4) The taxable income of a regulated investment company, see section 882(b)(2)(E) and the regulations thereunder.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved February 26, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on February 27, 1957, at 8:59 a. m., and published in the issue of the Federal Register for March 1, 1957, 22 F. R. 1287.)

SECTION 442.—CHANGE OF ANNUAL ACCOUNTING PERIOD

26 CFR 1.442: Statutory provisions; change of annual accounting period.

Regulations under the Internal Revenue Code of 1954. See T. D. 6226, page 172.

SECTION 443.—RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS

26. CFR 1.443: Statutory provisions; returns for a period of less than 12 months.

Regulations under the Internal Revenue Code of 1954. See T. D. 6226, page 172.

PART II.—METHODS OF ACCOUNTING

SUBPART A.—METHODS OF ACCOUNTING IN GENERAL

SECTION 446.—GENERAL RULE FOR METHODS OF ACCOUNTING

Rev. Rul. 57-166

Applicant of Mimeograph 6475, C. B. 1950-1, 50, to capital gains and losses incurred over a period of years in a foreign country having monetary or exchange restrictions.
Mimeograph 6475, *supra*, clarified.

Advice has been requested as to the treatment for Federal income tax purposes of capital gains and losses allocable to blocked foreign income the reporting of which as taxable income has been deferred under the provisions of Mimeograph 6475, C. B. 1950-1, 50.

The taxpayer, a United States citizen previously residing in England, has resumed residence in the United States. After he gave up his English residence, he was able from time to time to convert certain of his blocked sterling assets into United States dollars. Included in the converted assets are amounts representing net gains resulting from a series of transactions occurring over a period of some ten years

involving both long-term capital gains and long and short-term capital losses.

It has been questioned whether, upon conversion of the blocked sterling assets, there shall be treated as taxable long-term capital gain that proportion of each dollar realized at the date of conversion which the suspended net long-term capital gain (consisting of total long-term capital gains reduced by total long and short-term capital losses) bears to the total of such blocked sterling assets taken at book value.

Mimeograph 6475, *supra*, is primarily concerned with the time of reporting income arising in countries having monetary or exchange restrictions. It provides a method of accounting pursuant to which the reporting of "deferable income" may be postponed until the income ceases to be "deferable income," at which time it is includible in gross income. The Mimeograph provides that, for the taxable year in which any "deferable income" is includible in gross income under the method provided for, the taxpayer shall include such income in gross income and claim the deductions allocable thereto, the income thus reported together with such deductions to be verified against the returns of deferable income previously filed. It is provided that expenses paid or accrued or incurred in the currency of the country in which there is deferable income will be deductible in any subsequent taxable year in the same proportion as the deferable income is includible in gross income. The same treatment is accorded to depreciation, obsolescence and depletion measured in terms of such currency.

Paragraph 8 of Mimeograph 6475, *supra,* provides that, where the taxpayer adopts the method of accounting provided for by the Mimeograph, losses shall also be taken into account under the rules for deferment stated therein. The question is, then, whether the "losses" referred to in this case, which may be taken into account under the rules for deferment, include capital losses. The intention of the Mimeograph is to defer such deductions as are generally allocable to the deferred income. Thus, losses incurred in the production of deferable income, as, for instance, losses incurred in carrying on a trade or business, would be deferred if the income from such business is deferred. On the other hand, a capital loss from the sale of securities, as in the present case, has no direct relation to the production of deferable income and is not attributable to income from any other operation. The recognition of capital losses is a matter of statutory grace, and the extent to which such losses may be taken into account is expressly limited by the provision of section 1211 (b) of the Internal Revenue Code of 1954, that section provides that, in the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets are allowable only to the extent of the gains from such sales or exchanges, plus the taxable income of the taxpayer or $1,000.00, whichever is smaller. The Mimeograph does not expressly authorize the deferment of capital losses, and it should not be so construed, since to do so would in effect amount to the allowance of the deduction of losses which the Internal Revenue Code does not recognize.

Subchapter P of Chapter 1 of the Internal Revenue Code of 1954 applies to all capital gains and losses of a particular taxpayer for a particular year wherever such gain or losses may be incurred. In the case of a particular taxpayer who has capital gains and losses in a foreign country and is subject to Mimeograph 6475, *supra*, the capi-

tal losses for each year from both foreign and domestic sources should be applied against the capital gains from all sources in accordance with the statute, computing the foreign gains and losses in terms of the foreign currency and then translating the result into terms of United States currency at the official rate of exchange at the time of sale. If the net result of the transaction of the particular year is a loss, such loss should be reflected in his regular return for that year and may be carried forward as provided in the statute but not otherwise. Section 1212 of the Internal Revenue Code of 1954. If the net result is a gain, then such gain, to the extent it is derived in the United States, must be included in his regular return. To the extent the gain is derived in the foreign country, it may properly be considered as "deferable income" within the meaning of Mimeograph 6475, *supra.*

Accordingly, it is held, that in determining the amount of the taxpayer's income which has ceased to be deferable in any taxable year, a proportionate part of the convertible blocked assets is considered unblocked capital gains and a proportionate part is considered return of capital. The proportionate parts shall be in the same ratio that the total blocked capital gains, computed in accordance with the foregoing paragraphs, bear to the total blocked assets.

Mimeograph 6475, *supra*, is hereby clarified.

SUBCHAPTER C.—TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

(Also Part II, Section 43; Regulations 118, Section 39.43–2) Rev. Rul. 57–28

In Revenue Ruling 56–315, C. B. 1956–2, 304, the Internal Revenue Service stated that the provisions of Revenue Ruling 54–608, C. B. 1954–2, page 8, relating to the accrual of vacation pay, would not be applicable to taxable years ending prior to January 1, 1957. Under authority of section 7805(b) of the Internal Revenue Code of 1954, the inapplicability of Revenue Ruling 54–608 is hereby further extended for a period of six months and, accordingly, that ruling will not be applicable to taxable years ending prior to July 1, 1957.

Rev. Rul. 57–105

In the case of an accrual method taxpayer, an increase in the amount of State tax accrues and is allowable as a deduction for Federal income tax purposes when the amount is finally determined by litigation, or default, or when the taxpayer acknowledges his liability to the State for the amount of such increase.

G. C. M. 25298, C. B. 1947–2, 39 amplified.

The Internal Revenue Service has been requested to state its position respecting the time for accrual for Federal income tax purposes of additional State income taxes asserted against a taxpayer for prior years.

The general rule applicable to taxpayers who keep their accounts and file their returns on the accrual method is that expenses should

be accrued and deducted in the year in which the liability therefor is incurred. The courts have continuously expressed the view that all events must occur to fix a liability of the obligor before an obligation can be recognized by acrual on a taxpayers' books of account. *United States* v. *Chauncey Anderson et al*, 269, U. S. 422, T. D. 3839, C. B. V-1, 179 (1926).

Thus, an obligation is considered contigent when the existence of any liability at all is uncertain or when its existence depends upon the happening of a future contingent event. When a taxpayer disagrees with the determination of an additional tax liability, he is in effect disputing or contesting the existence of such additional liability. Therefore, until the contingency disappears and the fact of the additional liability becomes fixed and certain, there can be no accrual for tax purposes of the additional tax liability.

In G. C. M. 25298, C. B. 1947-2, 39, the term "contest" was held to include a contest lodged with the tax authorities as well as a contest in court. Therefore, unpaid amounts asserted against a taxpayer as additional tax liabilities, which amounts are the subject of a bona fide contest, are not accruable items for Federal income tax purposes while they are unsettled as to amount and prior to establishment of the fact of liability.

A "contest" arises any time there is a dipute as to the proper evaluation of the facts necessary to determine the correct tax liability. The soundness of this position is supported by the holding in the case of *Great Island Holding Corp.* v. *Commissioner*, 5 T. C. 150, cited with approval in *Gunderson Bros. Engineering Corp.* v. *Commissioner*, 16 T. C. 118.

The rationale of Gunderson Bros. Engineering Corp., *supra*, is that where a taxpayer files with the State taxing authorities a return reflecting only x dollars tax liability, the taxpayer is in effect denying any greater tax liability. At such time as the taxpayer properly recognizes or concedes a liability to the State for taxes in a greater amount than x dollars, the taxpayer is entitled to an accrual for the additional amount. Thus, an agreement between the taxpayer and the Internal Revenue Service with respect to the taxpayer's income for Federal income tax purposes is not necessarily determinative of the taxpayer's income for State tax purposes. It follows that a taxpayer is not entitled to accrue as additional tax liability an amount of State tax until the fact of liability is established and the amount thereof is settled.

Accordingly, in the case of an accrual method taxpayer, an increase in the amount of the State tax accrues and is allowable as a deduction for Federal income tax purposes when the amount is finally determined by litigation or default, or when the taxpayer acknowledges his liability to the State for the amount of such increase.

Pursuant to the authority granted by section 7805(b) of the Internal Revenue Code of 1954, the tax liability for taxable years ended prior to May 1, 1957, shall not be adjusted to apply this Revenue Ruling unless such adjustment is requested by the taxpayer in a timely claim for refund.

When the Federal excise tax on transportation of oil by pipeline is deductible by a carrier whose records are kept on the accural basis. See Rev. Rul. 57-148, page 409.

SUBPART D.—INVENTORIES

SECTION 472.—LAST-IN, FIRST-OUT INVENTORIES

Rev. Rul. 57–180

Price indexes for January 1957, published by the Bureau of Labor Statistics on March 5, 1957, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for January 1957, published by the Bureau of Labor Statistics on March 5, 1957, 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 December 31, 1956 and January 31, 1957.

Indexes are given on a national basis for the store total, for 20 major groups of departments, and for two special group combinations. The store total includes all departments in the store, both those listed in the groups and those not specifically listed, except for candy, foods, liquor, tobacco, and paints and wall paper. Contract departments are also excluded.

Bureau of Labor Statistics, Department Store Inventory Price Indexes, By Groups

[January 1941=100]

Department group	Jan. 1956	Jan. 1957	Percent change from Jan. 1956 to Jan. 1957
I Piece goods	200. 2	199. 4	−0. 4
II Domestics and draperies	189. 3	194. 2	+2. 6
III Women's and children's shoes	220. 8	233. 6	+5. 8
IV Men's and boys' shoes	217. 5	228. 3	+5. 0
V Infants' wear	171. 2	174. 5	+1. 9
VI Women's underwear	169. 7	172. 3	+1. 5
VII Women's and girls' hosiery	164. 8	163. 1	−1. 0
VIII Women's and girls' accessories	172. 1	175. 4	+1. 9
IX Women's outerwear and girls' wear	179. 1	180. 4	+. 7
X Men's clothing	206. 4	211. 2	+2. 3
XI Men's furnishings	197. 3	199. 9	+1. 3
XII Boys'clothing and furnishings	202. 2	205. 9	+1. 8
XIII Jewelry	165. 6	168. 9	+2. 0
XIV Notions	158. 6	162. 1	+2. 2
XV Toilet articles and drugs	172. 1	178. 6	+3. 8
XVI Furniture and bedding	211. 9	218. 1	+2. 9
XVII Floor covering	189. 9	192. 0	+1. 1
XVIII Housewares	201. 5	213. 9	+6. 2
XIX Major appliances	143. 4	141. 7	−1. 2
XX Radios and television sets	139. 5	138. 8	−. 5
Total: Groups I–XV	188. 0	192. 0	+2. 1
Total: Groups XVI–XX	187. 9	193. 1	+2. 8
Store total	187. 9	192. 3	+2. 3

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

SECTION 501.—EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

Rev. Rul. 57-52

A corporation organized for the purpose of promoting and conducting home shows, the net earnings of which inures to the benefit of a county recreational board in the form of rent for the use of its premises, is not exempt from Federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether a corporation is entitled to exemption from Federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1954, under the circumstances set forth below.

The corporation in the instant case was organized for the purpose of promoting and conducting an annual home show. The show consists of exhibitors' booths which are rented to manufacturing, mercantile, and building supply organizations. The show is conducted on premises which are under the jurisdiction of a county recreation board. An admission fee is charged the general public for attending the show. All of the net income realized, minus a reserve for making preliminary plans and starting the show for the following year, is turned over to the county recreation board to be used for the purpose of operating and maintaining its playgrounds and recreational facilities. Payments to the board vary with the amount of profit made by each show and are received as rental for the use of its premises.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations which are exempt from Federal income tax under section 501(a) of the Code and reads, in part, as follows:

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

In order to qualify for exemption under the above cited provision of the law, an organization must be both organized and operated exclusively for one or more of the purposes specified therein. Where an organization's only activity is that of conducting a business which is ordinarily carried on for profit, it is not operated for charitable or any other purpose specified in section 501 (c) (3), not withstanding the fact that all of its profits are payable to a public body or corporate instrumentality for exclusively public purposes. See section 502 of the Code. This is true whether the payments are made in the form of rent or as direct contributions.

In view of the foregoing, it is held that a corporation organized for the purpose of promoting and conducting home shows, the net

earnings of which inure to the benefit of a county recreational board in the form of rent for the use of its premises, is not exempt from Federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1954.

Rev. Rul. 57-61

An organization which furnishes transportation for medical care and services for its members and their families qualifies for exemption from Federal income tax as an organization (voluntary employees' beneficiary association) described in section 501(c)(9) of the Internal Revenue Code of 1954, provided no part of its net earnings inures to the benefit of any private shareholder or individual and 85 percent or more of its 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 payments for transportation for medical care and meeting expenses.

Advice has been requested whether an organization which furnishes transportation for medical care and services for the members of a designated labor union and their families qualifies for exemption from Federal income tax under section 501(c)(9) of the Internal Revenue Code of 1954 as a voluntary employees' beneficiary association.

The instant organization was formed by employees or as a result of collective bargaining for the purpose of furnishing transportation for medical care and services for the members of a designated labor union and their families. Receipts are derived from contributions and collections by drivers from members. Funds are expended for wages, car expenses, taxes, office supplies, interest, insurance and miscellaneous supplies. No part of the net income inures to the benefit of any private shareholder or individual and 85 percent or more of its income is received from members and contributions by their employer.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations exempt from Federal income tax under section 501(a) and provides 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.

The transportation of members of the union and their families for medical care and services may reasonably be considered as such "other benefits" within the contemplation of section 501(c)(9) of the Internal Revenue Code of 1954. Accordingly, it is held that an organization which furnishes such services for its members and their families qualifies for exemption from Federal income tax as an organization (voluntary employees' beneficiary association) described in section 501(c)(9) of the 1954 Code, provided no part of its net earnings inures to the benefit of any private shareholder or individual and 85 percent or more of its 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 payments for transportation for medical care and meeting expenses.

SECTION 503.—REQUIREMENTS FOR EXEMPTION

Procedure as to the issuance, by the National Office, of registered notification letters with respect to prohibited transactions. See Rev. Proc. 57–5, page 727.

SUBCHAPTER H.—BANKING INSTITUTIONS

PART I.—RULES OF GENERAL APPLICATION TO BANKING INSTITUTIONS

SECTION 582.—BAD DEBT AND LOSS DEDUCTION WITH RESPECT TO SECURITIES HELD BY BANKS

26 CFR 1.582–1: Bad debt and loss deduction with respect to securities held by bank.

Treatment of losses from transactions in bonds by member banks of an affiliated group filing a consolidated return. See Rev. Rul. 57–167, page 294.

SECTION 584.—COMMON TRUST FUNDS

26 CFR 1.584–1: Common trust funds.

Consolidated funds of separate and individual trusts providing unemployment and other benefits to employees. See Rev. Rul. 57–37, page 18.

PART II.—MUTUAL SAVINGS BANK, ETC.

SECTION 591.—DEDUCTION FOR DIVIDENDS PAID ON DEPOSITS

(Also Sections 316, 331; 26 CFR 1.316–1, 1.331–1.) Rev. Rul. 57–39

> Undistributed earnings of a domestic building and loan association distributed in complete liquidation to the holders of withdrawable shares in the association are not deductible by the association as dividends paid within the meaning of section 591 of the Internal Revenue Code of 1954, in computing its taxable income for the year of liquidation. However, amounts paid or credited to shareholders prior to formal action to liquidate, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw, may be deducted by the association in accordance with section 591 of the Code.

Advice has been requested whether undistributed earnings of a domestic building and loan association distributed in complete liquidation to the holders of withdrawable shares in the association may be deducted by the association as dividends paid within the meaning of section 591 of the Internal Revenue Code of 1954, in computing its taxable income for the year of liquidation.

A domestic building and loan association, which had outstanding several types of withdrawable shares of capital stock, liquidated in

1955. All of the undistributed earnings and profits of the association were distributed to its shareholders during that year. Such distributions were held to represent amounts received by the shareholders as full payment in exchange for their shares of stock in the association, as provided in section 331 of the Code, and the gain or loss on the liquidation was held to fall within the provisions of section 1001 of the Code.

Section 591 of the Code provides that mutual savings banks, cooperative banks, and domestic building and loan associations may deduct from gross income amounts which during the year are paid to or credited to the accounts of depositors or holders of accounts as dividends on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject to customary notice of intention to withdraw. The term "dividends" is defined in section 1.316–1(a)(1) of the Income Tax Regulations as meaning any distribution of property made by a corporation to its shareholders in the ordinary course of business out of earnings and profits accumulated after February 28, 1913, or out of its earnings and profits of the taxable year. Such distributions, therefore, do not include distributions in liquidation under section 331 of the Code, which are to be treated by the shareholders as received in full payment in exchange for their stock.

Accordingly, it is held that undistributed earnings of a domestic building and loan association distributed in complete liquidation to the holders of withdrawable shares in the association are not deductible by the association as dividends paid within the meaning of section 591 of the Code in computing its taxable income for the year of liquidation. However, amounts paid or credited to shareholders prior to formal action to liquidate, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw, may be deducted by the association in accordance with section 591 of the Code.

SUBCHAPTER I.—NATURAL RESOURCES

PART III.—SALES AND EXCHANGES

SECTION 631.—GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

(Also Section 1231) Rev. Rul. 57–90

In the case of the disposal of timber, held for more than six months prior to such disposal, by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber, pursuant to the provisions of section 631(b) of the Internal Revenue Code of 1954, the gain or loss on such disposal is subject to the tax treatment provided by section 1231 regardless of the nature of the taxpayer's business or the purpose for which the timber is held. To the extent that the opinion in *Ah Pah Redwood Co.*, v. *Commissioner*, 26 T. C. 1197, maybe inconsistent with the foregoing, it does not represent the position of the Internal Revenue Service.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

SUBPART A.—GENERAL RULES FOR TAXATION OF ESTATES

SECTION 642.—SPECIAL RULES FOR CREDITS AND DEDUCTIONS

26 CFR 1.642(c)-1: Charitable contributions deduction. **Rev. Rul. 57-133**

> Where under applicable state law real property is subject to administration the income derived therefrom is includible in the gross income of the estate for the period that the estate is under administration; and, if under the terms of the decedent's will the net income from such property is to be used exclusively for a charitable purpose, it is deductible by the estate under the provisions of section 642(c). of the Internal Revenue Code of 1954.

Advice has been requested whether the net income realized on real property transferred to a testamentary trust is, under the circumstances set forth below, deductible by the estate of the decedent.

The decedent died domiciled in the State of Oregon. After making certain specific bequests and devises, he devised certain real property situated in the State of Oregon to a trust and provided that, commencing in the year following the date on which the administration of his estate is closed, the net income of the trust is to be used for the benefit of certain charitable organizations exempt from taxation under the provisions of section 501 (c) of the Internal Revenue Code of 1954. The specific question presented is whether, under the provisions of section 642(c) of the Code, the net income realized on the real property transferred to the trust is deductible by the estate for the period that it is under administration.

Section 116.105 of Chapter 116 of the Revised Statutes of Oregon provides that the executor or administrator is entitled to the possession and control of the property of the deceased, both real and personal, and to receive the rents and profits thereof until the administration is completed or the same is surrendered to the heirs or devisees by order of the court or judge thereof. Although title to property specifically devised passes direct to the devisees and they are entitled to the income therefrom from the date of testator's death, under the Revised Statutes of Oregon, the property is subject to administration. Consequently, any income on the real property received by the decedent's estate during the period of administration is includible in the gross income of the estate under the provisions of section 641(a)(3) of the Internal Revenue Code of 1954.

Section 642(c) of Code, relating to deduction for amounts paid or permanently set aside for a charitable purpose, provides as follows:

> In the case of an estate or trust (other than a trust meeting the specifications of subpart B) there shall be allowed as a deduction in computing its taxable income (in lieu of the deductions allowed by section 170 (a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. * * *

It is the position of the Internal Revenue Service that the net income derived from the real property during the period of administration of the estate is deductible by the estate under the provisions of section 642(c) of the Code on the ground that under the terms of the decedent's will such income is to be used exclusively for a charitable purpose.

In view of the foregoing, it is held that, where under applicable state law real property is subject to administration, the income derived therefrom is includible in the gross income of the estate for the period that the estate is under administration; and, if under the terms of the decedent's will the net income from such property is to be used exclusively for a charitable purpose, it is deductible by the estate under the provisions of section 642(c) of the Internal Revenue Code of 1954.

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26 CFR 1.642(h)–2: Excess deductions on termination of an estate or trust. Rev. Rul. 57–31

> Where a residuary testamentary trust, which has the status of a beneficiary succeeding to the property of the estate within the meaning of section 642(h) of the Internal Revenue Code of 1954, has deductions in excess of its gross income after the allowance of excess deductions from an estate, as authorized by section 642(h)(2), the amount in excess of the gross income of the trust would not be deductible by the income beneficiaries of the trust; but, if the trust terminated in the year in which it was allowed the section 642(h)(2) deductions, they would be available to the remaindermen.

Advice has been requested whether excess deductions allowable to a residuary testamentary trust on the termination of an estate, which trust distributes all of its current income, will be available to the income beneficiary of the trust should such deductions exceed the gross income of the trust for its taxable year.

Section 642(h)(2) of the Internal Revenue Code of 1954 provides that any deductions (other than deductions for personal exemption and charitable contributions) in excess of the gross income of an estate or trust for its year of termination may be allowed as a deduction to the beneficiaries succeeding to the property of the estate or trust. A testamentary trust may be a legatee or beneficiary of an estate for purposes of section 642(h). See G. C. M. 24749, C. B. 1945, 237.

In the instant case, the decedent provided in his will that the rest and residue of his estate be placed in trust and that the income therefrom be distributed currently to his surviving spouse. Deductions of the estate for the year in which it was terminated exceeded gross income and resulted in the allowance of the excess thereof to the residuary trust. The excess deductions exceeded the gross income of the trust for its taxable year.

Since the amount of trust income taxable to a beneficiary of a trust is limited to that beneficiary's proportionate share of the distributable net income of the trust, excess deductions from an estate which become available through operation of section 642(h)(2) to a testamentary trust having the status of a beneficiary under section 642(h) would in turn reduce the amount of income taxable to the beneficiary of the trust.

If a testamentary trust has deductions in excess of its gross income after the allowance of deductions from an estate made available to it through section 642(h)(2), the amount in excess of the gross income would not be deductible by the income beneficiary of the trust. However, if the trust also terminates during the taxable year in which it is allowed the section 642(h)(2) deductions, the deductions in excess of its gross income will be available under section 642(h)(2) to the remaindermen succeeding to the property.

In view of the foregoing, it is held that where a residuary testamentary trust, which has the status of a beneficiary succeeding to the property of the estate within the meaning of section 642(h) of the Internal Revenue Code of 1954, has deductions in excess of its gross income after the allowance of excess deductions from an estate as authorized by section 642(h)(2), the amount in excess of the gross income of the trust would not be deductible by the income beneficiaries of the trust; but, if the trust terminated in the year in which it was allowed the section 642(h)(2) deductions, they would be available to the remaindermen.

SUBPART B.—TRUSTS WHICH DISTRIBUTE CURRENT INCOME ONLY

SECTION 652.—INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY

26 CFR 1.652(b)-1: Character of amounts.

Income from estate or trusts as retirement income for purpose of determining retirement income credit. See Rev. Rul. 57-277 page 12.

SUBPART C.—ESTATES AND TRUSTS WHICH MAY ACCUMULATE INCOME OR WHICH DISTRIBUTE CORPUS

SECTION 661.—DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS

26 CFR 1.661(b)-1: Character of amounts distributed; In general.

Income from estate or trust as retirement income for purpose of termining retirement income credit. See Rev. Rul. 57-277 page 12.

SECTION 662.—INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS. ACCUMULATING INCOME OR DISTRIBUTING CORPUS

26 CFR 1.662(b)-1: Character of amounts: When no charitable contributions are made.

Income from estate or trust as retirement income for purpose of determining retirement income credit. See Rev. Rul. 57-277 page 12.

SECTION 663.—SPECIAL RULES APPLICABLE TO SECTIONS 661 AND 662

26 CFR 1.663(a)-1: Special rules applicable to sections 661 and 662; exclusions; gifts, bequests, etc. Rev. Rul. 57-214

> Where the decedent's will provides that from the residue of the estate x dollars be placed in trust and the distributable net income of the estate for the current taxable year exceeded such amount, the funding of such trust will constitute a payment, under the terms of the will, of a bequest of a specific sum of money within the meaning of section 663(a)(1) of the Code and, as such, is neither taxable to the trustee nor deductible by the executor.

Advice has been requested regarding the tax consequences for Federal income tax purposes of the funding of a testamentary trust created under the facts set forth below.

The will of the decedent provides that, from the residue of his estate, x dollars be placed in trust for the benefit of his son, who is to be paid the income therefrom quarterly or as he may direct during his lifetime. In order to provide immediate income to the beneficiary of the trust, the executor plans to fund the trust as soon as possible. The current distributable net income of the estate, is in excess of the amount needed to fund the trust. The possibility that the value of the estate would decrease to the extent that it would not be sufficient to fund the trust is remote.

The issue for consideration is whether the funding of the trust constitutes a payment under the terms of the will of a bequest of a specific sum of money within the meaning of section 663 of the Internal Revenue Code of 1954 and, as such, is not includible as amounts falling within the purview of sections 661(a) and 662(a) of the Code.

Section 661(a) of the Code relates to deductions for estates and trusts accumulating income or distributing corpus while in process of administration and provides in part as follows:

> (a) DEDUCTION.—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust * * * the sum of * * *
>
> (1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and
>
> (2) any other amounts properly paid or credited or required to be distributed for such taxable year; but such deduction shall not exceed the distributable net income of the estate or trust.

Section 662 of the Code relates to the amounts includable in gross income of the beneficiaries of trusts and estates accumulating income or distributing corpus and provides in part as follows:

> (a) INCLUSION.—there shall be included in the gross income of the beneficiary to whom an amount specified in section 661(a) is paid, credited, or required to be distributed by an estate or trust described in section 661), the sum of the following amounts:
>
> (1) the amount of income for the taxable year required to be distributed currently to such beneficiary whether distributed or not * * *
>
> (2) all other amounts properly paid, credited or required to be distributed to such beneficiary for the taxable year. If the sum of * * *
>
> (A) the amount of income for the taxable year required to be distributed currently to all beneficiaries and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries, exceeds the distributable net income of the estate or trust, then in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

Section 663 of the Code provides, in part, that gifts or bequests of specific sums of money or specific property paid under the terms of the governing instrument, which are paid or credited all at once or in not more than three installments, are not allowable as additional deduction to a trust accumulating income or distributing corpus or to an estate under section 661 and are not includible in the taxable income of the beneficiary under section 662. For this purpose, an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

It is the well established rule that a testamentary trust may be a legatee or beneficiary. G. C. M. 24749, C. B. 1945, 237, and court decisions cited therein.

In the instant case, giving due consideration to the remoteness of the possibility that the value of the estate would decrease to the extent that the residue thereof would not be sufficient to fund the trust, it is concluded that funding of the trust would constitute a payment, under the terms of the will, of a bequest of a specific sum of money within the meaning of section 663(a)(1) of the Code and as such is neither taxable to the trustee nor deductible by the executor.

SUBPART E.—GRANTORS AND OTHERS TREATED AS SUBSTANTIAL OWNERS

SECTION 676.—POWER TO REVOKE

Treatment of trust income where power of revocation may be exercised only with consent of surviving income beneficiary. See Rev. Rul. 57-8, below.

SECTION 677.—INCOME FOR BENEFIT OF GRANTOR

(Also Section 676.) Rev. Rul. 57-8

Where the net income and/or principal of a trust is, in the discretion of the trustee, to be paid to the grantor or applied for his benefit so long as he shall live, the grantor will be treated as the owner of the trust and the income therefrom, including any capital gains realized by the trust, shall be taxable to him even though a reserved power to revoke the trust may be exercised only with the consent of his wife, the surviving income beneficiary of the trust.

Advice has been requested whether the grantor will be treated as the owner of a trust and the income therefrom will be taxable to him where the trust agreement provides (1) that the net income and/or principal of the trust estate is, in the discretion of the trustee, to be paid to the grantor or applied for his benefit so long as he shall live and (2) the grantor has reserved the right to revoke the trust but

only with the consent of his wife, the surviving income beneficiary.

Section 671 of the Internal Revenue Code of 1954 states the general rule that, in cases where the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income and credits of an individual.

Section 676(a) of the Internal Revenue Code of 1954 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of subpart E, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

Furthermore, under the general rule contained in section 677(a) of the Code, the grantor shall be treated as the owner of any portion of a trust whose income, without the approval or consent of any adverse party, is or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor.

Although the power to revoke the trust reserved by the instant grantor may be exercised only with the consent of the surviving income beneficiary of the trust, an adverse party, the provision contained in the trust instrument to the effect that the principal of the trust may be applied by the trustee, a nonadverse party, for the benefit of the grantor is considered to be a power to revest in the grantor, the title to the trust corpus within the purview of section 676(a) of the 1954 Code.

In view of the foregoing, it is held that where the net income and/or principal of a trust is, in the discretion of the trustee, to be paid to the grantor or applied for his benefit so long as he shall live, the grantor will be treated as the owner of the trust and the income therefrom including any capital gains realized by the trust, shall be taxable to him even though a reserved power to revoke the trust may be exercised only with the consent of his wife, the surviving income beneficiary of the trust.

SUBCHAPTER K.—PARTNERS AND PARTNERSHIPS

PART II.—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

SUBPART B.—DISTRIBUTIONS BY A PARTNERSHIP

SECTION 731.—EXTENT OF RECOGNITION OF GAIN OR LOSS ON DISTRIBUTION

26 CFR 1.731–1: Extent of recognition of gain or loss on distribution. Rev. Rul. 57–200

The transfer of the capital stock of several corporations to a partnership, where the taxpayers who own such stock are also partners in the partnership, followed immediately by a distribution in complete liquidation of the partnership assets, constitute steps of

a single integrated transaction resulting in a taxable exchange of stock interests between the individual partners.

Advice has been requested regarding the Federal income tax consequences of a transaction whereby partners transfer certain of their stock holdings to a partnership in which they are partners followed by the distribution of the partnership assets in complete liquidation of the partnership.

A and *B*, individuals, each owned a one-half interest in a partnership and each owned one-half interests in corporations *X* and *Y*. The partnership had been in existence for some years. *A* and *B* desired to sever all of their business relations. To accomplish a complete severance, *A* and *B* each contributed to the partnership their one-half interests in corporations *X* and *Y*. The partnership was then terminated with certain of the partnership assets and all of the stock in corporation *X* being distributed to *A*, and the remainder of the partnership assets and all of the stock in corporation *Y* being distributed to *B*. There were no unrealized receivables or inventory, and no money in excess of a partner's adjusted basis of his partnership interest was distributed to him. The specific question presented is whether the transfer of the corporate stock to the partnership and the complete liquidation of the partnership immediately thereafter results in gains or losses not being recognized to the partnership or any partner, or whether the two transactions taken together constitute a single taxable exchange of stock between the partners.

Section 731 of the Internal Revenue Code of 1954 provides in general that in the case of a distribution by a partnership to a partner of property other than unrealized receivables, inventory, or money in excess of a partner's adjusted basis, no gain or loss shall be recognized to the partners or to the partnership.

However, section 1.731–1(c)(3) of the Income Tax Regulations states that:

(3) If there is a contribution of property to a partnership and within a short period:

(i) Before or after such contribution other property is distributed to the contributing partner and the contributed property is retained by the partnership, or

(ii) After such contribution the contributed property is distributed to another partner,

such distribution may not fall within the scope of section 731. Section 731 does not apply to a distribution of property, if, in fact, the distribution was made in order to effect an exchange of property between two or more of the partners or between the partnership and a partner. Such a transaction shall be treated as an exchange of property.

In the instant case, the transfer of the corporate stock to the partnership followed by the immediate distribution of this stock to the partners, along with the other partnership assets in complete liquidation of the partnership, constituted steps in an integrated transaction entered into for the purpose of effecting an exchange of the corporate stock interests between the partners without the recognition of gain to the partners or the partnership. Accordingly, to such extent, section 731 of the Code does not apply and the transactions, therefore, constitute an exchange of property between the partners upon which gain or loss is recognized for Federal income tax purposes.

Recognition of gain or loss on "inventory items which have appreciated substantially in value" distributed to a partner by a partnership in liquidation. See Rev. Rul. 57-68, below.

SUBPART D.—PROVISIONS COMMON TO OTHER SUBPARTS

SECTION 751.—UNREALIZED RECEIVABLES AND INVENTORY ITEMS

26 CFR 1.751-1: Unrealized receivables and inventory items. (Also Section 731; 1.731-1.) Rev. Rul. 57-68

Where, in liquidation of his interest in a partnership, a partner receives a distribution in kind of his proportionate share of partnership assets which would be considered "inventory items which have appreciated substantially in value," within the meaning of the definition of that term set forth in section 751(d) of the Internal Revenue Code of 1954, such distribution does not constitute a sale or exchange of such assets, subject to the provisions of section 751.

Advice has been requested whether, in a liquidation of a partnership, a distribution in kind to a partner of his proportionate share of partnership assets which would be considered "inventory items which have appreciated substantially in value," within the meaning of the definition of that term set forth in section 751(d) of the Internal Revenue Code of 1954, constitutes a sale or exchange of such assets subject to the provisions of section 751.

In September 1955, a partnership engaged in the business of subdividing and developing land, and the development and construction of commercial buildings, was completely liquidated and terminated. The assets of the business consisted of some cash, machinery and equipment used in the business, and a parcel of land which had been held for development as a commercial center. After payment of partnership debts, the remaining assets, including the land, were divided among the partners in accordance with their percentage of ownership in the net worth of the business. The land was physically partitioned among the partners in accordance with their respective partnership interests. The land had an adjusted cost basis to the partnership of approximately $100x$ dollars, and its fair market value at the time of distribution to the partners was approximately $500x$ dollars.

Section 751(b) of the Code provides that distributions by a partnership to a partner shall be considered as sales or exchanges between the partnership and the partner to the extent that the distributee partner receives unrealized receivables of the partnership or inventory items of the partnership which have appreciated substantially in value *in exchange* for all or a part of his interest in other partnership property. Section 751(b) also applies to the extent that the distributee partner receives other partnership property *in exchange* for all or a part of his interest in such receivables and inventory items. Section 751(b) does not apply to the extent that a distribution consists of a distributee partner's share of section 751 property or his share of other property. Sec. 1.751-1(b)(1)(ii) of the Income Tax Regulations. Distributions which are not subject to section 751(b)

of the Code are governed by the regular distribution rules of sections 731 through 736 of the Code.

Section 731(a) of the Code provides, in part, that gain shall not be recognized on a distribution by a partnership to a partner, except to the extent than any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution. Section 1.731–1(a) of the Income Tax Regulations states that this rule is applicable both to current distributions (*i. e.*, distributions other than in liquidation of an entire interest) and to distributions in liquidation of a partner's entire interest in a partnership.

Accordingly, it is held that where a partner receives, in liquidation of his interest in a partnership, a distribution of his proportionate share of partnership assets which would be considered "inventory items which have substantially appreciated in value," within the meaning of the definition of that term set forth in section 751(d) of the Code, such distribution does not constitute a sale or exchange of such assets, subject to the provisions of section 751 of the Code.

PART III.—DEFINITIONS

SECTION 761.—TERMS DEFINED

26 CFR 1.761–1: Terms defined. Rev. Rul. 57–215

Partnerships, of the types described in section 761(a) (1) and section 761(a) (2) of the Internal Revenue Code of 1954, must obtain the prior approval of the Commissioner, under section 1.761–1(a) (2) (iv) (b) of the Income Tax Regulations, to be excluded from only certain sections of Subchapter K of Chapter 1 of the Code relating to partners and partnerships. Such approval will not be extended to section 706(b) of the Code for the purpose of eliminating the necessity of establishing a business purpose, as required thereunder, 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 A.—1955 FORMULA

SECTION 801.—DEFINITION OF LIFE INSURANCE COMPANY

26 CFR 1.801–1: Definitions. Rev. Rul. 57–229

A health and accident insurance policy under which the insurance company reserves the right to adjust premium rates, in accordance with experience under such form of policy which runs to age sixty or a higher specified age, and which is renewable at the option of the insured, but only at the then applicable rate, does not constitute a

noncancellable contract of health and accident insurance within the meaning of section 801 of the Internal Revenue Code of 1954. The reserves maintained for such policies may not be included as part of "life insurance reserves" in determining whether an insurance company qualifies as a life insurance company for Federal income tax purposes.

Advice has been requested whether a health and accident insurance policy under which the insurance company reserves the right to adjust premium rates by classes, in accordance with experience under such form of policy, which runs to age sixty or a higher specified age, and which would be renewable at the option of the insured, but at the then applicable rate, constitutes a noncancellable contract of health and accident insurance within the meaning of section 801 of the Internal Revenue Code of 1954.

Section 801(a) of the Code defines a life insurance company and provides in part:

> "* * * the term 'life insurance company' means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, if (1) its life insurance reserves (as defined in subsection (b)), plus (2) unearned premiums and unpaid losses on noncancellable life, health, or accident policies not included in life insurance reserves, comprise more than 50 percent of its total reserves (as defined in subsection (c))."

Section 801(b)(1)(B) defines "life insurance reserves" to include reserves for "noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies."

Section 1.801–1(a) of the Income Tax Regulations and section 39.201–3 of Regulations 118 (made applicable to the 1954 Code by T. D. 6091, C. B. 1954–2, 47) define a noncancellable insurance policy as a contract which the insurance company is under obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium must be carried to cover the obligation. The words "specify" and "specific" are defined in Webster's New International Dictionary as "to tell or state precisely or in detail" and "precisely formulated or restricted." In the opinion of the Internal Revenue Service, a premium which varies according to the experience of the company under a particular type of contract does not qualify as a "specified" premium.

Accordingly, a health and accident insurance policy under which the insurance company reserves the right to adjust premium rates, in accordance with experience under such form of policy which runs to age sixty or a higher specified age, and which is renewable at the option of the insured, but only at the then applicable rate, does not constitute a noncancellable contract of health and accident insurance within the meaning of section 801 of the Internal Revenue Code of 1954. The reserves maintained for such policies may not be included as part of "life insurance reserves" in determining whether an insurance company qualifies as a life insurance company for Federal income tax purposes.

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 tax imposed by section 831.

Deductibility of a dividend to policyholders declared during a taxable year in an amount representing the entire or a specified portion of the net profits of the company at the end of the taxable year. See Rev. Rul. 57–134, below.

PART III.—OTHER INSURANCE COMPANIES

SECTION 831.—TAX ON INSURANCE COMPANIES (OTHER THAN LIFE OR MUTUAL), MUTUAL MARINE INSURANCE COMPANIES, AND MUTUAL FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES

26 CFR 1.831–1: Taxes on insurance companies (other than life or mutual), mutual marine insurance companies, and mutual fire insurance companies issuing perpetual policies. Rev. Rul. 57–134

(Also Sections 821, 1.821–1.)

(Also Part II, Sections 204, 207; Regulations 118, Sections 39.204–3, 39.207–3.)

Insurance companies falling within the provisions of sections 821 or 831 of the Internal Revenue Code of 1954, except mutual fire insurance companies described in section 831(a) of the Code, and employing the accrual method of accounting may deduct dividends to policyholders in the year of declaration, even though such dividends are declared in unspecified amounts representing all or a specified portion of net profits for such year and are not paid until the following year.

Revenue Ruling 55–300, C. B. 1955–1, 406, revoked.

Advice has been requested whether certain dividends to policyholders, declared during a taxable year by certain insurance companies employing the accrual method of accounting, are deductible from gross income where the dividends are declared as an amount representing all or a portion of the net profits of the company as of the end of the taxable year.

The facts disclose that on November 15th the taxpayer, a stock insurance company falling within the provisions of section 831 of the Internal Revenue Code of 1954, through its board of directors, declared a dividend to policyholders of all the company's profits in excess of $2,500x$ dollars for such taxable year payable after the close thereof. On January 20th of the following year, the dividend was paid.

Section 1.823-2 and section 1.832-2 of the Income Tax Regulations provide, in part, that, if the method of accounting employed is the cash receipts and disbursements method, the deduction for dividends paid to policyholders is limited to the dividends actually paid in the taxable year. However, if the method of accounting employed is the accrual method, the deduction, or a reasonably accurate estimate thereof, for dividends declared to policyholders for any taxable year will, in general, be computed by adding to dividends paid during the taxable year the amount of dividends declared but unpaid at the end of the taxable year and deducting dividends declared but unpaid at the beginning of the taxable year.

Revenue Ruling 55-300, C. B. 1955-1, 406, holds, in effect, that with respect to the type of insurance company under consideration dividends to policyholders declared in an undetermined amount are not deductible in determining such company's income tax liability.

The question in the instant case then is whether such dividends declared by the company were in a determined or an undetermined amount. Dividends of the type involved in the instant case cannot create a debt at the time the resolution therefor is adopted by the board of directors, because losses may occur during the remainder of the year which would more than offset the corporation's prior earnings for such year. Thus, under such a resolution, no debt between the corporation and the policyholders can be created until the taxable year has closed, since only then would it be clear whether there were earnings available for the purposes of the dividend declaration.

At the end of the taxable year during which the dividend is declared, pursuant to a resolution of the board of directors, however, all events will have occurred which fix the company's liability for the dividend and such liability cannot be affected by anything transpiring after that time. See *United States* v. *P. Chauncey Anderson et al.*, T. D. 3839, C. B. V-1, 179 (1926); *Uncasville Mfg. Co.* v. *Commissioner*, 55 Fed. (2d) 893, certiorari denied 286 U. S. 545; and *Anderson-Clayton Securities Corp.* v. *Commissioner*, 35 B. T. A. 795, acquiescence C. B. 1937-2, 2. Thus, such a declaration may be treated as an accrued liability for the taxable year during which the resolution therefor is adopted by the board of directors, provided there are sufficient earnings for such year available for dividends at the close of the taxable year and the dividends would be deductible in the year in which declared since the resolution would satisfy the requirements of sections 1.823-2 and 1.832-2 of the Income Tax Regulations.

Accordingly, insurance companies falling within the provisions of sections 821 or 831 of the Internal Revenue Code of 1954, except mutual fire insurance companies described in section 831(a) of the Code, and employing the accrual method of accounting may deduct dividends to policyholders in the year of declaration, even though such dividends are declared in unspecified amounts representing all or a specified portion of net profits for such year and are not paid until the following year.

Revenue Ruling 55-300, C. B. 1955-1, 406, is revoked.

SECTION 832.—INSURANCE COMPANY TAXABLE INCOME

26 CFR 1.832–1: Gross income. Rev. Rul. 57–48
(Also Part II, Section 204; Regulations 111, Section 29.204–2.)

The portions of original premiums established and segregated as a reinsurance reserve by a title insurance company from June 1, 1938, to May 31, 1945, under section 434 l. a. of the New York State Insurance Law, may be treated as unearned premiums under section 832(b)(4) of the Internal Revenue Code of 1954 (section 204(b)(5) of the Internal Revenue Code of 1939).

I. T. 3798, C. B. 1946–1, 127, modified; and Rev. Rul. 151, C. B. 1953–2, 222, revoked.

The Internal Revenue Service has been asked to reconsider the conclusions stated in I. T. 3798, C. B. 1946–1, 127, and Revenue Ruling 151, C. B. 1953–2, 222, relative to the application of section 832 (b) (4) of the Internal Revenue Code of 1954 (section 204(b)(5) of the Internal Revenue Code of 1939) to portions of the original premiums established and segregated as a reinsurance reserve by a title insurance company from June 1, 1938, to May 31, 1945, under section 434 l. a. of the New York State Insurance Law, as enacted by chapter 882 of the laws of the State of New York for 1939.

I. T. 3798, *supra*, holds that (1) the portions of original premiums established and segregated as a reinsurance reserve by a title insurance company on and after June 1, 1945, under section 434 l. b. of the New York State Insurance Law, as amended, may be treated as unearned premiums under section 204(b)(5) of the Internal Revenue Code of 1939; and (2) the portions of original premiums established and segregated as a reinsurance reserve by a title insurance company from June 1, 1938, to May 31, 1945, under section 434 l. a. of the New York State Insurance Law, may not be treated as unearned premiums under section 204(b)(5) of the 1939 Code. Revenue Ruling 151, *supra*, affirmed the position expressed in I. T. 3798 with respect to issue (2) above.

After careful consideration of the matter, it has been concluded that the treatment for Federal income tax purposes, of the portions of the original premiums established and segregated as a reinsurance reserve by a title insurance company from June 1, 1938, to May 31, 1945, under section 434 l. a. of the New York State Insurance Law (prior to the 1945 amendment), should not differ from that accorded the portions of the original premiums established and segregated as a reinsurance reserve by such a company on and after June 1, 1945, under section 434 l. b. of that law, as amended by the laws of the State of New York for 1945. See *Early* v. *Lawyers Title Insurance Corporation*, 132 Fed. (2d) 42; *Title and Trust Company* v. *Commissioner*, 192 Fed. (2d) 93; *Pacific Abstract Title Company* v. *United States*, 192 Fed. (2d) 934; *Washington Title Insurance Company* v. *United States*, 135 F. Supp. 426; and *Home Title Guaranty Company* v. *Commissioner*, 15 T. C. 637, nonacquiescence C. B. 1953–2, 8, and *City Title Insurance Company*, T. C. Memo 1955–233.

Accordingly, it is held that a title insurance company, filing its corporation income tax returns in accordance with the provisions of sections 831 and 832 of the Internal Revenue Code of 1954 (section 204 of the 1939 Code) may treat as unearned premiums under section

832(b)(4) of the 1954 Code (section 204(b)(5) of the 1939 Code) the portions of original premiums established and segregated as a reinsurance reserve from June 1, 1938, to May 31, 1945, in accordance with the provisions of Section 434 l. a. of the New York State Insurance Law enacted by chapter 882 of the laws of the State of New York for 1939 (the period preceding enactment of section 434 l. b. of such laws, as amended, for 1945). Restorations to income from such reserves will constitute taxable income in the year of such restoration.

In view of the above, Revenue Ruling 151, C. B. 1953–2, 222, is revoked; and I. T. 3798, C. B. 1946–1, 127, is modified to the extent that it holds that the portions of original premiums established and segregated as a reinsurance reserve by a title insurance company from June 1, 1938, to May 31, 1945, under section 434 l. a. of the New York State Insurance Law, may not be treated as unearned premiums under section 204(b)(5) of the Code. In addition, the prior nonacquiescence in the case of Home Title Guaranty Company v. Commissioner, *supra*, has been withdrawn and acquiescence substituted therefor. See page 4 of this Bulletin.

Rev. Rul. 57–279

> The term "administrative or clerical expenses of a nature that can be actually determined," as used in Revenue Ruling 55–580, means "statistically determined" expenses, which are to be considered separately, and not combined with estimates of future costs of adjusting claims, in determining "expenses incurred" under section 832(b)(6) of the Internal Revenue Code of 1954.
> Revenue Ruling 55–580, C. B. 1955–2, 282, amplified.

The Internal Revenue Service has been requested to clarify the last sentence of the fourth paragraph of Revenue Ruling 55–580, C. B. 1955–2, 282, relative to the computation of "expenses incurred" of insurance companies under the provisions of section 832 of the Internal Revenue Code of 1954.

Section 832(b) of the Code provides, in part, as follows:

> (6) EXPENSES INCURRED.—The term "expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows: To all expenses paid during the taxable year, add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the taxable income subject to the tax imposed by section 831, there shall be deducted from expenses incurred (as defined in this paragraph) all expenses incurred which are not allowed as deductions by subsection (c).

At issue is the meaning of the above-mentioned sentence contained in Revenue Ruling 55–580, *supra*, which states:

> The question here relates to "expenses incurred" involving estimates of future costs of adjusting claims and similar types of expenses *but does not include administrative or clerical expenses of a nature that can be actually determined.* [Underscoring supplied.]

Revenue Ruling 55–580 was issued to entitle insurance companies, taxable under the provisions of section 831 of the Internal Revenue Code of 1954, to a deduction under section 832(b)(6) for "expenses incurred" involving estimates of future costs of adjusting claims and similar types of expenses, according to the accounting method adopted

by the National Convention of Insurance Commissioners used in filing the companies' annual statements.

The underscored portion of the above quoted sentence should not be considered as implying that "administrative or clerical expenses of a nature that can be actually determined" are not allowable. It was inserted to assure that determinable administrative and clerical expenses would not be combined with estimates of future costs of adjusting claims and similar types of expenses, but would be considered separately in determining "expenses incurred" under section 832(b)(6) of the Code.

By way of explanation, the term "administrative or clerical expenses of the nature that can be actually determined" means "statistically determined" expenses which can be formulated in the same manner in which the Service has approved the determination of "unpaid losses" under the "case basis" (*i. e.*, the method used in arriving at their estimates by averaging the expenses of settling claims over a five-year period based on the company's actual past experience as shown in their prior annual statements for such years).

Accordingly, the term "administrative or clerical expenses of a nature that can be actually determined," as used in Revenue Ruling 55–580, *supra*, means "statistically determined" expenses, which are to be considered separately and not combined with estimates of future costs of adjusting claims, in determining "expenses incurred" under section 832(b)(6) of the Code.

SUBCHAPTER M.—REGULATED INVESTMENT COMPANIES

SECTION 851.—DEFINITION OF REGULATED INVESTMENT COMPANY

26 CFR 1.851: Statutory provisions: definition of regulated investment company. T. D. 6236[1]

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

Regulations prescribed under subchapter M of chapter 1 of the Internal Revenue Code of 1954.

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

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

On June 24, 1955, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954 (except as otherwise provided therein), under subchapter M (regulated investment companies) of chapter 1 of the Internal Revenue Code of 1954 was published in the Federal Register (20 F. R. 4444). After consideration of all such relevant matter as was presented by interested persons regarding the rules

[1] 22 F. R. 3872.

proposed, the following regulations (which supersede paragraph 17 of Treasury Decision 6118 (19 F. R. 9896), approved December 30, 1954) [C. B. 1955–1, 698], are hereby adopted. The regulations hereby adopted do not give effect to the amendments made to section 852(b)(3) of the Internal Revenue Code of 1954, by Public Law 700, 84th Congress, approved July 11, 1956 [C. B. 1956–2, 1169] (effective with respect to taxable years of regulated investment companies beginning after December 31, 1956). Regulations under Public Law 700 will be published as a notice of proposed rulemaking at a subsequent date.

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REGULATED INVESTMENT COMPANIES

AUTHORITY: §§ 1.851 to 1.855–1, incl., issued under sec. 7805, I. R. C., 1954; 68A Stat. 917; 26 U. S. C. 7805.

REGULATED INVESTMENT COMPANIES

§ 1.851 STATUTORY PROVISIONS; DEFINITION OF REGULATED INVESTMENT COMPANY.

SEC. 851. DEFINITION OF REGULATED INVESTMENT COMPANY.

(a) GENERAL RULE.—For purposes of this subtitle, the term "regulated investment company" means any domestic corporation (other than a personal holding company as defined in section 542)—

(1) Which, at all times during the taxable year, is registered under the Investment Company Act of 1940, as amended (54 Stat. 789; 15 U. S. C. 80 a–1 to 80 b–2), either as a management company or as a unit investment trust, or

(2) Which is a common trust fund or similar fund excluded by section 3(c)(3) of such Act (15 U. S. C. 80 a–3 (c)) from the definition of "investment company" and is not included in the definition of "common trust fund" by section 584(a).

(b) LIMITATIONS.—A corporation shall not be considered a regulated investment company for any taxable year unless—

(1) It files with its return for the taxable year an election to be a regulated investment company or has made such election for a previous taxable year which began after December 31, 1941;

(2) At least 90 percent of its gross income is derived from dividends, interest, and gains from the sale or other disposition of stock or securities;

(3) Less than 30 percent of its gross income is derived from the sale or other disposition of stock or securities held for less than 3 months; and

(4) At the close of each quarter of the taxable year—

(A) At least 50 percent of the value of its total assets is represented by—

(i) Cash and cash items (including receivables), Government securities and securities of other regulated investment companies, and

(ii) Other securities for purposes of this calculation limited, except and to the extent provided in subsection (e), in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the taxpayer and to not more than 10 percent of the outstanding voting securities of such issuer, and

(B) Not more than 25 percent of the value of its total assets is invested in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary or his delegate, to be engaged in the same or similar trades or businesses or related trades or businesses.

(c) RULES APPLICABLE TO SUBSECTION (B) (4).—For purposes of subsection (b)(4) and this subsection—

(1) In ascertaining the value of the taxpayer's investment in the securities of an issuer, for the purposes of subparagraph (B), there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer, as determined under regulations prescribed by the Secretary or his delegate.

(2) The term "controls" means the ownership in a corporation of 20 percent or more of the total combined voting power of all classes of stock entitled to vote.

(3) The term "controlled group" means one or more chains of corporations connected through stock ownership with the taxpayer if—

(A) 20 percent or more of the total combined voting power of all classes of stock entitled to vote of each of the corporations (except the taxpayer) is owned directly by one or more of the other corporations, and

(B) The taxpayer owns directly 20 percent or more of the total combined voting power of all classes of stock entitled to vote, of at least one of the other corporations.

(4) The term "value" means, with respect to securities (other than those of majority-owned subsidiaries) for which market quotations are readily available, the market value of such securities; and with respect to other securities and assets, fair value as determined in good faith by the board of directors, except that in the case of securities of majority-owned subsidiaries which are investment companies such fair value shall not exceed market value or asset value, whichever is higher.

(5) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

(d) DETERMINATION OF STATUS.—A corporation which meets the requirements of subsections (b)(4) and (c) at the close of any quarter shall not lose its status as a regulated investment company because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. A corporation which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

(e) INVESTMENT COMPANIES FURNISHING CAPITAL TO DEVELOPMENT CORPORATIONS.—

(1) GENERAL RULE.—If the Securities and Exchange Commission determines, in accordance with regulations issued by it, and certifies to the Secretary or his delegate not less than 60 days prior to the close of the taxable year of a registered management company, that such investment company is principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, such investment company may, in the computation of 50 percent of the value of its assets under subparagraph (A) of subsection (b) (4) for any quarter of such taxable year, include the value of any securities of an issuer, whether or not the investment company owns more than 10 percent of the outstanding voting securities of such issuer, the basis of which, when added to the basis of the investment company for securities of such issuer previously acquired, did not exceed 5 percent of the value of the total assets of the investment company at the time of the subsequent acquisition of securities. The preceding sentence shall not apply to the securities of an issuer if the investment company has continuously held any security of such issuer (or of any predecessor company of such issuer as determined under regulations prescribed by the Secretary or his delegate) for 10 or more years preceding such quarter of such taxable year.

(2) LIMITATION.—The provisions of this subsection shall not apply at the close of any quarter of a taxable year to an investment company if at the close of such quarter more than 25 percent of the value of its total assets is represented by securities of issuers with respect to each of which the investment company holds more than 10 percent of the outstanding voting securities of such issues and in respect of each of which or any predecessor thereof the investment company has continuously held any security for 10 or more years preceding such quarter unless the value of its total assets so represented is reduced to 25 percent or less within 30 days after the close of such quarter.

(3) DETERMINATION OF STATUS.—For purposes of this subsection, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the date of the first acquisition of any security in such corporation or any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and an investment company shall be considered at any date to be furnishing capital to any company whose securities it holds if within 10 years prior to such date it has acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or predecessor thereof. For purposes of the certification

under this subsection, the Securities and Exchange Commission shall have authority to issue such rules, regulations and orders, and to conduct such investigations and hearings, either public or private, as it may deem appropriate.

(4) DEFINITIONS.—The terms used in this subsection shall have the same meaning as in subsections (b)(4) and (c) of this section.

§ 1.851–1 DEFINITION OF REGULATED INVESTMENT COMPANY.—(a) *In general.*—The term "regulated investment company" is defined to mean any domestic corporation (other than a personal holding company as defined in section 542) which meets (1) the requirement of section 851(a) and paragraph (b) of this section, and (2) the limitations of section 851(b) and § 1.851–2. As to the definition of the term "corporation", see section 7701(a)(3).

(b) *Requirement.*—To qualify as a regulated investment company, a corporation must be—

(1) Registered at all times during the taxable year, under the Investment Company Act of 1940, as amended (54 Stat. 789; 15 U. S. C. 80 a–1 to 80 b–2), either as a management company or a unit investment trust, or

(2) A common trust fund or similar fund excluded by section 3(c)(3) of the Investment Company Act of 1940 (15 U. S. C. 80 a–3(c)) from the definition of "investment company" and not included in the definition of "common trust fund" by section 584(a).

§ 1.851–2 LIMITATIONS.—(a) *Election to be regulated investment company.*—Under the provisions of section 851(b)(1), a corporation, even though it satisfies the other requirements of subchapter M of chapter 1 of the Internal Revenue Code of 1954 for the taxable year, will not be considered a regulated investment company for such year, within the meaning of subchapter M, unless it elects to be a regulated investment company for such taxable year, or has made such an election for a previous taxable year which began after December 31, 1941. The election shall be made by the taxpayer by computing income as a regulated investment company in its return for the first taxable year for which the election is applicable. No other method of making such election is permitted. An election once made is irrevocable for such taxable year and all succeeding taxable years.

(b) *Gross income requirement.*—Section 851(b)(2) and (3) provides that (1) at least 90 percent of the corporation's gross income for the taxable year must be derived from dividends, interest, and gains from the sale or other disposition of stocks or securities, and (2) less than 30 percent of its gross income must have been derived from the sale or other disposition of stock or securities held for less than three months. In determining the gross income requirements under section 851(b)(2) and (3), a loss from the sale or other disposition of stock or securities does not enter into the computation. A determination of the period for which stock or securities have been held shall be governed by the provisions of section 1223 insofar as applicable.

(c) *Diversification of investments.*—(1) Subparagraph (A) of section 851(b)(4) requires that at the close of each quarter of the taxable year at least 50 percent of the value of the total assets of the taxpayer corporation be represented by one or more of the following:

(i) Cash and cash items, including receivables;

(ii) Government securities;

(iii) Securities of other regulated investment companies; or

(iv) Securities (other than those described in subdivisions (ii) and (iii) of this subparagraph) of any one or more issuers which meet the following limitations: (*a*) The entire amount of the securities of the issuer owned by the taxpayer corporation is not greater in value than 5 percent of the value of the total assets of the taxpayer corporation, and (*b*) the entire amount of the securities of such issuer owned by the taxpayer corporation does not represent more than 10 percent of the outstanding voting securities of such issuer. For the modification of the percentage limitations applicable in the case of certain venture capital investment companies, see section 851(e) and § 1.851–6.

Assuming that at least 50 percent of the value of the total assets of the corporation satisfies the requirements specified in this subparagraph, and that the limiting provisions of subparagraph (B) of section 851(b)(4) and subparagraph (2) of this paragraph are not violated, the corporation will satisfy the requirements of section 851 (b)(4), notwithstanding that the remaining assets do not satisfy the diversification requirements of subparagraph (A) of section 851 (b) (4). For example, a corporation may own all the stock of another corporation, provided it otherwise meets the requirements of subparagraphs (A) and (B) of section 851 (b) (4).

(2) Subparagraph (B) of section 851(b)(4) prohibits the investment at the close of each quarter of the taxable year of more than 25 percent of the value of the total assets of the corporation (including the 50 percent or more mentioned in subparagraph (A) of section 851(b)(4)) in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer company controls and which are engaged in the same or similar trades or businesses or related trades or businesses, including such issuers as are merely a part of a unit contributing to the completion and sale of a product or the rendering of a particular service. Two or more issuers are not considered as being in the same or similar trades or businesses merely because they are engaged in the broad field of manufacturing or of any other general classification of industry, but issuers shall be construed to be engaged in the same or similar trades or businesses if they are engaged in a distinct branch of business, trade, or manufacture in which they render the same kind of service or produce or deal in the same kind of product, and such service or products fulfill the same economic need. If two or more issuers produce more than one product or render more than one type of service, then the chief product or service of each shall be the basis for determining whether they are in the same trade or business.

§ 1.851–3 Rules Applicable to Section 851(b)(4).—In determining the value of the taxpayer's investment in the securities of any one issuer, for the purposes of subparagraph (B) of section 851(b)-(4), there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer. See example (4) in § 1.851–5. For purposes of §§ 1.851–2, 1.851–4, 1.851–5, and 1.851–6, the terms "controls", "controlled group", and "value" have the meaning assigned to them by section 851(c). All other terms used in such sections have the same

meaning as when used in the Investment Company Act of 1940 (15 U. S. C., c. 2D) or that Act as amended.

§ 1.851–4 DETERMINATION OF STATUS.—With respect to the effect which certain discrepancies between the value of its various investments and the requirements of section 851(b)(4) and § 1.851–2(c), or the effect that the elimination of such discrepancies, will have on the status of a company as a regulated investment company for the purposes of subchapter M of chapter 1 of the Internal Revenue Code of 1954, see section 851(d). A company claiming to be a regulated investment company shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 851 during the taxable year. Such records shall be kept at all times available for inspection by any internal revenue officer or employee and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

§ 1.851–5 EXAMPLES.—The provisions of section 851 may be illustrated by the following examples:

Example (1). Investment Company W at the close of its first quarter of the taxable year has its assets invested as follows:

	Percent
Cash	5
Government securities	10
Securities of regulated investment companies	20
Securities of CorporationA	10
Securities of Corporation B	15
Securities of Corporation C	20
Securities of various corporations (not exceeding 5 percent of its assets in any one company)	20
Total	100

Investment Company W owns all of the voting stock of Corporations A and B, 15 percent of the voting stock of Corporation C, and less than 10 percent of the voting stock of the other corporations. None of the corporations is a member of a controlled group. Investment Company W meets the requirements under section 851(b)(4) at the end of its first quarter. It complies with subparagraph (A) of section 851(b)(4) since it has 55 percent of its assets invested as provided in such subparagraph. It complies with subparagraph (B) of section 851(b)(4) since it does not have more than 25 percent of its assets invested in the securities of any one issuer, or of two or more issuers which it controls.

Example (2). Investment Company V at the close of a particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash	10
Government securities	35
Securities of Corporation A	7
Securities of Corporation B	12
Securities of Corporation C	15
Securities of Corporation D	21
Total	100

Investment Company V fails to meet the requirements of subparagraph (A) of section 851(b)(4) since its assets invested in Corporations A, B, C, and D exceed in each case 5 percent of the value of the total assets of the company at the close of the particular quarter.

Example (3). Investment Company X at the close of the particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash and Government securities	20
Securities of Corporation A	5
Securities of Corporation B	10
Securities of Corporation C	25
Securities of various corporations (not exceeding 5 percent of its assets in any one company)	40
Total	100

Investment Company X owns more than 20 percent of the voting power of Corporations B and C and less than 10 percent of the voting power of all of the other corporations. Corporation B manufactures radios and Corporation C acts as its distributor and also distributes radios for other companies. Investment Company X fails to meet the requirements of subparagraph (B) of section 851(b)(4) since it has 35 percent of its assets invested in the securities of two issuers which it controls and which are engaged in related trades or businesses.

Example (4). Investment Company Y at the close of a particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash and Government securities	15
Securities of Corporation K (a regulated investment company)	30
Securities of Corporation A	10
Securities of Corporation B	20
Securities of various corporations (not exceeding 5 percent of its assets in any one company)	25
Total	100

Corporation K has 20 percent of its assets invested in Corporation L and Corporation L has 40 percent of its assets invested in Corporation B. Corporation A also has 30 percent of its assets invested in Corporation B, and owns more than 20 percent of the voting power in Corporation B. Investment Company Y owns more than 20 percent of the voting power of Corporations A and K. Corporation K owns more than 20 percent of the voting power of Corporation L, and Corporation L owns more than 20 percent of the voting power of Corporation B. Investment Company Y is disqualified under subparagraph (B) of section 851(b)(4) since more than 25 percent of its assets are considered invested in Corporation B as shown by the following calculation:

Percentage of assets invested directly in Corporation B	20.0
Percentage invested through the controlled group, Y-K-L-B (40 percent of 20 percent of 30 percent)	2.4
Percentage invested in the controlled group, Y-A-B (30 percent of 10 percent)	3.0
Total percentage of assets of Investment Company Y invested in Corporation B	25.4

Example (5). Investment Company Z, which keeps its books and makes its returns on the basis of the calandar year, at the close of the first quarter of 1955 meets the requirements of section 851(b)(4) and has 20 percent of its assets invested in Corporation A. Later during the taxable year it makes distributions to its shareholders and because of such distributions it finds at the close of the taxable year that it has more than 25 percent of its remaining assets invested in Corporation

A. Investment Company Z does not lose its statuts as a regulated investment company for the taxable year 1955 because of such distributions, nor will it lose its status as a regulated investment company for 1956 or any subsequent year solely as a result of such distributions.

Example (6). Investment Company Q, which keeps its books and makes its returns on the basis of a calendar year, at the close of the first quarter of 1955, meets the requirements of section 851(b)(4) and has 20 percent of its assets invested in Corporation P. At the close of the taxable year 1955 it finds that it has more than 25 percent of its assets invested in Corporation P. This situation results entirely from fluctuations in the market values of the securities in Investment Company Q's portfolio and is not due in whole or in part to the acquisition of any security or other property. Corporation Q does not lose its status as a regulated investment company for the taxable year 1955 because of such fluctuations in the market values of the securities in its portfolio, nor will it lose its status as a regulated investment company for 1956 or any subsequent year solely as a result of such market value fluctuations.

§ 1.851–6 Investment Companies Furnishing Capital to Development Corporations.—(a) *Qualifying requirements.*—(1) In the case of a regulated investment company which furnishes capital to development corporations, section 851(e) provides an exception to the rule relating to the diversification of investments, made applicable to regulated investment companies by section 851(b)(4)(A). This exception (as provided in paragraph (b) of this section) is available only to registered management investment companies which the Securities and Exchange Commission determines, in accordance with regulations issued by it, and certifies to the Secretary or his delegate, not ness than 60 days before the close of the taxable year of such investment company, to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available.

(2) For the purpose of the aforementioned determination and certification, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the date of the first acquisition of any security in such corporation or any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and an investment company shall be considered at any date to be furnishing capital to any company whose securities it holds if within 10 years before such date it had acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or its predecessor.

(b) *Exception to general rule.*—(1) The registered management investment company, which for the taxable year meets the requirements of paragraph (a) of this section, may (subject to the limitations of section 851(e)(2) and paragraph (c) of this section) in the computation of 50 percent of the value of its assets under section 851(b)(4)(A) and § 1.851–2(c)(1) for any quarter of such taxable year, include the value of any securities of an issuer (whether or not

the investment company owns more than 10 percent of the outstanding voting securities of such issuer) if at the time of the latest acquisition of any securities of such issuer the basis of all such securities in the hands of the investment company does not exceed 5 percent of the value of the total assets of the investment company at that time. The exception provided by section 851(e)(1) and this subparagraph is not applicable to the securities of an issuer if the investment company has continuously held any security of such issuer or of any predecessor company (as defined in paragraph (d) of this section) for 10 or more years preceding such quarter of the taxable year. The rule of section 851(e)(1) with respect to the relationship of the basis of the securities of an issuer to the value of the total assets of the investment company is, in substance, a qualification of the 5-percent limitation in section 851(b)(4)(A)(ii) and § 1.851–2(c)(1)(iv). All other provisions and requirements of section 851 and §§ 1.851–1 through 1.851–6 are applicable in determining whether such registered management investment company qualifies as a registered investment company.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). (i) The XYZ Corporation, a regulated investment company, qualified under section 851(e) as an investment company furnishing capital to development corporations. On June 30, 1954, the XYZ Corporation purchased 1,000 shares of the stock of the A Corporation at a cost of $30,000. On June 30, 1954, the value of the total assets of the XYZ Corporation was $1,000,000. Its investment in the stock of the A Corporation ($30,000) comprised 3 percent of the value of its total assets, and it therefore met the requirements prescribed by section 851(b)(4)(A)(ii) as modified by section 851(e)(1).

(ii) On June 30, 1955, the value of the total assets of the XYZ Corporation was $1,500,000 and the 1,000 shares of stock of the A Corporation which the XYZ Corporation owned appreciated in value so that they were then worth $60,000. On that date, the XYZ Investment Company increased its investment in the stock of the A Corporation by the purchase of an additional 500 shares of that stock at a total cost of $30,000. The securities of the A Corporation owned by the XYZ Corporation had a value of $90,000 (6 percent of the value of the total assets of the XYZ Corporation) which exceeded the limit provided by section 851(b)(4)(A)(ii). However, the investment of the XYZ Corporation in the A Corporation on June 30, 1955, qualified under section 851(b)(4)(A) as modified by section 851(e)(1), since the basis of those securities to the investment company did not exceed 5 percent of the value of its total assets as of June 30, 1955, illustrated as follows:

Basis to the XYZ Corporation of the A Corporation's stock acquired on June 30, 1954	$30,000
Basis of the 500 shares of the A Corporation's stock acquired by the XYZ Corporation on June 30, 1955	30,000
Basis of all stock of A Corporation	60,000

$$\frac{\text{Basis of stock of A Corporation}}{\text{Value of XYZ Corporation's total assets at June 30, 1955, time of the latest acquisition.}} = \frac{\$60,000}{\$1,500,000} = 4 \text{ percent}$$

Example (2). The same facts existed as in example (1), except that on June 30, 1955, the XYZ Corporation increased its investment in the stock of the A Corporation by the purchase of an additional 1,000 shares of that stock (instead of 500 shares) at a total cost of $60,000. No part of the investment of the XYZ Corporation in the A Corporation qualified under the 5-percent limitation provided by section 851(b)(4)(A) as modified by section 851(e)(1), illustrated as follows:

Basis to the XYZ Corporation of the 1,000 shares of the A Corporation's stock acquired on June 30, 1954	$30,000
Basis of the 1,000 shares of the A Corporation's stock acquired on June 30, 1955	60,000
Total	90,000

$$\frac{\text{Basis of stock of A Corporation}}{\text{Value of XYZ Corporation's total assets at June 30, 1955, time of the latest acquisition.}} = \frac{\$90,000}{\$1,500,000} = 6 \text{ percent}$$

Example (3). The same facts existed as in example (2) and on June 30, 1956, the XYZ Corporation increased its investment in the stock of the A Corporation by the purchase of an additional 100 shares of that stock at a total cost of $6,000. On June 30, 1956, the value of the total assets of the XYZ Corporation was $2,000,000 and on that date the investment in the A Corporation qualified under section 851(b)(4)(A) as modified by section 851(e)(1) illustrated as follows:

Basis to the XYZ Corporation of investments in the A Corporation's stock:	
1,000 shares acquired June 30, 1954	$30,000
1,000 shares acquired June 30, 1955	60,000
100 shares acquired June 30, 1956	6,000
Total	96,000

$$\frac{\text{Basis of stock of A Corporation}}{\text{Value of XYZ Corporation's total assets at June 30, 1956, time of the latest acquisition.}} = \frac{\$96,000}{\$2,000,000} = 4.8 \text{ percent}$$

(c) *Limitation.*—Section 851(e) and this section do not apply in the quarterly computation of 50 percent of the value of the assets of an investment company under subparagraph (A) of section 851(b)(4) and § 1.851–2(c)(1) for any taxable year if at the close of any quarter of such taxable year more than 25 percent of the value of its total assets (including the 50 percent or more mentioned in such subparagraph (A)) is represented by securities (other than Government securities or the securities of other regulated investment companies) of issuers as to each of which such investment company (1) holds more than 10 percent of the outstanding voting securities of such issuer, and (2) has continuously held any security of such issuer (or any security of a predecessor of such issuer) for 10 or more years preceding such quarter, unless the value of its total assets so represented is reduced to 25 percent or less within 30 days after the close of such quarter.

(d) *Definition of predecessor company.*—As used in section 851(e) and this section, the term "predecessor company" means any corporation the basis of whose securities in the hands of the investment company was, under the provisions of section 358 or corresponding provisions of prior law, the same in whole or in part as the basis of any of the securities of the issuer and any corporation with respect to whose securities any of the securities of the issuer were received

directly or indirectly by the investment company in a transaction or series of transactions involving nonrecognition of gain or loss in whole or in part. The other terms used in this section have the same meaning as when used in section 851(b)(4). See §§ 1.851–2(c) and 1.851–3.

§ 1.852 STATUTORY PROVISIONS; TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

SEC. 852. TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

(a) REQUIREMENTS APPLICABLE TO REGULATED INVESTMENT COMPANIES.—The provisions of this subchapter shall not be applicable to a regulated investment company for a taxable year unless—

(1) The deduction for dividends paid during the taxable year (as defined in section 561, but without regard to capital gains dividends) equals or exceeds 90 percent of its investment company taxable income for the taxable year (determined without regard to subsection (b)(2)(D)), and

(2) The investment company complies for such year with regulations prescribed by the Secretary or his delegate for the purpose ascertaining the actual ownership of its outstanding stock.

(b) METHOD OF TAXATION OF COMPANIES AND SHAREHOLDERS—

(1) IMPOSITION OF NORMAL TAX AND SURTAX ON REGULATED INVESTMENT COMPANIES.—There is hereby imposed for each taxable year upon the investment company taxable income of every regulated investment company a normal tax and surtax computed as provided in section 11, as though the investment company taxable income were the taxable income referred to in section 11. For purposes of computing the normal tax under section 11, the taxable income and the dividends paid deduction of such investment company for the taxable year (computed without regard to capital gains dividends) shall be reduced by the deduction provided by section 242 (relating to partially tax-exempt interest).

(2) INVESTMENT COMPANY TAXABLE INCOME.—The investment company taxable income shall be the taxable income of the regulated investment company adjusted as follows:

(A) There shall be excluded the excess, if any, of the net long-term capital gain over the net short-term capital loss.

(B) The net operating loss deduction provided in section 172 shall not be allowed.

(C) The deductions for corporations provided in part VIII (except section 248) in subchapter B (section 241 and following, relating to the deduction for dividends received, etc.) shall not be allowed.

(D) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends.

(E) The taxable income shall be computed without regard to section 443(b) (relating to computation of tax on change of annual accounting period).

(3) CAPITAL GAINS.—

(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year in the case of every regulated investment company a tax of 25 percent of the excess, if any, of the net long-term capital gain over the sum of—

(i) The net short-term capital loss, and

(ii) The deduction for dividends paid (as defined in section 561) determined with reference to captial gains dividends only.

(B) TREATMENT OF CAPITAL GAIN DIVIDENDS BY SHAREHOLDERS.—A capital gain dividend shall be treated by the shareholders as a gain from the sale or exchange of a capital asset held for more than 6 months.

(C) DEFINITION OF CAPITAL GAIN DIVIDEND.—A capital gain dividend means any dividend, or part thereof, which is desig-

nated by the company as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including capital gains dividends paid after the close of the taxable year described in section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated.

(c) EARNINGS AND PROFITS.—The earnings and profits of a regulated investment company for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year.

§ 1.852–1 TAXATION OF REGULATED INVESTMENT COMPANIES.—(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 § 1.852–3(d)); and

(2) The company complies for such taxable year with the provisions of § 1.852–6 (relating to records required to be maintained by a regulated investment company).

See section 853(b)(1)(B) and § 1.853–2(a) for amounts to be added to the dividend paid deduction, and section 855 and § 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.

§ 1.852–2 METHOD OF TAXATION OF REGULATED INVESTMENT COMPANIES.—(a) *Imposition of normal tax and surtax.*—Section 852(b)(1) imposes a normal tax and surtax, computed at the rates and in the manner prescribed in section 11, on the investment company taxable income, as defined in section 852(b)(2) and § 1.852–3, for each taxable year of a regulated investment company. The tax is imposed as if the investment company taxable income were the taxable income referred to in section 11. In computing the normal tax under section 11, the regulated investment company's taxable income and the dividends paid deduction (computed without regard to the capital gains dividends) shall both be reduced by the deduction for the partially tax-exempt interest provided by section 242.

(b) *Taxation of capital gains.*—Section 852(b)(3) imposes a tax of 25 percent for each taxable year on the excess, if any, of the net long-term capital gain of a regulated investment company over the sum of its net short-term capital loss and its deduction for dividends

paid (as defined in section 561) determined with reference to capital gains dividends only. For the definition of capital gains dividends paid by a regulated investment company, see section 852(b)(3)(C) and § 1.852–4(b). See section 855 and § 1.855–1 relating to dividends paid after the close of the taxable year.

§ 1.852–3 INVESTMENT COMPANY TAXABLE INCOME.—Section 852(b)(2) requires certain adjustments to be made to convert taxable income of the investment company to investment company taxable income, as follows:

(a) The excess, if any, of the net long-term capital gain over the net short-term capital loss shall be excluded;

(b) The net operating loss deduction provided in section 172 shall not be allowed;

(c) The special deductions provided in part VIII of subchapter B (except the deduction under section 248) shall not be allowed. Those not allowed are the deduction for partially tax-exempt interest provided by section 242, the deductions for dividends received provided by sections 243, 244, and 245, and the deduction for certain dividends paid provided by section 247. However, the deduction provided by section 248 (relating to organizational expenditures), otherwise allowable in computing taxable income, shall likewise be allowed in computing the investment company taxable income. See section 852(b)(1) and § 1.852–2(a)(1) for treatment of the deduction for partially tax-exempt interest (provided by section 242) for purposes of computing the normal tax under section 11;

(d) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends (as defined in section 852(b)(3)(C) and § 1.852–4(b)) and

(e) The taxable income shall be computed without regard to section 443(b). Thus, the taxable income for a period of less than 12 months shall not be placed on an annual basis even though such short taxable year results from a change of accounting period.

§ 1.852–4 METHOD OF TAXATION OF SHAREHOLDERS OF REGULATED INVESTMENT COMPANIES—(a) *In general.*—(1) A shareholder receiving dividends from a regulated investment company shall include such dividends in gross income for the taxable year in which they are received. Under section 852(b)(3)(B), shareholders of a regulated investment company who receive capital gain dividends, in respect of the capital gains of an investment company for a taxable year for which it is taxable under subchapter M as a regulated investment company, shall treat such capital gain dividends as gains from the sale or exchange of capital assets held for more than six months.

(2) See section 853(b)(2) and (c), and §§ 1.853–2(b) and 1.853–3, for the treatment by shareholders of dividends received from a regulated investment company which has made an election under section 853(a) with respect to the foreign tax credit. See section 854 and §§ 1.854–1 through 1.854–3 for limitations applicable to dividends received from regulated investment companies for the purpose of the credit under section 34, the exclusion from gross income under section 116, and the deduction under section 243. See section 855(b) and (d), and § 1.855–1(c) and (f), for treatment by shareholders of dividends

paid by a regulated investment company after the close of the taxable year in the case of an election under section 855(a).

(b) *Definition of capital gain dividend.*—A capital gain dividend, as defined in section 852(b)(3)(C), is any dividend or part thereof which is designated by a regulated investment company as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. If the aggregate amount so designated with respect to the taxable year (including capital gain dividends paid after the close of the taxable year pursuant to an election under section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. For example, a regulated investment company making its return on the calendar year basis advised its shareholders by written notice mailed December 30, 1955, that of a distribution of $500,000 made December 15, 1955, $200,000 constituted a capital gain dividend, amounting to $2 per share. It was later discovered that an error had been made in determining the excess of the net long-term capital gain over the net short-term capital loss of the taxable year and that such excess was $100,000 instead of $200,000. In such case each shareholder would have received a capital gain dividend of $1 per share instead of $2 per share.

§ 1.852–5 Earnings and Profits of A Regulated Investment Company.—In the determination of the earnings and profits of a regulated investment company, section 852(c) provides that such earnings and profits for any taxable year (but not the accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for the taxable year. Thus, if a corporation would have had earnings and profits of $500,000 for the taxable year except for the fact that it had a net capital loss of $100,000, which amount was not deductible in determining its taxable income, its earnings and profits for that year if it is a regulated investment company would be $500,000. If the regulated investment company had no accumulated earnings and profits at the beginning of the taxable year, in determining its accumulated earnings and profits as of the beginning of the following taxable year, the earnings and profits for the taxable year to be considered in such computation would amount to $400,000 assuming that there had been no distribution from such earnings and profits. If distributions had been made in the taxable year in the amount of the earnings and profits then available for distribution, $500,000, the corporation would have as of the beginning of the following taxable year neither accumulated earnings and profits nor a deficit in accumulated earnings and profits, and would begin such year with its paid-in capital reduced by $100,000, an amount equal to the excess of the $500,000 distributed over the $400,000 accumulated earnings and profits which would otherwise have been carried into the following taxable year.

§ 1.852–6 Records To Be Kept for Purpose of Determining Whether a Corporation Claiming To Be a Regulated Investment

COMPANY IS A PERSONAL HOLDING COMPANY.—(a) Every regulated investment company shall maintain in the internal revenue district in which it is required to file its income tax return permanent records showing the information relative to the actual owners of its stock contained in the written statements required by this section to be demanded from the shareholders. The actual owner of stock includes the person who is required to include in gross income in his return the dividends received on the stock. Such records shall be kept at all times available for inspection by any internal revenue officer or employee, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(b) For the purpose of determining whether a domestic corporation claiming to be a regulated investment company is a personal holding company as defined in section 542, the permanent records of the company shall show the maximum number of shares of the corporation (including the number and face value of securities convertible into stock of the corporation) to be considered as actually or constructively owned by each of the actual owners of any of its stock at any time during the last half of the corporation's taxable year, as provided in section 544.

(c) Statements setting forth the information (required by paragraph (b) of this section) shall be demanded not later than 30 days after the close of the corporation's taxable year as follows:

(1) In the case of a corporation having 2,000 or more record owners of its stock on any dividend record date, from each record holder of 5 percent or more of its stock; or

(2) In the case of a corporation having less than 2,000 and more than 200 record owners of its stock, on any dividend record date, from each record holder of 1 percent or more of its stock; or

(3) In the case of a corporation having 200 or less record owners of its stock, on any dividend record date, from each record holder of one-half of 1 percent or more of its stock.

When making demand for the written statements required of each shareholder by this paragraph, the company shall inform each of the shareholders of his duty to submit as a part of his income tax return the statements which are required by § 1.852–7 if he fails or refuses to comply with such demand. A list of the persons failing or refusing to comply in whole or in part with a company's demand shall be maintained as a part of its record required by this section. A company which fails to keep such records to show the actual ownership of its outstanding stock as are required by this section shall be taxable as an ordinary corporation and not as a regulated investment company.

§ 1.852–7 ADDITIONAL INFORMATION REQUIRED IN RETURNS OF SHAREHOLDERS.—Any person who fails or refuses to comply with the demand of a regulated investment company for the written statements which § 1.852–6 requires the company to demand from its shareholders shall submit as a part of his income tax return a statement showing, to the best of his knowledge and belief—

(a) The number of shares actually owned by him at any and all times during the period for which the return is filed in any company claiming to be a regulated investment company;

(b) The dates of acquisition of any such stock during such period and the names and addresses of persons from whom it was acquired;

(c) The dates of disposition of any such stock during such period and the names and addresses of the transferees thereof;

(d) The names and addresses of the members of his family (as defined in section 544(a)(2)); the names and addresses of his partners, if any, in any partnership; and the maximum number of shares, if any, actually owned by each in any corporation claiming to be a regulated investment company, at any time during the last half of the taxable year of such company;

(e) The names and addresses of any corporation, partnership, association, or trust in which he had a beneficial interest to the extent of at least 10 percent at any time during the period for which such return is made, and the number of shares of any corporation claiming to be a regulated investment company actually owned by each;

(f) The maximum number of shares (including the number and face value of securities convertible into stock of the corporation) in any domestic corporation claiming to be a regulated investment company to be considered as constructively owned by such individual at any time during the last half of the corporation's taxable year, as provided in section 544 and the regulations thereunder; and

(g) The amount and date of receipt of each dividend received during such period from every corporation claiming to be a regulated investment company.

§ 1.852–8 INFORMATION RETURNS.—Nothing in §§ 1.852–6 and 1.852–7 shall be construed to relieve regulated investment companies or their shareholders from the duty of filing information returns required by regulations prescribed under the provisions of subchapter A of chapter 61.

§ 1.853 STATUTORY PROVISIONS; FOREIGN TAX CREDIT ALLOWED TO SHAREHOLDERS.

SEC. 853. FOREIGN TAX CREDIT ALLOWED TO SHAREHOLDERS.

(a) GENERAL RULE.—A regulated investment company—

(1) More than 50 percent of the value (as defined in section 851(c)(4) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations, and

(2) Which meets the requirements of section 852(a) for the taxable year,

may, for such taxable year, elect the application of this section with respect to income, war profits, and excess profits taxes described in section 901(b)(1), which are paid by the investment company during such taxable year to foreign countries and possessions of the United States.

(b) EFFECT OF ELECTION.—If the election provided in subsection (a) is effective for a taxable year—

(1) The regulated investment company—

(A) Shall not, with respect to such taxable year, be allowed a deduction under section 164(a) or a credit under section 901 for taxes to which subsection (a) is applicable, and

(B) Shall be allowed as an addition to the dividends paid deduction for such taxable year the amount of such taxes;

(2) Each shareholder of such investment company shall—

(A) Include in gross income and treat as paid by him his proportionate share of such taxes, and

(B) Treat as gross income from sources within the respective foreign countries and possessions of the United States, for

purposes of applying subpart A of part III of subchapter N, the sum of his proportionate share of such taxes and the portion of any dividend paid by such investment company which represents income derived from sources within foreign countries or possessions of the United States.

(c) NOTICE TO SHAREHOLDERS.—The amounts to be treated by the shareholder, for purposes of subsection (b)2, as his proportionate share of—

(1) Taxes paid to any foreign country or possession of the United States, and

(2) Gross income derived from sources within any foreign country or possession of the United States,

shall not exceed the amounts so designated by the company in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year.

(d) MANNER OF MAKING ELECTION AND NOTIFYING SHAREHOLDERS.—The election provided in subsection (a) and the notice to shareholders required by subsection (c) shall be made in such manner as the Secretary or his delegate may prescribe by regulations.

(e) CROSS REFERENCES.—

(1) For treatment by shareholders of taxes paid to foreign countries and possessions of the United States, see section 164(a) and section 901.

(2) For definition of foreign corporation, see section 7701(a)(5).

§ 1.853–1 FOREIGN TAX CREDIT ALLOWED TO SHAREHOLDERS.—(a) *In general.*—Under section 853, a regulated investment company, meeting the requirements set forth in section 853(a) and paragraph (b) of this section, may make an election with respect to the income, war-profits, and excess profits taxes described in section 901(b)(1) which it pays to foreign countries or possessions of the United States during the taxable year, including such taxes as are deemed paid by it under the provisions of any income tax convention to which the United States is a party. If an election is made, the shareholders of the regulated investment company shall apply their proportionate share of such foreign taxes paid, or deemed to have been paid by it pursuant to any income tax convention, as either a credit (under section 901) or as a deduction (under section 164(a)) as provided by section 853(b)(2) and § 1.853–2(b). The election is not applicable with respect to taxes deemed to have been paid under section 902 (relating to the credit allowed to corporate stockholders of a foreign corporation for taxes paid by such foreign corporation).

(b) *Requirements.*—To qualify for the election provided in section 853(a), a regulated investment company (1) must have more than 50 percent of the value of its total assets, at the close of the taxable year for which the election is made, invested in stocks and securities of foreign corporations, and (2) must also, for that year, comply with the requirements prescribed in section 852(a) and § 1.852–1(a). The term "value", for purposes of the first requirement, is defined in section 851(c)(4). For the definition of foreign corporation, see section 7701(a).

§ 1.853–2 EFFECT OF ELECTION.—(a) *Regulated investment company.*—A regulated investment company making a valid election with respect to a taxable year under the provisions of section 853(a) is, for such year, denied both the deduction for foreign taxes provided by section 164(a) and the credit for foreign taxes provided by section 901 with respect to all income, war-profits, and excess profits taxes

(described in section 901(b)(1)) which it has paid to any foreign country or possession of the United States. See section 853(b)(1)(A). However, under section 853(b)(1)(B) the regulated investment company is permitted to add the amount of such foreign taxes paid to its dividends paid deduction for that taxable year. See § 1.852–1(a).

(b) *Shareholder.*—Under section 853(b)(2), a shareholder of an investment company, which has made the election under section 853, is, in effect, placed in the same position as a person directly owning stock in foreign corporations, in that he must include in his gross income (in addition to taxable dividends actually received) his proportionate share of such foreign taxes paid and must treat such amount as foreign taxes paid by him for the purposes of the deduction under section 164(a) and the credit under section 901. For such purposes he must treat as gross income from a foreign country or possession of the United States (1) his proportionate share of the taxes paid by the regulated investment company to such foreign country or possession and (2) the portion of any dividend paid by the investment company which represents income derived from such sources.

(c) *Dividends paid after the close of the taxable year.*—For additional rules applicable to certain distributions made after the close of the taxable year which may be designated as income received from sources within and taxes paid to foreign countries or possessions of the United States, see section 855(d) and § 1.855–1(f).

(d) *Example.*—This section may be illustrated as follows:

(1) The X Corporation, a regulated investment company, has total assets, at the close of the taxable year, of $10 million invested as follows:

Domestic corporations		$4,000,000
Foreign corporations in:		
Country A	$3,500,000	
Country B	2,500,000	
		6,000,000
Total assets		10,000,000

(2) The dividend income of X Corporation is received from the following sources:

Domestic corporations		$300,000
Foreign corporations:		
Country A	$250,000	
Country B	250,000	
		500,000
Total dividend income		800,000
Operation and management expenses		80,000
Net dividend income		720,000
Taxes withheld by Country A on dividends of $250,000 at a rate of 10 percent	$25,000	
Taxes withheld by Country B on dividends of $250,000 at a rate of 20 percent	50,000	
Total foreign taxes withheld		75,000
Income available for distribution		645,000

(3) X Corporation has 250,000 shares of common stock outstanding and distributes the entire $645,000 as a dividend of $2.58 per share of stock.

(4) The X Corporation meets the 50 percent requirement of section 851(b)(4) and the requirements of section 852(a). It notifies each shareholder by mail, within the time prescribed by section 853(c), that by reason of the election they are to treat as foreign taxes paid $0.30 per share of stock $75,000 of foreign taxes paid, divided by the 250,000 shares of stock outstanding), of which $0.20 represents taxes paid to Country B and $0.10 taxes paid to Country A. The shareholders must report as income $2.88 per share $2.58 of dividends actually received plus the $0.30 representing foreign taxes paid). Of the $2.88 per share, $1.80 per share ($450,000 (which represents such part of the net dividend income of $720,000 as the foreign dividend income of $500,000 bears to the total dividend income of $800,000) divided by 250,000 shares) is to be considered as received from foreign sources. Ninety cents is to be considered as received from Country A, and ninety cents from Country B.

§ 1.853–3 NOTICE TO SHAREHOLDERS.—If a regulated investment company makes an election under section 853(a), in the manner provided in § 1.853–4, the investment company is required, under section 853(c), to furnish its shareholders with a written notice mailed not less than 30 days after the close of its taxable. The notice must designate the shareholder's portion of foreign taxes paid to each such country or possession and the portion of the dividend which represents income derived from sources within each such country or possession. For purposes of section 853(b)(2) and § 1.853–2(b), the amount that a shareholder may treat as his proportionate share of foreign taxes paid and the amount to be included as gross income derived from any foreign country or possession of the United States shall not exceed the amounts so designated by the company in such written notice. If, however, the amount designated by the company in the notice exceeds the shareholder's proper proportionate share of foreign taxes or gross income from sources within any foreign country or possession, the shareholder is limited to the amount correctly ascertained.

§ 1.853–4 MANNER OF MAKING ELECTION.—(a) *General rule.*—A regulated investment company, to make a valid election under section 853, must—

(1) File with Form 1099 and Form 1096 a statement as part of its return which sets forth the following information:

(i) The total amount of income received from sources within foreign countries and possessions of the United States;

(ii) The total amount of income, war-profits, or excess profits taxes (described in section 901(b)(1)) paid, or deemed to have been paid under the provisions of any treaty to which the United States is a party, to such foreign countries or possessions;

(iii) The date, form, and contents of the notice to its shareholders;

(iv) The proportionate share of such taxes paid during the taxable year and foreign income received during such year attributable to one share of stock of the regulated investment company; and

(2) File as part of its return for the taxable year a Form 1118 modified so that it becomes a statement in support of the election made by a regulated investment company for taxes paid to a foreign country or a possession of the United States.

(b) *Irrevocability of the election.*—The election is applicable only with respect to taxable years subject to the Internal Revenue Code of 1954, shall be made with respect to all such foreign taxes, and must be made not later than the time prescribed for filing the return (including extensions thereof). Such election, if made, shall be irrevocable with respect to the dividend (or portion thereof), and the foreign taxes paid with respect thereto, to which the election applies.

§ 1.854 STATUTORY PROVISIONS; LIMITATIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANY.

SEC. 854. LIMITATIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANY.

(a) CAPITAL GAIN DIVIDEND.—For purposes of section 34(a) (relating to credit for dividends received by individuals), section 116 (relating to an exclusion for dividends received by individuals), and section 243 (relating to deductions for dividends received by corporations), a capital gain dividend (as defined in section 852(b)(3)) received from a regulated investment company shall not be considered as a dividend.

(b) OTHER DIVIDENDS.—

(1) GENERAL RULE.—In the case of a dividend received from a regulated investment company (other than a dividend to which subsection (a) applies)—

(A) If such investment company meets the requirements of section 852(a) for the taxable year during which it paid such dividends; and

(B) The aggregate dividends received by such company during such taxable year are less than 75 percent of its gross income,

then, in computing the credit under section 34(a), the exclusion under section 116, and the deduction under section 243, there shall be taken into account only that portion of the dividend which bears the same ratio to the amount of such dividend as the aggregate dividends received by such company during such taxable year bear to its gross income for such taxable year.

(2) NOTICE TO SHAREHOLDERS.—The amount of any distribution by a regulated investment company which may be taken into account as a dividend for purposes of the credit under section 34, the exclusion under section 116, and the deduction under section 243 shall not exceed the amount so designated by the company in a written notice to its shareholders mailed not later than 30 days after the close of its taxable year.

(3) DEFINITIONS.—For purposes of this subsection—

(A) The term "gross income" does not include gain from the sale or other disposition of stock or securities.

(B) The term "aggregate dividends received" includes only dividends received from domestic corporations other than dividends described in section 116(b) (relating to dividends excluded from gross income). In determining the amount of any dividend for purposes of this subparagraph, the rules provided in section 116(c) (relating to certain distributions) shall apply.

§ 1.854–1 LIMITATIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANY.—(a) *In general.*—Section 854 provides special limitations applicable to dividends received from a regulated investment company for purposes of the credit under section 34 and the exclusion under section 116 for dividends received by individuals, and the deduction under section 243 for dividends received by corporations.

(b) *Capital gain dividend.*—Under the provisions of section 854(a) a capital gain dividend as defined in section 852(b)(3) and § 1.852–4(b) shall not be considered a dividend for purposes of the

credit under section 34, the exclusion under section 116, or the deduction under section 243.

(c) *Rule for dividends other than capital gain dividends.*—(1) Section 854(b)(1) limits the amount that may be treated as a dividend (other than a capital gain dividend) by the shareholder of a regulated investment company, for the purposes of the credit, exclusion, and deduction specified in paragraph (b) of this section, where the investment company receives substantial amounts of income (such as interest, etc.) from sources other than dividends from domestic corporations, which dividends qualify for the exclusion under section 116.

(2) Where the "aggregate dividends received" (as defined in section 854(b)(3)(B) and § 1.854–3(b)) during the taxable year by a regulated investment company (which meets the requirements of section 852(a) and § 1.852–1(a) for the taxable year during which it paid such dividend) are less than 75 percent of its gross income for such taxable year (as defined in section 854(b)(3)(A) and § 1.854–3(a)), only that portion of the dividend paid by the regulated investment company which bears the same ratio to the amount of such dividend paid as the aggregate dividends received by the regulated investment company, during the taxable year, bears to its gross income for such taxable year (computed without regard to gains from the sale or other disposition of stocks or securities) may be treated as a dividend for purposes of such credit, exclusion, and deduction.

(3) Subparagraph (2) of this paragraph may be illustrated by the following example:

Example. The XYZ regulated investment company meets the requirements of section 852(a) for the taxable year and has received income from the following sources:

Capital gains (from the sale of stock or securities)	$100,000
Dividends (from domestic sources other than dividends described in section 116(b))	70,000
Dividend (from foreign corporations)	5,000
Interest	25,000
Total	200,000
Expenses	20,000
Taxable income	180,000

The regulated investment company decides to distribute the entire $180,000. It distributes a capital gain dividend of $100,000 and a dividend of ordinary income of $80,000. The aggregate dividends received by the regulated investment company from domestic corporations ($70,000) is less than 75 percent of its gross income ($100,000) computed without regard to capital gains from sales of securities. Therefore, an apportionment is required. Since $70,000 is 70 percent of $100,000, out of every $1 dividend of ordinary income paid by the regulated investment company only 70 cents would be available for the credit, exclusion, or deduction referred to in section 854(b)(1). The capital gains dividend and the dividend received from foreign corporations are excluded from the computation.

(d) *Dividends received from a regulated investment company during taxable years of shareholders ending after July 31, 1954, and subject to the Internal Revenue Code of 1939.*—For the application of section 854 to taxable years of shareholders of a regulated investment

company ending after July 31, 1954, and subject to the Internal Revenue Code of 1939, see § 1.34–5 and § 1.116–2.

§ 1.854–2 NOTICE TO SHAREHOLDERS.—Section 854(b)(2) provides that the amount that a shareholder may treat as a dividend for purposes of the credit for dividends received by individuals provided by section 34(a), the exclusion for dividends received by individuals provided by section 116, and the deduction for dividends received by corporations provided by section 243, shall not exceed the amount so designated by the company in a written notice to its shareholders mailed not later than 30 days after the close of the company's taxable year. If, however, the amount so designated by the company in the notice exceeds the amount which may be treated by the shareholder as a dividend for such purposes, the shareholder is limited to the amount as correctly ascertained under section 854(b)(1) and § 1.854–1(c).

§ 1.854–3 DEFINITIONS.—(a) For the purpose of computing the limitation prescribed by section 854(b)(1)(B) and § 1.854–1(c), the term "gross income" does not include gain from the sale or other disposition of stock or securities. However, capital gains arising from the sale or other disposition of capital assets, other than stock or securities, shall not be excluded from gross income for this purpose.

(b) The term "aggregate dividends received" includes only dividends received from domestic corporations other than dividends described in section 116(b) (relating to dividends not eligible for exclusion from gross income). Accordingly, dividends received from foreign corporations will not be included in the computation of "aggregate dividends received". In determining the amount of any dividend for purposes of this section, the rules provided in section 116(c) (relating to certain distributions) shall apply.

§ 1.855 STATUTORY PROVISIONS; DIVIDENDS PAID BY REGULATED INVESTMENT COMPANY AFTER CLOSE OF TAXABLE YEAR.

SEC. 855. DIVIDENDS PAID BY REGULATED INVESTMENT COMPANY AFTER CLOSE OF TAXABLE YEAR.

(a) GENERAL RULE.—For purposes of this chapter, if a regulated investment company—

(1) Declares a dividend prior to the time prescribed by law for the filing of its return for a taxable year (including the period of any extension of time granted for filing such return), and

(2) Distributes the amount of such dividend to shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular divdend payment made after such declaration,

the amount so declared and distributed shall, to the extent the company elects in such return in accordance with regulations prescribed by the Secretary or his delegate, be considered as having been paid during such taxable year, except as provided in subsections (b), (c) and (d).

(b) RECEIPT BY SHAREHOLDER.—Amounts to which subsection (a) is applicable shall be treated as received by the sharehloder in the taxable year in which the distribution is made.

(c) NOTICE TO SHAREHOLDERS.—In the case of amounts to which subsection (a) is applicable, any notice to shareholders required under this subchapter with respect to such amounts shall be made not later than 30 days after the close of the taxable year in which the distribution is made.

(d) FOREIGN TAX ELECTION.—If an investment company to which section 853 is applicable for the taxable year makes a distribution as provided in subsection (a) of this section, the shareholders shall con-

sider the amounts described in section 853(b)(2) allocable to such distribution as paid or received, as the case may be, in the taxable year in which the distribution is made.

§ 1.855–1 DIVIDENDS PAID BY REGULATED INVESTMENT COMPANY AFTER CLOSE OF TAXABLE YEAR.—(a) *General rule.*—In—

(1) Determining under section 852(a) and § 1.852–1(a) whether the deduction for dividends paid during the taxable year (without regard to capital gain dividends) by a regulated investment company equals or exceeds 90 percent of its investment company taxable income (determined without regard to the provisions of section 852(b)(2)(D)),

(2) Computing its investment company taxable income (under section 852(b)(2) and § 1.852–3), and

(3) Determining the amount of capital gain dividends (as defined in section 852(b)(3) and § 1.852–4(b)) paid during the taxable year,

any dividend (or portion thereof) declared by the investment company either before or after the close of the taxable year but in any event before the time prescribed by law for the filing of its return for the taxable year (including the period of any extension of time granted for filing such return) shall, to the extent the company so elects in such return, be treated as having been paid during such taxable year. This rule is applicable only if the entire amount of such dividend is actually distributed to the shareholders in the 12-month period following the close of such taxable year and not later than the date of the first regular dividend payment made after such declaration.

(b) *Election.*—(1) *Method of making election.*—The election must be made in the return filed by the company for the taxable year. The election shall be made by the taxpayer (the regulated investment company) by treating the dividend (or portion thereof) to which such election applies as a dividend paid during the taxable year in computing its investment company taxable income, or if the dividend (or portion thereof) to which such election applies is to be designated by the company as a capital gain dividend, in computing the amount of capital gain dividends paid during such taxable year. The election provided in section 855(a) may be made only to the extent that the earnings and profits of the taxable year (computed with the application of section 852(c) and § 1.852–5) exceed the total amount of distributions out of such earnings and profits actually made during the taxable year (not including distributions with respect to which an election has been made for a prior year under section 855(a)). The dividend or portion thereof, with respect to which the regulated investment company has made a valid election under section 855(a), shall be considered as paid out of the earnings and profits of the taxable year for which such election is made, and not out of the earnings and profits of the taxable year in which the distribution is actually made.

(2) *Irrevocability of the election.*—After the expiration of the time for filing the return for the taxable year for which an election is made under section 855(a), such election shall be irrevocable with respect to the dividend or portion thereof to which it applies.

(c) *Receipt by shareholders.*—Under section 855(b), the dividend or portion thereof, with respect to which a valid election has been

made, will be includible in the gross income of the shareholders of the regulated investment company for the taxable year in which the dividend is received by them.

(d) *Examples.*—The application of paragraphs (a), (b), and (c) of this section may be illustrated by the following examples:

Example (1). The X Company, a regulated investment company, had taxable income (and earnings or profits) for the calendar year 1954 of $100,000. During that year the company distributed to shareholders taxable dividends aggregating $88,000. On March 10, 1955, the company declared a dividend of $37,000 payable to shareholders on March 20, 1955. Such dividend consisted of the first regular quarterly dividend for 1955 of $25,000 plus an additional $12,000 representing that part of the taxable income for 1954 which was not distributed in 1954. On March 15, 1955, the X Company filed its Federal income tax return and elected therein to treat $12,000 of the total dividend of $37,000 to be paid to shareholders on March 20, 1955, as having been paid during the taxable year 1954. Assuming that the X Company actually distributed the entire amount of the dividend of $37,000 on March 20, 1955, an amount equal to $12,000 thereof will be treated for the purposes of section 852(a) as having been paid during the taxable year 1954. Such amount ($12,000) will be considered by the X Company as a distribution out of the earnings and profits for the taxable year 1954, and will be treated by the shareholders as a taxable dividend for the taxable year in which such distribution is received by them.

Example (2). The Y Company, a regulated investment company, had taxable income (and earnings or profits) for the calendar year 1954 of $100,000, and for 1955 taxable income (and earnings or profits) of $125,000. On January 1, 1954, the company had a deficit in its earnings and profits accumulated since February 28, 1913, of $115,000. During the year 1954 the company distributed to shareholders taxable dividends aggregating $85,000. On March 5, 1955, the company declared a dividend of $65,000 payable to shareholders on March 31, 1955. On March 15, 1955, the Y Company filed its Federal income tax return in which it included $40,000 of the total dividend of $65,000 payable to shareholders on March 31, 1955, as a dividend paid by it during the taxable year 1954. On March 31, 1955, the Y Company distributed the entire amount of the dividend of $65,000 declared on March 5, 1955. The election under section 855(a) is valid only to the extent of $15,000, the amount of the undistributed earnings and profits for 1954 ($100,000 earnings and profits less $85,000 distributed during 1954). The remainder ($50,000) of the $65,000 dividend paid on March 31, 1955, could not be the subject of an election, and such amount will be regarded as a distribution by the Y Company out of earnings and profits for the taxable year 1955. Assuming that the only other distribution by the Y Company during 1955 was a distribution of $75,000 paid as a dividend on October 31, 1955, the total amount of the distribution of $65,000 paid on March 31, 1955, is to be treated by the shareholders as taxable dividends for the taxable year in which such dividend is received. The Y Company will treat the amount of $15,000 as a distribution of the earnings or profits of the company for the taxable year 1954, and the remaining $50,000 as a distribution of the earnings or profits for the year 1955. The dis-

tribution of $75,000 on October 31, 1955, is, of course, a taxable dividend out of the earnings and profits for the year 1955.

(e) *Notice to shareholders.*—Section 855(c) provides that in the case of dividends, with respect to which a regulated investment company has made an election under section 855(a), any notice to shareholders required under subchapter M, with respect to such amounts, shall be made not later than 30 days after the close of the taxable year in which the distribution is made. Thus, the notice requirements of section 852(b)(3)(C) and § 1.852–4(b) with respect to capital gain dividends, section 853(c) and § 1.853–3 with respect to allowance to shareholder of foreign tax credit, and section 854(b)(2) and § 1.854–2 with respect to the amount of a distribution which may be treated as a dividend, may be satisfied with respect to amounts to which section 855(a) and this section apply if the notice relating to such amounts is mailed to the shareholders not later than 30 days after the close of the taxable year in which the distribution is made. If the notice under section 855(c) relates to an election with respect to any capital gain dividends, such capital gain dividends shall be aggregated by the investment company with the designated capital gain dividends actually paid during the taxable year to which the election applies (not including such dividends with respect to which an election has been made for a prior year under section 855) for the purpose of determining whether the aggregate of the designated capital gain dividends with respect to such taxable year of the company is greater than the excess of the net long-term capital gain over the net short-term capital loss of the company. See section 852(b)(3)(C) and § 1.852–4(b).

(f) *Foreign tax election.*—Section 855(d) provides that in the case of an election made under section 853 (relating to foreign taxes), the shareholder of the investment company shall consider the foreign income received, and the foreign tax paid, as received and paid, respectively, in the shareholder's taxable year in which distribution is made.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved May 28, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

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SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART I.—DETERMINATION OF SOURCES OF INCOME

SECTION 861.—INCOME FROM SOURCES WITHIN THE UNITED STATES

Rev. Rul. 57–69

Employees of offices of United States agencies or instrumentalities in foreign countries, other than citizens or resident aliens of

the United States, may be exempt from United States income tax on compensation for personal services performed in the United States provided they meet the conditions of section 861(a)(3) of the Intetrnal Revenue Code of 1954.

Advice has been requested relative to the extent to which employees of United States agencies or instrumentalities in foreign countries, other than citizens or resident aliens of the United States, may be exempt from Federal income tax on compensation for personal services performed in the United States.

Section 861(a) of the Internal Revenue Code of 1954, relating to the taxation of nonresident alien individuals, provides in part:

Section 861(a) GROSS INCOME FROM SOURCES WITHIN THE UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

* * * * * * *

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if—

(A) the labor or services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

(B) such compensation does not exceed $3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under contract with—

(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(ii) a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such corporation.

It is clear that the United States as a sovereign entity is a corporation, and nonresident aliens hired by an agency or instrumentality of the United States would be hired therefore by a domestic corporation. *Helvering v. Stockholm Enskilda Bank*, 293 U. S. 84, Ct. D. 887, C. B. XIII–2, 298 (1934). See also *Hancock* v. *Louisville and Nashville R. R. Co.*, 145 U. S. 409 (1892), where it would appear that a United States agency or instrumentality could be considered to be a corporation since the court there stated, "It is enough that an artificial entity was created with power to exercise the functions of a corporation."

Accordingly, it is held that employees of instrumentalities or agencies of the United States in foreign countries, other than citizens or alien residents of the United States, may be exempt from Federal income tax with respect to compensation for personal services performed in the United States provided the other conditions of section 861(a)(3) of the Internal Revenue Code of 1954 are met.

In this connection, it is to be noted that, under the provisions of several of the bilateral income tax conventions between the United States and various foreign countries, an individual resident of the foreign country shall be exempt from Federal income tax upon compensation for personal services performed in the United States 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 his compensation for such personal services does not exceed a certain stated amount. But, even though such compensation may be exempt

from Federal income tax, it does not necessarily follow that such income is exempt from the withholding of tax under section 1441 of the Code. However, if the withholding agent can certify, upon the basis of experience and judgement, and that in each case the time spent in this country will not exceed 183 days during the taxable year and that the compensation for all services performed in the United States by each employee will not exceed $3,000 in the aggregate during such year, no withholding of United States income tax will be required. In certain cases, however, where income tax conventions exist between the United States and foreign countries, specific provisions relating to the number of days of presence in the United States and the amount of compensation will govern over the above stated general rule.

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

Rev. Rul. 57-62

The privilege tax imposed by section 178 of the National Internal Revenue Code of the Republic of the Philippines, is not an income, war profit, or excess profits tax, or a tax imposed in lieu of such taxes, for which a credit is allowable under the provisions of section 901 of the Internal Revenue Code of 1954.

Advice has been requested whether the tax imposed by section 178 of the National Internal Revenue Code of the Republic of the Philippines is allowable as a credit against United States income taxes under the provisions of section 901 of the Internal Revenue Code of 1954.

Section 178 of the Philippine Code provides that "A privilege tax must be paid before any business or occupation hereinafter specified can be lawfully begun or pursued. The tax on business is payable for every separate or distinct establishment or place where business subject to the tax is conducted; and one occupation or line of business does not become exempt by being conducted with some other occupation or business for which such tax has been paid. * * *" Sections 192 and 195 of the Philippine Code set forth the provisions under which the privilege tax is applicable to the taxpayer in the instant case.

Section 192 of the Philippine Code provides, in part, that "Keepers of garages, transportation contractors, persons who transport passengers or freight for hire, and common carriers by land, air, or water, except owners of bancas, and owners of animal-drawn two-wheeled vehicles, shall pay a tax equivalent to two *per centum* of their gross receipts: *Provided*, that those whose gross receipts do not exceed two hundred pesos each quarter shall be exempt from the payment of the tax provided for in this section."

Section 195 of the Philippine Code provides, in part, that "Stock, real estate, commercial, customs, and immigration brokers shall pay a percentage tax equivalent to six *per centum* of the gross compensa-

tion received by them. Cinematographic film owners, lessors, or distributors shall pay a percentage tax of two *per centum* of their gross receipts."

In order for a tax paid to a foreign country or possession of the United States to be allowable for credit against United States income taxes, it must be shown that such tax is a tax on income, war profits, or excess profits within the meaning of section 901 of the Internal Revenue Code of 1954, or is a tax imposed in lieu of such a tax within the meaning of section 903.

Under the provisions of section 178 of the Philippine Code, set forth above, a tax is imposed on the privilege of carrying on or doing business or conducting an occupation and is payable as a condition of doing business or conducting an occupation. As applied to a business referred to in sections 192 and 195 of the Philippine Code, the amount of such tax is measured by a percentage of the gross receipts of the business. Such tax is payable whether or not income, as defined for United States tax purposes, is realized. Payment of such tax does not relieve a taxpayer from payment of the income tax imposed by Title II of the Philippine Code.

Accordingly, it is held that the privilege tax levied under section 178 of the National Internal Revenue Code of the Republic of the Philippines is not an income, war profits, or excess profits tax, or a tax imposed in lieu of such taxes, for which a credit is allowable under the provisions of section 901 of the Internal Revenue Code of 1954. See *Elias Mallouk et al.* v. *Commissioner*, 34 B. T. A. 269.

Rev. Rul. 57–106

Income taxes payable to a foreign country which are accrued against a domestic corporation and are assumed by a foreign corporation incident to the sale thereto of the assets of the domestic corporation constitute part of the sales price of the assets and are allowable as a credit under section 901 of the Internal Revenue Code of 1954 only to the domestic corporation, the entity upon whom the foreign government imposed the tax.

Advice has been requested whether a domestic corporation doing business in a foreign country is allowed a credit for income taxes paid or accrued under the provisions of section 901 of the Internal Revenue Code of 1954, under the circumstances set forth below.

A foreign corporation purchased for a stated price substantially all the assets of two affiliates of a domestic corporation. The affiliates were doing business in a foreign country but were incorporated in the United States. In addition to the purchase price, the purchaser agreed to pay all taxes relating to the sale. The foreign corporation was granted a subsidy by its country equivalent to 100 percent of the taxes as a result of the acquisition of the property. When the domestic corporation filed its consolidated returns for United States income taxes, it included the income of the affiliated companies. The amount of foreign taxes imposed on the seller but paid by the purchaser was included in the United States income tax return of the domestic corporation and affiliates as a part of the amount realized on the sale and a credit claimed for the foreign taxes as being paid or accrued under the provisions of section 901 of the Internal Revenue Code of 1954.

There is an analogy in this situation with the concept set out in section 39.23(a)–10(a) of Income Tax Regulations 118, which are made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, wherein the amount of taxes paid by a tenant for a landlord are held to be taxable income to the landlord, and the amount of such taxes are deductible by the landlord.

Under the provisions of section 901(b) of the Code, a domestic corporation shall be allowed a foreign tax credit, subject to the limitation of section 904, with respect to 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.

Accordingly, it is held that income taxes payable to a foreign country which have accrued against a domestic corporation and which are assumed by a foreign corporation as an incident to the sale of assets of the domestic corporation, constitute part of the sales price of the assets and are allowable as a credit to the domestic corporation, which is the entity upon whom the foreign government imposed the tax.

(Also Part II, Section 131(a); Regulations 118, Section 39.131(a)–2.) Rev. Rul. 57–153

In any case involving a determination under section 901(b)(3) of the Internal Revenue Code of 1954 as to the entitlement of an alien resident of the United States or Puerto Rico to credit against his United States income tax for taxes paid or accrued during the taxable year to the foreign country of which such alien is a citizen or subject, the Internal Revenue Service will require that such alien taxpayer furnish a certified copy of a translation of the current tax law of such foreign country as evidence that the tax imposed by the statutes of such foreign country comes within the United States concept of an "income, war profits, or excess profits tax." Where a determination is required as to the entitlement of such an alien resident to credit against his United States income tax for taxes paid or accrued during the taxable year to a foreign country other than his own, it will also be necessary for him to furnish such evidence that the tax imposed by such other country is an income or profits tax. For the purpose of determining whether the similar credit requirements of section 901(b)(3) of the Code are met, the Service will accept either a certified translated copy of the law providing for allowance of similar credit by the country of which the alien resident is a citizen or subject; an official statement from an accredited diplomatic representative of such foreign country, containing excerpts of the pertinent current laws of the country and evidence of the country's current practice with respect to the allowance of a similar credit to a United States citizen residing in that country; or such other official document originating from the alien resident's country containing matter of sufficient scope and quality to enable the Service to ascertain whether such country meets the similar credit requirements.

O. D. 253, C. B. 1, 162 (1919), revoked.

The Internal Revenue Service recognizes a need for clarification of the administrative requirements of section 901 of the Internal Revenue Code of 1954 (formerly section 131(a) of the Internal Revenue Code of 1939) with respect to the evidence which is acceptable from an alien resident of the United States or Puerto Rico in a case requiring a determination by the Service as to his entitlement to credit against his United States income tax for taxes paid to a particular foreign country.

In each case where a taxpayer claims credit against his United States income tax for taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States, as provided in section 901 of the Code, a determination must be made whether the tax imposed by such foreign country or possession is an income, war profits, or excess profits tax. Section 903 of the Code provides that "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."

With respect to an alien resident of the United States or Puerto Rico, section 901 (b) of the Code provides:

> (b) AMOUNT ALLOWED.—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):
>
> * * * * * * *
>
> (3) * * * In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign county of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; * * *

Accordingly, when an alien resident of the United States or Puerto Rico claims a tax credit under section 901 of the Code, in addition to determining whether the tax for which credit is claimed is an income or profits tax within the purview of section 901 or 903 of the Code, the Service must also determine whether the foreign country, of which such alien resident is a citizen or subject, in imposing an income or profits tax satisfies the similar credit requirements of section 901(b)(3) of the Code.

Under section 901(b)(3) of the Code, a credit may be allowed against the United States income tax liability of an alien resident of the United States or Puerto Rico for income or profits taxes paid or accrued to any foreign country, *i. e.*, his own or any other foreign country. In order for an alien residing in the United States or Puerto Rico to receive a credit for a tax paid to a foreign country other than his own country, the country of which he is a citizen or subject, *and not the country to which the tax is paid*, must allow a similar credit against its income or profits tax to a United States citizen residing in the country of which the alien is a national for a tax paid to the other country. See *Charles W. Bowring* v. *Commissioner*, 27 B. T. A. 449; *Max Freudmann et al.* v. *Commissioner*, 10 T. C. 775.

O. D. 253, C. B. 1, 162 (1919), dealing with the somewhat similar administrative requirements with respect to the credit for personal exemption and dependents allowed by section 216 of the Revenue Act of 1918, provides:

> In order that a nonresident alien may prove that his country satisfies the similar credit requirement of the income tax law, he should submit to the Commissioner a copy of the income tax laws of his native country, or an official communication from an accredited diplomatic representative of such country, showing that the country imposes no income tax, or in doing so grants similar credits required by statute.

In any case involving a determination under section 901(b)(3) of the Code as to the entitlement of an alien resident of the United States or Puerto Rico to credit against his United States income tax

for taxes paid or accrued during the taxable year to the foreign country of which such taxpayer is a citizen or subject, the Service will require that such alien taxpayer furnish a certified copy of a translation of the pertinent provisions of the current tax law of such foreign country as evidence that the tax imposed by the statutes of such foreign country comes within the United States concept of an "income, war profits, or excess profits tax." Where a determination is required as to the entitlement of such an alien resident to credit against his United States income tax for taxes paid or accrued during the taxable year to a foreign country other than his own, it will also be necessary for him to furnish such evidence that the tax imposed by such other country is an income or profits tax. For the purpose of determining whether the similar credit requirements of section 901(b)(3) of the Code are met, the Service will accept either a certified translated copy of the pertinent provisions of the law providing for allowance of similar credit by the country of which the alien resident is a citizen or subject; an official statement from an accredited diplomatic representative of such foreign country, containing excerpts of the pertinent current laws of the country and evidence of the country's current practice with respect to the allowance of a similar credit to a United States citizen residing in that country; or such other official document originating from the alien resident's country containing matter of sufficient scope and quality to enable the Service to ascertain whether such country meets the similar credit requirements.

Since the provisions of law under which O. D. 253, C. B. 1, 162 (1919), was issued are no longer in effect, O. D. 253 is hereby revoked.

SECTION 904.—LIMITATION ON CREDIT

(Also Section 63.) Rev. Rul. 57–116

> Where substantial net long-term capital gains were realized in a taxable year by a member of an affiliated group of corporations which may result in the consolidated income tax liability being computed by the alternative tax method, the fraction limiting a foreign tax credit, as provided in section 904 of the Internal Revenue Code of 1954, is applicable to the total United States income tax of the affiliated group for the taxable year, whether computed by the regular method or by the alternative method.

Advice has been requested concerning the limitation applicable to a foreign tax credit of an affiliated group of corporations filing a consolidated income tax return where consolidated income tax liability was computed according to the alternative tax method.

M corporation is a parent corporation of an affiliated group of corporations which filed a consolidated income tax return for the calendar year 1955. The income of *M* consisted of dividends from domestic corporations, dividends from a wholly-owned foreign subsidiary, and net long-term capital gains. The net long-term capital gains were sufficiently substantial to result in the consolidated income tax liability being computed under the alternative tax method. The foreign subsidiary paid income tax to the foreign country on income received in that country.

Section 904 of the Internal Revenue Code of 1954 provides that the amount of the credit for taxes 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 bears to its entire taxable income for the same taxable year. For the purpose of the limiting fraction under section 904, the term "taxable income" as used therein means the taxable income as defined in section 63 of the Code; and the tax to which the limiting fraction is applied is the total United States tax, whether computed by the regular method or by the alternative tax method.

Accordingly, it is held that where substantial net long-term capital gains were realized in a taxable year by a member of an affiliated group of corporations which may result in the consolidated tax liability being computed by the alternative tax method, the fraction limiting a foreign tax credit, as provided in section 904 of the Code, is applicable to the total United States income tax of the affiliated group for the taxable year, whether computed by the regular method or by the alternative method.

SUBPART B.—EARNED INCOME OF CITIZENS OF UNITED STATES

SECTION 911.—EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

Rev. Rul. 57-142

All of the farm income derived by a United States citizen, a bona fide resident in Mexico, who rents and operates a truck farm in Mexico with the use of his farm equipment of comparatively little value, represents earned income for the purpose of the exclusion provided by section 911(a) of the Internal Revenue Code of 1954.

Advice has been requested whether, for the purpose of the exclusion provided by section 911(a) of the Internal Revenue Code of 1954, the earned income of a United States citizen who operates a truck farm in Mexico consists of his entire net earnings or an amount not in excess of 30 percent of the net profits from such farm operations.

In the instant case, the taxpayer, a United States citizen and a bona fide resident in Mexico, has leased farm lands in Mexico in order to operate a truck farm. He owns certain farm equipment of comparatively little value. The actual labor on the farm is done primarily by the taxpayer.

Section 911(a) of the Code provides, in part (with certain exceptions not here material), for the statutory exclusion from gross income of earned income from sources without the United States in the case of a United States citizen who is a bona fide resident of a foreign country.

Section 911(b) of the Code reads in part as follows:

For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, * * *. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, * * *, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

In general, farming is a business requiring a substantial use of capital. However, because the farm equipment in the instant case is of

comparatively little value, capital is not a material income-producing factor. Therefore, all of the farm income represents earned income for the purpose of the exclusion provided by section 911(a) of the Code. On the other hand, where a farmer owns the land, or is engaged in a type of farming requiring a substantial amount of capital so that both personal services and capital are material income-producing factors, only an amount up to 30 percent of his share of the net profits of the business is considered as earned income.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART II.—COMMON NONTAXABLE EXCHANGES

SECTION 1031.—EXCHANGE OF PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT

26 CFR 1.1031(b)-1: Receipt of other property or money in tax-free exchange. Rev. Rul. 57-244

Applicability of section 1031 of the 1954 Code to a situation involving exchanges of like properties and cash among three individuals.

Advice has been requested whether an exchange of lots by three taxpayers under the circumstances set forth below constitutes a nontaxable exchange of property within the purview of section 1031 of the Internal Revenue Code of 1954.

In 1950, three taxpayers, *A*, *B*, and *C*, acquired from another individual a tract of 25 acres of undeveloped land in a residential suburb of a city. After the property was divided into three separate lots slightly unequal in size, the parties entered into an agreement among themselves that the lots could not be subdivided in the future. The agreement also contained a statement that the land was purchased by each of them for the purpose of constructing homes thereon.

Shortly after the acquisition of the property, the three individuals abandoned their plans to construct homes on the property because *A* acquired a home elsewhere in the city; *B*, by reason of his employment, moved to another city; and *C*, a single individual, decided not to build a home for himself. However, they did not then dispose of the property but continued to hold it for investment purposes.

In 1955, the three individuals agreed to exchange lots, with any difference in acreage to be paid for at the rate of $100x$ dollars per acre. In the exchange, *C* acquired the lot owned by *B*, *B* acquired the lot owned by *A*, and *A* acquired the lot owned by *C*. After the exchange, *A* sold the lot acquired from *C* to another individual.

Section 1031(a) of the Code provides, in effect, that no gain or loss shall be recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment.

Where money is received as boot in an exchange, section 1031 of the Code provides, in effect, that if an exchange would be within the

provisions of section 1031(a) of the Code if it were not for the fact that money was also received in the exchange, then the gain, if any, to the recipient shall be recognized but not in excess of the money received.

In view of the foregoing, it is held that the above-described transactions constitute exchanges within the meaning of section 1031 of the Code, and the gain, if any, is recognized only to the extent of the cash received. Compare *W. D. Haden Co.* v. *Commissioner*, 165 Fed. (2d) 588. The basis of the property acquired in the exchange is the basis of the property transferred by the taxpayer, decreased by the amount of any money received and increased by the amount of any gain recognized on the exchange.

SECTION 1033.—INVOLUNTARY CONVERSIONS

26 CFR 1.1033(a): Statutory provisions; common nontaxable exchanges; involuntary conversions; general rule. T. D. 6222[1]

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

Regulations with respect to section 1033 of the Internal Revenue Code of 1954 (relating to involuntary conversions).

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 8, 1956, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, under section 1033 of the Internal Revenue Code of 1954 was published in the Federal Register (21 F. R. 3931). After consideration of all such relevant matter as was presented by interested parties regarding the rules proposed, the regulations as so published have been modified and are hereby adopted as set forth below. The regulations so adopted do not give effect to the amendment to section 1033, relating to livestock sold on account of drought, which was made by section 5 of Public Law 629, 84th Congress, approved June 29, 1956 [C. B. 1956-2, 1165]. Notice of rulemaking with respect to regulations under such amendment will be published in the Federal Register at a later date.

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[1] The publication of this Treasury Decision in 22 F. R. 215, dated January 10, 1957, contains (1) a series of instructions for modifying the notice of proposed rulemaking published in 21 F. R. 3931, dated June 8, 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.

Authority: §§ 1.1033(a) to 1.1033(f)-1, incl., issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

The following regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, are hereby prescribed under section 1033 of the Internal Revenue Code of 1954:

§ 1.1033(a) STATUTORY PROVISIONS; COMMON NONTAXABLE EXCHANGES; INVOLUNTARY CONVERSIONS; GENERAL RULE.

SEC. 1033. INVOLUNTARY CONVERSIONS.

(a) GENERAL RULE.—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(1) CONVERSION INTO SIMILAR PROPERTY.—Into property similar or related in service or use to the property so converted, no gain shall be recognized.

(2) CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED PRIOR TO 1951.—Into money, and the disposition of the converted property occurred before January 1, 1951, no gain shall be recognized if such money is forthwith in good faith, under regulations prescribed by the Secretary or his delegate, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund. If any part of the money is not so expended, the gain shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain). For purposes of this paragraph and paragraph (3), the term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(3) CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED AFTER 1950.—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) NONRECOGNITION OF GAIN.—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation

owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. For purposes of this paragraph—

(i) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) The taxpayer shall be considered to have purchased property or stock only if, but for the provisions of subsection (c) if this section, the unadjusted basis of such property or stock would be its cost within the meaning of section 1012.

(B) PERIOD WITHIN WHICH PROPERTY MUST BE REPLACED.—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending——

(i) One year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) Subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

(C) TIME FOR ASSESSMENT OF DEFICIENCY ATTRIBUTABLE TO GAIN UPON CONVERSION.—If a taxpayer has made the election provided in subparagraph (A), then—

(i) The statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain on such conversion is realized, attributable to such gain shall not expire prior to the expiration of 3 years from the date the Secretary or his delegate is notified by the taxpayer (in such manner as the Secretary or his delegate may by regulations prescribe) of the replacement of the converted property or of an intention not to replace, and

(ii) Such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of section 6212 (c) or the provisions of any other law or rule of law which would otherwise prevent such assessment.

(D) TIME FOR ASSESSMENT OF OTHER DEFICIENCIES ATTRIBUTABLE TO ELECTION.—If the election provided in subparagraph (A) is made by the taxpayer and such other property or such stock was purchased before the beginning of the last taxable year in which any part of the gain upon such conversion is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last taxable year may be assessed (notwithstanding the provisions of section 6212 (c) or 6501 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

§ 1.1033(a)-1 INVOLUNTARY CONVERSIONS; NONRECOGNITION OF GAIN—(a) *In general.*—Section 1033 applies to cases where property is compulsorily or involuntarily converted. An "involuntary conversion" may be the result of the destruction of property in whole or

in part, the theft of property, the seizure of property, the requisition or condemnation of property, or the threat or imminence of requisition or condemnation of property. An "involuntary conversion" may be a conversion into similar property or into money or into dissimilar property. Section 1033 provides that, under certain specified circumstances, any gain which is realized from an involuntary conversion shall not be recognized. In cases where property is converted into other property similar or related in service or use to the converted property, no gain shall be recognized regardless of when the disposition of the converted property occurred and regardless of whether or not the taxpayer elects to have the gain not recognized. In other types of involuntary conversion cases, however, the proceeds arising from the disposition of the converted property must (within the time limits specified) be reinvested in similar property in order to avoid recognition of any gain realized. Different rules for reinvestment apply, depending upon whether the disposition of the converted property occurred after 1950 or before 1951 (see §§ 1.1033(a)-2, 1.1033(a)-3, and 1.1033(a)-4). Section 1033 applies only with respect to gains; losses from involuntary conversions are recognized or not recognized without regard to this section.

(b) *Special rules.*—For rules relating to basis of property acquired through involuntary conversions, see § 1.1033(c)-1. Special rules apply to involuntary conversions of residence property, property sold pursuant to reclamation laws, and livestock destroyed by disease (see §§ 1.1033(b)-1, 1.1033(d)-1, and 1.1033(e)-1, respectively). For determination of the period for which the taxpayer has held property acquired as a result of certain involuntary conversions, see section 1223 and regulations issued thereunder. For treatment of gains from involuntary conversions as capital gains in certain cases, see section 1231(a) and regulations issued thereunder. For portion of war loss recoveries treated as gain on involuntary conversion, see section 1332(b)(3) and regulations issued thereunder.

§ 1.1033(a)-2 Involuntary Conversion Where Disposition of the Converted Property Occurred After December 31, 1950.—(a) *In general.*—This section applies only with respect to involuntary conversions where the disposition of the converted property occurred after December 31, 1950, and where the proceeds are received in a taxable year to which the Internal Revenue Code of 1954 applies. The term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(b) *Conversion into similar property.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted only into property similar or related in service or use to the property so converted, no gain shall be recognized. Such nonrecognition of gain is mandatory.

(c) *Conversion into money or into dissimilar property*—(1) if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the

gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, if the taxpayer purchased such other property, or such stock, for the purpose of replacing the property so converted and during the period specified in subparagraph (3) of this paragraph. For the purposes of section 1033 the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(2) All of the details in connection with an involuntary conversion of property at a gain (including those relating to the replacement of the converted property, or a decision not to replace, or the expiration of the period for replacement) shall be reported in the return for the taxable year or years in which any of such gain is realized. An election to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph shall be made by including such gain in gross income for such year or years only to such extent. If, at the time of filing such a return, the period within which the converted property must be replaced has expired, or if such an election is not desired, the gain should be included in gross income for such year or years in the regular manner. A failure to so include such gain in gross income in the regular manner shall be deemed to be an election by the taxpayer to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph even though the details in connection with the conversion are not reported in such return. If, after having made an election under section 1033(a)(3), the converted property is not replaced within the required period of time, or replacement is made at a cost lower than was anticipated at the time of the election, or a decision is made not to replace, the tax liability for the year or years for which the election was made shall be recomputed. Such recomputation should be in the form of an "amended return". If a decision is made to make an election under section 1033(a)(3) after the filing of the return and the payment of the tax for the year or years in which any of the gain on an involuntary conversion is realized and before the expiration of the period within which the converted property must be replaced, a claim for credit or refund for such year or years should be filed. If the replacement of the converted property occurs in a year or years in which none of the gain on the conversion is realized, all of the details in connection with such replacement shall be reported in the return for such year or years.

(3) The period referred to in subparagraphs (1) and (2) of this paragraph is the period of time commencing with the date of the disposition of the converted property, or the date of the beginning of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier, and ending one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or at the close of such later date as may

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

(4) Property or stock purchased before the disposition of the converted property shall be considered to have been purchased for the purpose of replacing the converted property only if such property or stock is held by the taxpayer on the date of the disposition of the converted property. Property or stock shall be considered to have been purchased only if, but for the provisions of section 1033(c), the unadjusted basis of such property or stock would be its cost to the taxpayer within the meaning of section 1012. If the taxpayer's unadjusted basis of the replacement property would be determined, in the absence of section 1033(c), under any of the exceptions referred to in section 1012, the unadjusted basis of the property would not be its cost within the meaning of section 1012. For example, if property similar or related in service or use to the converted property is acquired by gift and its basis is determined under section 1015, such property will not qualify as a replacement for the converted property.

(5) If a taxpayer makes an election under section 1033(a)(3), any deficiency, for any taxable year in which any part of the gain upon the conversion is realized, which is attributable to such gain may be assessed at any time before the expiration of three years from the date the district director with whom the return for such year has been filed is notified by the taxpayer of the replacement of the converted property or of an intention not to replace, or of a failure to replace, within the required period, notwithstanding the provisions of section 6212(c) or the provisions of any other law or rule of law which would otherwise prevent such assessment. If replacement has been made, such notification shall contain all of the details in connection with such replacement. Such notification should be made in the return for the taxable year or years in which the replacement occurs, or the intention not to replace is formed, or the period for replacement expires, if this return is filed with such district director. If this return is not filed with such district director, then such notification shall be made to such district director at the time of filing this return. If the taxpayer so desires, he may, in either event, also notify such district director before the filing of such return.

(6) If a taxpayer makes an election under section 1033(a)(3) and the replacement property or stock was purchased before the beginning of the last taxable year in which any part of the gain upon the conversion is realized, any deficiency, for any taxable year ending before such last taxable year, which is attributable to such election may be assessed at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any law or rule of law which would otherwise prevent such assessment.

(7) If the taxpayer makes an election under section 1033(a)(3), the gain upon the conversion shall be recognized to the extent that the amount realized upon such conversion exceeds the cost of the replacement property or stock, regardless of whether such amount is realized in one or more taxable years.

(8) The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

(9) There is no investment in property similar in character and devoted to a similar use if—

(i) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(ii) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(iii) The owner of a requisitioned tug uses the proceeds to buy barges.

(10) If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation, the amount so retained shall be deducted from the gross award in determining the amount of the net award.

(11) If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property, and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. If, in a condemnation proceeding, the Government makes an award to a mortgagee to satisfy a mortgage on the condemned property, the amount of such award shall be considered as a part of the "amount realized" upon the conversion regardless of whether or not the taxpayer was personally liable for the mortgage debt. Thus, if a taxpayer has acquired property worth $100,000 subject to a $50,000 mortgage (regardless of whether or not he was personally liable for the mortgage debt) and, in a condemnation proceeding, the Government awards the taxpayer $60,000 and awards the mortgagee $50,000 in satisfaction of the mortgage, the entire $110,000 is considered to be the "amount realized" by the taxpayer.

(12) An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

§ 1.1033(a)-3 Involuntary Conversion Where Disposition of the Converted Property Occurred Before January 1, 1951.—(a) This section applies only with respect to involuntary conversions where the disposition of the converted property occurred before January 1, 1951, and where the proceeds are received in a taxable year to which the Internal Revenue Code of 1954 applies. The term "disposition of the converted property" means the destruction, theft,

seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(b) (1) Upon the involuntary conversion of property described in section 1033, no gain is recognized if the provisions of that section are complied with. If any part of the money received as a result of such an involuntary conversion is not expended in the manner provided in section 1033(a)(2), the gain, if any, is recognized to the extent of the money which is not so expended. For example, a vessel purchased by A in 1949 for $100,000 is destroyed by a typhoon in 1950, and A receives in 1954 insurance in the amount of $100,000. This money is not expended in the manner provided in section 1033(a)(2), but there is no gain since the insurance does not exceed the basis (disregarding, for the purposes of this example, the adjustment for depreciation). In 1955, A receives insurance from a second policy of $200,000 on account of the destruction of the vessel. He expends this amount in the manner provided in section 1033(a)(2). The gain in 1955 upon the receipt of the $200,000 is recognized to the extent of $100,000, the amount of the money received in 1954 which was not expended in the manner provided in section 1033(a)(2).

(2) Losses from involuntary conversions are recognized or not recognized without regard to section 1033. The expenditure in the manner provided in section 1033(a)(2) of money received upon an involuntary conversion is not necessary for the transaction to be considered completed for the purpose of determining such loss.

(c) In order to avail himself of the benefits of section 1033(a)(2) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 1033(a)(2) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

(d) If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. If, in a condemnation proceeding, the Government makes an award to a mortgagee to satisfy a mortgage on the condemned property, the amount of such award shall be considered as part of the "money" into which the property is converted, regardless of whether or not the taxpayer was personally liable for the mortgage debt. Thus, if a taxpayer has acquired property worth $100,000 subject to a $50,000 mortgage (regardless of whether or not he was personally liable for the mortgage debt) and, in a condemnation proceeding, the Government awards the taxpayer $60,000 and awards the mortgagee $50,000 in satisfaction of the mortgage, the entire

$110,000 is considered to be the "money" into which the property was converted. An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

(e) The provisions of section 1033(a)(2) are applicable to property used for residiential or farming purposes.

(f) The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

(g) There is no investment in property similar in character and devoted to a similar use if—

(1) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(2) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(3) The owner of a requisitioned tug uses the proceeds to buy barges.

(h) It is incumbent upon a taxpayer "forthwith" to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

[Section 1.1033(a)-3 is substantially the same as § 29.112(f)-1 of Regulations 111.]

§ 1.1033(a)-4 Replacement Funds Where Disposition of the Converted Property Occurred Before January 1, 1951.—(a) This section applies only with respect to involuntary conversions where the disposition of the converted property (as defined in § 1.1033(a)-3) occurred before January 1, 1951, and where the proceeds are received in a taxable year to which the Internal Revenue Code of 1954 applies.

(b) In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately (for example, because of a shortage of materials or an industry-wide strike), he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application on Form 1114 to the district director for the district in which his return is required to be filed for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the district director may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. See 6 U. S. C. 15, (Appendix to the Income Tax Regulations), providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. The estimated additional taxes, for the amount of which the applicant is required to furnish security, should be computed at the rates at

which the applicant would have been obliged to pay, taking into consideration the remainder of his taxable (or net) income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the district director, the applicant, and the surety or depositary may each have a copy.

[Section 1.1033(a)-4 is substantially the same as § 29.112(f)-2 of Regulations 111.]

§ 1.1033(b) STATUTORY PROVISIONS; INVOLUNTARY CONVERSIONS; RESIDENCE OF TAXPAYER.

SEC. 1033. INVOLUNTARY CONVERSIONS. * * *

(b) RESIDENCE OF TAXPAYER.—Subsection (a) shall not apply, in the case of property used by the taxpayer as his principal residence, if the destruction, theft, seizure, requisition, or condemnation of the residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950, and before January 1, 1954.

§ 1.1033(b)-1 INVOLUNTARY CONVERSION OF PRINCIPAL RESIDENCE.—Section 1033 shall apply in the case of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, or condemnation of such residence, or the sale or exchange of such residence under threat or imminence thereof, occurs before January 1, 1951, or after December 31, 1953. Section 1033 shall not apply in the case of an involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition or condemnation of such residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950, and before January 1, 1954. In the case of property disposed of after December 31, 1950, and before January 1, 1954, which is used by the taxpayer partially as a principal residence and partially for other purposes, proper allocation shall be made and § 1.1033(a)-2 and § 1.1033(c)-1 shall apply only with respect to the involuntary conversion of the portion used for such other purposes.

§ 1.1033(c) STATUTORY PROVISIONS; INVOLUNTARY CONVERSIONS; BASIS OF PROPERTY ACQUIRED THROUGH INVOLUNTARY CONVERSION.

SEC. 1033. INVOLUNTARY CONVERSIONS. * * *

(c) BASIS OF PROPERTY ACQUIRED THROUGH INVOLUNTARY CONVERSION.—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in subsection (a) (1) or (2), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made. This subsection shall not apply in respect of property acquired as a result of a compulsory or involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, or condemnation of such residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950, and before January 1, 1954. In the case of property purchased by the taxpayer in a transaction described in subsection (a)(3) which

resulted in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than one piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

§ 1.1033(c)-1 Basis of Property Acquired as a Result of an Involuntary Conversion.—(a) The provisions of the first sentence of section 1033(c) may be illustrated by the following example:

Example. A's vessel which has an adjusted basis of $100,000 is destroyed in 1950 and A receives in 1951 insurance in the amount of $200,000. If A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be recognized. The basis of the new vessel is $100,000; that is, the adjusted basis of the old vessel ($100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

(b) The provisions of the last sentence of section 1033(c) may be illustrated by the following example:

Example. A taxpayer realizes $22,000 from the involuntary conversion of his barn in 1955; the adjusted basis of the barn to him was $10,000, and he spent in the same year $20,000 for a new barn which resulted in the nonrecognition of $10,000 of the $12,000 gain on the conversion. The basis of the new barn to the taxpayer would be $10,000—the cost of the new barn ($20,000) less the amount of the gain not recognized on the conversion ($10,000). The basis of the new barn would not be a substituted basis in the hands of the taxpayer within the meaning of section 1016(b)(2). If the replacement of the converted barn had been made by the purchase of two smaller barns which, together, were similar or related in service or use to the converted barn and which cost $8,000 and $12,000, respectively, then the basis of the two barns would be $4,000 and $6,000, respectively, the total basis of the purchased property ($10,000) allocated in proportion to their respective costs (8,000/20,000 of $10,000, or $4,000; and 12,000/20,000 of $10,000, or $6,000).

§ 1.1033(d) Statutory Provisions; Involuntary Conversions; Property Sold Pursuant to Reclamation Laws.

SEC. 1033. INVOLUNTARY CONVERSIONS. * * *

(d) Property Sold Pursuant to Reclamation Laws.—For purposes of this subtitle, if property lying within an irrigation project is sold or otherwise disposed of in order to conform to the acreage limitation provisions of Federal reclamation laws, such sale or disposition shall be treated as an involuntary conversion to which this section applies.

§ 1.1033(d)-1 Disposition of Excess Property Within Irrigation Project Deemed to be Involuntary Conversion.—(a) The sale, exchange, or other disposition occurring in a taxable year to which the Internal Revenue Code of 1954 applies, of excess lands lying within an irrigation project or division in order to conform to acreage limitations of the Federal reclamation laws effective with respect to such project or division shall be treated as an involuntary conversion

to which the provisions of section 1033 and the regulations thereunder shall be applicable. The term "excess lands" means irrigable lands within an irrigation project or division held by one owner in excess of the amount of irrigable land held by such owner entitled to receive water under the Federal reclamation laws applicable to such owner in such project or division. Such excess lands may be either (1) lands receiving no water from the project or division, or (2) lands receiving water only because the owner thereof has executed a valid recordable contract agreeing to sell such lands under terms and conditions satisfactory to the Secretary of the Interior.

(b) If a disposition in order to conform to the acreage limitation provisions of Federal reclamation laws includes property other than excess lands (as, for example, where the excess lands alone do not constitute a marketable parcel) the provisions of section 1033(d) shall apply only to the part of the disposition that relates to excess lands.

(c) The provisions of § 1.1033(a)-2 shall be applicable in the case of dispositions treated as involuntary conversions under this section. The details in connection with such a disposition required to be reported under § 1.1033(a)-2(c)(2) shall include the authority whereby the lands disposed of are considered "excess lands", as defined in this section, and a statement that such disposition is not part of a plan contemplating the disposition of all or any nonexcess land within the irrigation project or division.

(d) The term "involuntary conversion", where it appears in subtitle A or the regulations thereunder, includes dispositions of excess property within irrigation projects described in this section. (See, e. g., section 1231 and the regulations thereunder.)

§ 1.1033(e) STATUTORY PROVISIONS; INVOLUNTARY CONVERSIONS; LIVESTOCK DESTROYED BY DISEASE.

SEC. 1033. INVOLUNTARY CONVERSIONS. * * *

(e) LIVESTOCK DESTROYED BY DISEASE.—For purposes of this subtitle, if livestock are destroyed by or on account of disease, or are sold or exchanged because of disease, such destruction or such sale or exchange shall be treated as an involuntary conversion to which this section applies.

§ 1.1033(e)-1 DESTRUCTION OR DISPOSITION OF LIVESTOCK BECAUSE OF DISEASE.—(a) The destruction occurring in a taxable year to which the Internal Revenue Code of 1954 applies, of livestock by, or on account of, disease, or the sale or exchange, in such year, of livestock because of disease, shall be treated as an involuntary conversion to which the provisions of section 1033 and the regulations thereunder shall be applicable. Livestock which are killed either because they are diseased or because of exposure to disease shall be considered destroyed on account of disease. Livestock which are sold or exchanged because they are diseased or have been exposed to disease, and would not otherwise have been sold or exchanged at that particular time shall be considered sold or exchanged because of disease.

(b) The provisions of § 1.1033(a)-2 shall be applicable in the case of a disposition treated as an involuntary conversion under this section. The details in connection with such a disposition required to be reported under § 1.1033(a)-2(c)(2) shall include a recital of the evidence that the livestock were destroyed by or on account of disease, or sold or exchanged because of disease.

(c) The term "involuntary conversion," where it appears in subtitle A or the regulations thereunder, includes disposition of livestock described in this section. (See, e. g., section 1231 and the regulations thereunder.)

§ 1.1033(f) STATUTORY PROVISIONS; INVOLUNTARY CONVERSIONS; CROSS REFERENCES.

SEC. 1033. INVOLUNTARY CONVERSIONS. * * *

(f) 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(f)-1 EFFECTIVE DATE.—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, the date of enactment of the Internal Revenue Code of 1954. See section 7851(a)(1)(A).

O. GORDON DELK,
Acting Commissioner.

Approved January 4, 1957.

W. RANDOLPH BURGESS,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on January 9, 1957, at 8:47 a. m., and published in the issue of the Federal Register for January 10, 1957, 22 F.R. 215.)

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26 CFR 1.1033 (a)-1: Involuntary conversions; nonrecognition of gain. Rev. Rul. 57-70

Where in the taxable year 1954, under threat or imminence of condemnation, a corporation sold property to a city and concurrently leased the property for the period prior to its use by the city for the purpose for which acquired, such sale qualifies as an involuntary conversion.

Advice has been requested whether the sale of property by a corporation to a city, where the corporation enters into a five-year lease for the use of the property, qualifies as an involuntary conversion under section 1033 of the Internal Revenue Code of 1954.

A corporation was notified by the city in which it was located that its property would be taken for use in connection with the expansion of an airport. Before commencement of condemnation proceedings, it sold such property to the city in the taxable year 1954. Concurrently, the corporation entered into a five-year lease with the city with an option on the part of the city to cancel after three years from the date of the lease, should the property be required for the purpose acquired. The lease is noncancellable on the part of the corporation and payments under the lease must continue until its expiration; otherwise the balance of the payments will become due and payable in full upon vacating the lease.

Where an authority which has power to condemn property has notified an owner that his property will be taken and the property is sold to such authority through negotiation, such sale is considered to be transacted under threat or imminence of condemnation as contemplated by section 1033 of the Code. The fact that the city

purchased the property before it was actually needed is irrelevant in determining whether an involuntary conversion has taken place.

Accordingly, it is held that the lease back to the corporation of the property which it sold to the city, under threat or imminence of requisition or condemnation, will not disqualify such sale as an involuntary conversion under section 1033 of the Code.

Rev. Rul. 57–117

The sale of property which had lost its value as a golf course when it was bisected by a state highway and the use of the proceeds from the sale to purchase property on which to construct a course comparable to the one originally owned do not qualify for treatment as an involuntary conversion within the meaning of section 1033 of the Internal Revenue Code of 1954.

Advice has been requested whether the transactions described in the following paragraph constitute an involuntary conversion for Federal income tax purposes.

The taxpayer leased his real property to a nonprofit organization which operated a golf club. The state in which the property is located instituted proceedings to condemn acreage through the center of the golf course for a right of way for a state road and paid the taxpayer an agreed amount therefor. As the course was bisected by a heavily traveled highway and it was considered impossible to build a course on the remaining property, the property not taken by the state was sold at a considerable profit as a site for residential development and the proceeds of the sale, together with the amount received from the state, were used to purchase other property upon which a golf course comparable to the one originally owned could be constructed.

Section 1033 of the Internal Revenue Code of 1954 provides in part as follows:

(a) GENERAL RULE.—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof), is compulsorily or involuntarily converted—

Section 1033(a)(3) of the Code provides, generally, that where property is converted into money which is expended for property related in service or use to the property converted, no gain will be recognized, if the taxpayer so elects.

The above section provides for three specific instances under which its benefits may be claimed by and allowed to a taxpayer, namely, the destruction in whole or in part of the property; theft or seizure; and taking the property by the exercise of the power of requisition or condemnation or the threat or imminence thereof. The Board of Tax Appeals in *The Davis Co.* v. *Commissioner*, 6 B. T. A. 281, acquiescence C. B. VI–2, 2 (1927), pointed out that involuntary conversions under the statute may result only from the causes specified therein.

The property sold in the instant case was not under threat or imminence of condemnation and neither was theft or seizure involved. There is no evidence from the facts presented that the present or potential value of the property has been destroyed either in whole or in part. By destruction is meant physical ruin or state of being destroyed. The contract to sell the remainder of the property for an amount which would net the Taxpayer a considerable profit on the transaction, and the fact that no part of the proceeds received for the

condemned portion represented severance damages to the remaining property, indicate that the value or use of the property was not destroyed.

Although in *Massillon-Cleveland-Akron Sign Co.* v. *Commissioner*, 15 T. C. 79, acquiescence C. B. 1950–2, 3, the court stated that the section under consideration is a relief provision and should be liberally construed, it also stated in *Nehi Beverage Co.* v. *Commissioner*, 16 T. C. 1114, that a liberal construction of a relief provision to effectuate the intent of Congress does not mean that a loose construction (which would permit abuse) is justified. The statutory provisions must be met if the taxpayer is to benefit from the non-recognition of gain provisions.

In the Davis case, the sale of property at the request of the local Chamber of Commerce, in order to allow a large business which would be beneficial to the community to locate in its place was considered not to be an involuntary conversion. In *George S. Robins* v. *Commissioner*, 15 B. T. A. 1068, there was no doubt that as a business expediency the petitioner acted with foresight in selling his stock, bearing in mind the conditions that obtained; however, viewed in the light of his legal rights, he was under no compulsion to sell and, therefore, no involuntary conversion was involved. See also *Piedmont-Mt. Airy Guano Co.* v. *Commissioner*, 8 B. T. A. 72, acquiescence C. B. VII–1, 25 (1928), and *Philip F. Tirrell*, 14 B. T. A. 1399, with respect to what constitutes an involuntary conversion.

Accordingly, it is held that the sale of property which had lost its value as a golf course when it was bisected by a state highway and the use of the proceeds from the sale to purchase property on which to construct a course comparable to the one originally owned do not qualify for treatment as an involuntary conversion within the meaning of section 1033 of the Internal Revenue Code of 1954.

Rev. Rul. 57–154

Where involuntarily converted property consisting of a farm on which was located a home which was not used as residence is replaced with an interest, as a tenant in common, in a larger farm having similar improvements, whether or not located in another state, such replacement, if made within the time specified in section 1033(a)(3)(B) of the Internal Revenue Code of 1954, will qualify as a purchase of property similar or related in service or use to the property converted for the purpose of section 1033(a)(3)(A) of the Code. On the other hand, the use of condemnation proceeds for the acquisition of an interest in a partnership owning and operating property similar to that condemned would not constitute such a purchase. Compare Rev. Rul. 55–351, C. B. 1955–1, 343.

(Also Section 61) Rev. Rul. 57–261

The acquisition of property by a city under threat of condemnation, through a leasing agreement, and the exercise of an option contained therein to purchase the property, is a sale for the purposes of section 1033(a) of the Internal Revenue Code of 1954. The rental of the property is not an involuntary conversion and compensation for the use of such property does not constitute a part of

the proceeds from an involuntary conversion, but constitutes rent taxable as ordinary income.

Advice has been requested whether the entire proceeds received from a city under threat of condemnation of property, including rentals for the use of the property, constitute amounts received from an involuntary conversion.

A city desired a taxpayer's property for conversion into a municipal parking lot. Condemnation proceedings would have been commenced if a satisfactory settlement had not been arranged. Under an agreement, the city leased the property for a period of three years at a yearly rental payable in advance. The agreement included options to purchase the land and the improvements at stipulated prices and provided that regardless of when either or both options were exercised the rental payments would be continued for the three-year period. The city purchased the improvements and since that time the property has been used as a municipal parking lot.

An involuntary conversion of property under section 1033 (a) of the Internal Revenue Code of 1954 may be the result of its destruction in whole or in part, theft, seizure, or requisition or condemnation, or threat or imminence thereof. The power of requisition or condemnation implies a taking of property by a public authority for public use, as in the case of eminent domain. The sale of property under threat of condemnation to an authority having power to take the property is considered an involuntary sale of the property.

Accordingly, it is held that the acquisition of property by a city under threat of condemnation, through the execution of a lease and the exercise of an option contained therein to purchase the property and/or the improvements thereon, is a sale under threat or imminence of condemnation. Any gain resulting from such a sale will be subject to the relief provisions of section 1033 (a) of the Code where the taxpayer elects to replace the property with other property similar or related in service or use. However, compensation received for the use of the property pursuant to a lease in conjunction with the involuntary conversion does not constitute a part of the proceeds from an involuntary conversion, but represents rent taxable as ordinary income under section 61 (a) (5) of the Code.

SECTION 1034.—SALE OR EXCHANGE OF RESIDENCE

26 CFR 1.1034–1: Sale or exchange of residence. Rev. Rul. 57–234

A taxpayer who purchases a partially constructed new residence within a year from the sale of his old residence from a builder, who then completes the construction, has not engaged in construction "commenced by the taxpayer" within the meaning of section 1034(c)(5) of the Internal Revenue Code of 1954, and is not entitled to the extension of time to 18 months within which to complete and occupy the new residence in order that he may obtain the privilege of postponing the recognition of gain from the sale of the old residence. Any gain realized from the sale of the old residence will be recognized and subject to Federal income tax under the capital gains provisions of the Code.

Advice has been requested whether a taxpayer, under the circumstances described below, may obtain the nonrecognition of gain privileges provided by section 1034(a) of the Internal Revenue Code of 1954.

The taxpayer sold his residence on September 8, 1954. On July 12, 1955, he signed a contract of sale for a new residence then under construction by a builder. The taxpayer was assured that settlement could be made before September 8, 1955, but final completion by the builder and final inspection delayed the settlement date and occupancy to October 1, 1955.

Section 1034 of the Code, relating to the postponement of the recognition of gain on the sale of a taxpayer's residence where the proceeds of the sale are used to acquire a new residence within one year, or to construct a residence within 18 months, provides, in part, as follows:

> (a) NONRECOGNITION OF GAIN.—If property (in this section called "old residence") used by the taxpayer as his principal residence is sold by him after December 31, 1953, and, within a period beginning 1 year before the date of such sale and ending 1 year after such date, property (in this section called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price (as defined in subsection (b)) of the old residence exceeds the taxpayer's cost of purchasing the new residence.
>
> * * * * * * *
>
> (c) * * * For purposes of this section:
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> * * * * * * *
>
> (5) In the case of a new residence the construction of which was commenced by the taxpayer before the expiration of one year after the date of the sale of the old residence, the period specified in subsection (a), and the 1 year referred to in paragraph (4) of this subsection, shall be treated as including a period of 18 months beginning with the date of the sale of the old residence.

In the instant case, the taxpayer entered into a purchase contract of a new residence then under construction by a builder. The construction of the reisdence was not commenced by the taxpayer, inasmuch as the residence was partially completed at the time of purchase. He did not occupy the residence within the one-year period provided by section 1034(a) of the Code so as to come within the provisions of that section.

Accordingly, it is held that a taxpayer who purchases a partially constructed new residence within a year from the date of the sale of his old residence from a builder, who completed the construction, has not engaged in construction "commenced by the taxpayer" within the meaning of section 1034(c)(5) of the Internal Revenue Code of 1954. Therefore, he is not entitled to the extension of time to 18 months within which to complete and occupy the new residence in order that he may obtain the privilege of postponing the recognition of gain from the sale of the old residence. Any gain realized from the sale of the old residence will be recognized and subject to Federal income tax under the capital gains provisions of the Code.

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSETS DEFINED

Rev. Rul. 57-9

Income from the sale of tree stumps from land held by an investment company which is not in the timber or stump business, either as a buyer, seller or processor, is taxable as a capital gain where the land was acquired in a cutover state as a real estate investment and the stumps were sold in one lot.

Advice has been requested whether the sale of stumps by an investment company is taxable as a capital gain or as ordinary income.

The sale involves all of the stumps on a large tract of land for an agreed total consideration, payable in one lump sum. The seller is not in the timber or tree stump business, either as a buyer, seller or processor, but acquired the property years before in a cutover condition, with some young timber growth present. The property was acquired and held for its enhancement in value either as a new crop of timber developed or for sale as land values increased.

In the usual case the sale of tree stumps has been considered to be ordinary income. Such sales ordinarily occur either in the case of taxpayers engaged in buying and selling timber or from timber properties used in the trade or business.

Section 1221 of the Internal Revenue Code of 1954 provides, in part, that the term "capital assets" means property held by the taxpayer, whether or not connected with his trade or business, but does not include property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Whether property is held for sale to customers in the ordinary course of a taxpayer's trade or business is a question of fact to be determined in the light of all the circumstances of each particular case. However, the difference is recognized between a sale of tree stumps in one lot by a taxpayer who is not in the timber or stump business, either as a buyer, seller, or processor, such as the one in this case, and a sale of tree stumps as a byproduct, either by lot or on a tonnage basis by timber operators after the merchantable standing timber has been cut and removed, in which case the stumps are considered to be property held by the taxpayer for sale to customers in the ordinary course of his trade or business and income from their sale is considered to be ordinary income.

Accordingly, it is held that gain realized from the sale of stumps from land held by a taxpayer who is not in the timber or tree stump business, but who acquired the cutover property some years before as an investment, constitutes gain from the sale of "capital assets." Since no cost basis was allocated to the stumps, the entire amount received, less expenses of sale, constitutes capital gain.

SECTION 1231.—PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSION

Capital gain treatment with respect to amounts received for cutting and disposal of timber. See Rev. Rul. 57–90, page 199.

Gains and losses from sales or exchanges of capital in connection with liquidations. See Rev. Rul. 57–243, page 116.

SECTION 1235.—SALE OR EXCHANGE OF PATENTS

Rev. Rul. 57–40

The amount received by taxpayers for granting to a corporation an option to acquire an exclusive license to patents which they hold, such amount to be applied against installment payments representing a percentage of the selling price of articles which may be sold under the license, constitutes an amount received from the sale of a capital asset held more than six months in the year the option is exercised provided the transaction entered into in granting the license qualifies as a sale or exchange of a capital asset as provided in section 1235 of the Internal Revenue Code of 1954. However, in the event the option is allowed to lapse, the amount received for the option should be treated as ordinary income in the year the option lapses.

After exercise of the option, amounts received under the contract by the inventor or any other "holder" within the meaning of section 1235(b) of the Code constitute amounts received from the sale or exchange of a capital asset. Amounts received by related persons (except brothers and sisters) who have been assigned interests in the patent are not subject to capital gain treatment under section 1235.

Advice has been requested whether an amount received by certain taxpayers for granting a corporation an option to acquire at a later date an exclusive license to patents which they hold will qualify for capital gain treatment under the provisions of section 1235 of the Internal Revenue Code of 1954.

In the instant case, an inventor assigned to his uncle, in return for a substantial amount of capital which he invested in the promotion of an invention prior to its actual reduction to practice, a five percent interest, and to his wife and son each an equal interest, in the invention. The inventor thereafter promoted the formation of a corporation to develop the invention. In accordance with an agreement, the parties for a stipulated amount granted the corporation an option to acquire an exclusive license to the invention. The corporation upon payment of a fixed amount could exercise or close the option at any time within a twelve month period or it could for a prescribed payment extend the option for six months. Upon exercise of the option, the corporation agreed to enter into a license agreement providing for the payment of a specified percentage of the sale price of each article produced under the agreement. It was mutually agreed that a sum equal to the amount paid for the option would be deducted

from the amounts accruing in excess of the amounts payable by the corporation on the first 25,000 articles during the first and each succeeding year until such deductions equal the amount paid for the option.

Section 1235 of the Code provides, in part, as follows:

(a) GENERAL.—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—

(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) "HOLDER" DEFINED.—For purposes of this section, the term "holder" means—

(1) any individual whose efforts created such property, or

(2) 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—

(A) the employer of such creator, nor

(B) related to such creator (within the meaning of subsection (d)).

(c) EFFECTIVE DATE.—This section shall be applicable with regard to any amounts received, or payments made, pursuant to a transfer described in subsection (a) in any taxable year to which this subtitle [subtitle A] applies, regardless of the taxable year in which such transfer occurred.

(d) RELATED PERSONS.—Subsection (a) shall not apply to any sale or exchange between an individual and any other related person (as defined in section 267(b)), except brothers and sisters, whether by the whole or half blood.

In Senate Report No. 1622, 83rd Congress, 2nd Session, at page 440, it is stated with respect to section 1235(b), in part, as follows:

* * * A "holder" is defined as any individual whose efforts created the patent property transferred, *by which is meant the "first and original" inventor* (or joint inventor) within the meaning of section 31 of title 35 of the United States Code. Individuals not eligible to qualify as such "first and original" inventor will not qualify under this definition: for example, the inventor's employer may not here qualify, even though he may be the equitable owner of the patent by virtue of an employment relationship with the inventor. However, your committee is desirous of extending the scope of this section to cover (in addition to inventors) those individuals who contribute financially toward the development of the invention. Accordingly, *paragraph (2) of subsection (b) also includes within the definition of "holder" any other individual who acquired his interest in such property in exchange for consideration in money or money's worth (i. e., consideration capable of present valuation in monetary terms) actually paid to the creator prior to the time when the invention (to which the patent rights relate) is actually reduced to practice (as compared to "constructive" reduction to practice). This paragraph does not include any individual who is* either an employer of any creator or *related to any such creator within the meaning of subsection (d)*; however, the section does apply to all qualifying individuals, whether amateur or professional, regardless of how often they may have sold their patents. The section is not applicable to any other purchasers or assignees. [Italics supplied.]

In accordance with section 1235 of the Code, an express assignment of patent rights by an inventor or an exclusive license of the right to manufacture, use, and sell, the invention for the life of the patent can qualify as a "sale or exchange" of capital assets held for

more than six months; therefore, for taxable years to which section 1235 is applicable (see section 1235(c) and 7851(a)(1)(A)), the inventor can obtain long-term capital gain treatment on amounts received pursuant to such a transfer irrespective of whether the consideration may be payable periodically during the transferee's use of the patent or is contingent on the productivity, use or disposition of the property transferred.

Payments which come within the scope of the section include but are not limited to amounts which are payable over a period generally coterminous with the transferee's use of the patent, or amounts which are measured by a fixed percentage of the selling price of the patented article, or are based on units manufactured or sold; or any other method measured by profits, production, sale, or use.

If an inventor sells, assigns or grants an exclusive license of property consisting of all substantial right, title and interest in and to the patent, to other than a related person (brothers and sisters excepted) as defined in section 267(b) of the Code, such sale or transfer ordinarily constitutes a sale or exchange of a capital asset held for more than six months regardless of the period the patent is actually held. Under an option agreement constituting an executory contract to assign the patent and invention at a future date, where there is no present transfer of property in the invention, there is no sale within the purview of the statute.

Accordingly, it is held that the amount received by a taxpayer for granting to a corporation an option to acquire an exclusive license to patents which he holds, such amount to be applied against installment payments representing a percentage of the selling price of articles sold under the license, constitutes an amount received from the sale of a capital asset held more than six months in the year the option is exercised, provided the transaction entered into in granting the license qualifies as a sale or exchange of a capital asset as provided in section 1235 of the Code. However, in the event the option is allowed to lapse, the fee retained by the taxpayer should be treated as ordinary income in the year the option lapses. See *Virginia Iron Coal and Coke Company* v. *Commissioner*, 37 B. T. A. 195, affirmed 99 Fed. (2d) 919, certiorari denied 307 U. S. 630.

After the exercise of the option, amounts received under the contract by any person who is a "holder" within the meaning of section 1235 of the Code (in this instance the amounts received by the inventor's uncle as well as amounts received by the inventor) constitute amounts received from the sale or exchange of a capital asset. Amounts received by related persons (in this instance the inventor's wife and son) who have been assigned interests are not subject to capital gain treatment under section 1235.

It is assumed for the purpose of this ruling that more than 50 percent in value of the outstanding stock of the corporation which will acquire all substantial rights to the patent is not owned, directly or indirectly, within the meaning of section 267(b) of the Code, by or for any individual from whom such rights are acquired.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART IV.—WAR LOSS RECOVERIES

SECTION 1335.—ELECTION BY TAXPAYER FOR APPLICATION OF SECTION 1333

26 CFR 1.1335–1: Elective method; time and manner of making election and effect thereof. T. D. 6230[1]

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

Regulations under Part IV of subchapter Q of chapter 1 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:

The regulations prescribed under Part IV of subchapter Q of chapter 1 of the Internal Revenue Code of 1954 as Treasury Decision 6164 (21 F. R. 1640), approved March 8, 1956 [C. B. 1956–1,413], relating to war loss recoveries, are amended as set forth below.

PARAGRAPH 1. Section 1.1335–1(b) is amended to read as follows:

(b) *Manner of election.*—In all cases the election to have the provisions of section 1333 apply must be made by the taxpayer not later than six months from the last day prescribed by law for the filing of his income tax return for any taxable year in which a recovery of war loss property has occurred. The election shall be evidenced by a written statement, made within such 6-month period, that the taxpayer elects to have the provisions of section 1333 apply to any taxable year in which any money or property is recovered in respect of war loss property. The statement may be made in (or attached to)—

(1) The return or amended return filed for such taxable year;

(2) A claim for refund or credit filed for such taxable year for an overpayment resulting from application of such provisions;

(3) A timely petition or amended petition to The Tax Court of the United States for a redetermination of any deficiency for any taxable year in which a recovery of war loss property occurred; or

(4) A letter addressed to the district director for the district in which the return for such taxable year was required to be filed.

If the written statement of election is made in a letter, it shall be signed by the taxpayer making the election if an individual or, if the taxpayer is not an individual, the letter must be executed in the same manner as required in the case of the income tax return of such taxpayer. The date of the making of the election shall be the date the return, amended return, claim for refund or credit, or letter is filed in the office of the district director, or the date the petition or amended petition is filed with The Tax Court of the United States. In case the election is made in a return filed before the last day prescribed by law for the filing thereof (including any extension of time for such filing), such election shall not be considered made until such last day. See section 7502 and the regulations thereunder with respect to the timeliness of filing an election where filing is done by mail and section 7503 and the regu-

[1] 22 F. R. 2942.

lations thereunder with respect to the timeliness of filing where the last day for filing falls on a Saturday, Sunday, or legal holiday.

PAR. 2. The provisions of paragraph 1 of this Treasury Decision shall be effective as of the date of filing by the Division of the Federal Register. However, an election made under section 1335 shall be timely if made within 60 days of the effective date of this Treasury Decision by any taxpayer who can establish to the satisfaction of the district director that as a result of reliance in good faith upon the provisions of § 1.1335–1(b), effective prior to the amendment effected by this Treasury Decision, or corresponding provisions of regulations continued in effect by Treasury Decision 6091, an election under section 1335 for a taxable year governed by the Internal Revenue Code of 1954 was postponed beyond the 6-month period provided by paragraph 1.

Because the amendment made by this Treasury Decision clarifies the time within which and the manner in which the election for treating war loss recoveries is to be made, it is found unnecessary to issue this Treasury Decision with notice of 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved April 22, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on April 25, 1957, 8:48 a. m. and published in the issue of the Federal Register for April 26, 1957, 22 F. R. 2942.)

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

Rev. Rul. 57–58

Guides to be used in determining whether income, derived by an owner or tenant of land under a share-farming or other rental arrangements with another individual for the production of agricultural or horticultural commodities by such other individual on such land, should be considered in computing net earnings from self-employment under the Self-Employment Contributions Act of 1954, as amended.

In view of the changes made in the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) by the Social Security Amendments of 1956, C. B. 1956–2, 1188, the Internal Revenue Service has been requested to outline guides for determining when income derived by an owner or tenant of land under a share-farming or other rental arrangement with another individual for the production of agricultural or horticultural commodities, by such other individual on such land, should be considered in computing net earnings from self-employment.

Section 1402 of the Act, as amended, provides, in part, as follows:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(9) from any trade or business carried on by a partnership of which he is a member; except that in computing such gross income and deductions and such distributive share of partnership ordinary income or loss—

(1) there shall be excluded rentals from real estate and from personal property leased with the real estate (including such rentals paid in crop shares) together with the deductions attributable thereto, unless such rentals are received in the course of a trade or business as a real estate dealer; except that the preceding provisions of this paragraph shall not apply to any income derived by the owner or tenant of land if (A) such income is derived under an arrangement, between the owner or tenant and another individual, which provides that such other individual shall produce agricultural or horticultural commodities (including livestock, bees, poultry, and fur-bearing animals and wildlife) on such land, and that there shall be material participation by the owner or tenant in the production or the management of the production of such agricultural or horticultural commodities, and (B) there is material participation by the owner or tenant with respect to any such agricultural or horticultural commodity;

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In view of the language of the statute, it is obvious that the owner or tenant of land (hereinafter referred to as the landowner) on which agricultural or horticultural commodities are being produced by another individual must meet certain requirements before his rental income may be included in computing net earnings from self-employment.

In order for the rental income to be included, the written or oral arrangement between the landowner and the other individual must provide that such other individual shall produce one or more agricultural or horticultural commodities on the landowner's farm, and the arrangement must clearly contemplate that the landowner will materially participate in the production or the management of the production of such commodities. Furthermore, there must be actual participation by the landowner in the production or management of the production of a commodity to a degree which is material.

If the landowner, pursuant to the arrangement, participates to a material degree in the production of a commodity through physical work or management decisions, or a combination of both, the income derived by him under the arrangement is includible in computing net earnings from self-employment. However, no hard and fast rules can be laid down for determining in all cases the physical work and/or management decisions needed to establish the degree of participation contemplated by the statute. Also, while physical work and management decisions are the principal factors to be considered, the furnishing by the landowner of machinery, implements and livestock used in the production activities, or the furnishing or advancing of funds or the assuming of financial responsibility for expenses involved in the production of a commodity are additional factors which may be considered in arriving at a decision in a borderline case.

It is evident from the foregoing that, as a general rule, each case must be decided upon its own facts and circumstances. It may be stated, however, that a landowner, who establishes that he (1) periodically advises or consults with the other party regarding the produc-

tion of the commodity, (2) periodically inspects the production activities on the land, and (3) furnishes a substantial portion of the machinery, implements and livestock used in the production activities, or furnishes or advances funds or assumes financial responsibility for a substantial portion of the expense involved in the production of the commodity, should include the income derived by him under the arrangement in computing net earnings from self-employment.

It is believed that the examples which follow will prove beneficial as guides in determining whether material participation exists in a specific case. The examples are all based upon the assumption that the rental arrangement between the landowner and the other individual involved provides for material participation by the landowner.

Example (1). After the death of her husband, Mrs. *A* rented her farm, together with its machinery and equipment, to *B* on a 60–40 basis. It was agreed that *B* would live in the tenant house on the farm and be responsible for the over-all operation of the farm, such as planting, cultivating and harvesting the field crops, caring for the orchard and harvesting the fruit, and caring for the livestock and poultry. It also was agreed that Mrs. *A* would continue to live in the farm residence and help *B* operate the farm. Pursuant to this agreement, Mrs. *A* regularly operates and cleans the cream separator, feeds the poultry flock and collects the eggs. When possible, she assists *B* in such work as spraying the fruit trees, penning livestock, culling the poultry and controlling weeds. She also assists in preparing the meals when *B* engages seasonal workers.

The agreement between Mrs. *A* and *B* clearly provides that she will materially participate in the production operations to be conducted on her farm by *B*. In actual practice, Mrs. *A* regularly performs substantial services which are material to the production of an agricultural commodity, as well as intermittent services which are, nevertheless, material to the production operations to which they relate. She also furnishes a substantial portion of the farm machinery and equipment. Accordingly, the income Mrs. *A* receives from her farm should be included in net earnings from self-employment.

Example (2). *D* agrees to produce a crop on *C's* cotton farm with each getting one-half of the proceeds. *C* furnishes all the necessary equipment and advises *D* when to plant the cotton and when it needs to be chopped, plowed, sprayed and picked. During the growing season, *C* inspects the crop every few days to determine whether *D* is properly taking care of the crop. *D* furnishes all labor needed to grow and harvest the crop.

The management decisions made by *C* in connection with the planting, plowing, etc., of the cotton crop and his regular inspection of the crop, together with the fact that he furnishes all the necessary equipment, establish that he participates to a material degree in the cotton production operations. Accordingly, the income *C* receives from his cotton farm is to be included in computing his net earnings from self-employment.

Example (3). *X* owns a grain farm and has turned its operation over to his son, *Y*. The oral arrangement provides that *X* will inspect the crops and be available for consultation and advice and will help harvest the crops. Although the final decisions are made by *Y*, he

frequently consults with his father regarding the production of the crops. *X* furnishes most of the equipment, including a tractor, a combine, plows, wagons, drills and harrows. *X* continues to live on the farm and does some of the work such as repairing barns and farm machinery, going to town for supplies, cutting weeds, etc. During the growing season, *X* regularly inspects the crops. In accordance with the arrangement, *X* helps *Y* harvest the crops. An evaluation of all of *X's* activities indicates that they are sufficiently substantial and regular to support a conclusion that he is materially participating in the crop production operations. Accordingly, his income from the grain farm should be included in computing net earnings from self-employment.

Example (4). *M* owns a fully-equipped farm which he rents to *N*. *M* lives in town about five miles from the farm. About twice a month, he drives out to his farm and looks over the buildings and equipment. *M* may occasionally, in an emergency, discuss with *N* some phase of a crop production activity. *N* has complete charge of the farming operations although *M* pays one-half of the cost of the seed and fertilizer. *N* makes all necessary repairs and charges *M* for the cost of the purchased materials.

M's activities do not constitute material participation in the crop production activities. His inspection of the buildings and equipment does not count since it is not material to the production of the crops. His discussion with *N*, in an emergency, of a phase of a production activity does not constitute periodic consultation and advice. Furthermore, the payment by *M* of a portion of the production expenses (seed and fertilizer) is not sufficient, in and of itself, to constitute material participation. Accordingly, *M's* income from the crops should not be included in computing net earnings from self-employment.

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26 CFR 1.1402(a)–1: Net earnings from self-employment. Rev. Rul. 57–108

Income derived by an individual, who is not a real estate dealer, from the rental of furnished beach dwellings where, in addition to rendering the usual necessary services with respect to the property, he also performs many personal services for the comfort and convenience of his guests in connection with their recreational activities, does not constitute rentals from real estate and is includible in computing such individual's net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested by an individual whether payments received by him from tourists for the occupancy of beach dwellings, under the conditions and circumstances set forth below, are to be included in determining net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

In the instant case, the individual owns several beach dwellings which he rents during the summer months to tourists and other persons on vacation. These dwellings are large enough to accommodate from six to thirteen people and are completely furnished, including linens, silverware, cooking utensils, etc. They are rented for periods of one day, one week or two weeks. The usual necessary services are

performed with respect to the dwellings after each occupancy in getting them ready for new guests. Maid service is supplied to guests, but some of the guests prefer to do their own cleaning. Many other services are rendered for the guests for their convenience and comfort, especially in connection with their recreational activities. Such services include instruction in swimming, boating and fishing, conducting fishing parties, delivering messages and mail, furnishing bus schedules and church information and any other services deemed necessary for the convenience and comfort of the guests. No separate charges are made or tips accepted for such services.

Section 1402(a) of the Act defines the term "net earnings from self-employment" as gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by subtitle A of the Code which are attributable to such trade or business plus his distributive share of certain income or loss from any trade or business carried on by a partnership of which he is a member, with certain exclusions.

Paragraph (1) of section 1402(a), *supra*, excludes from net earnings from self-employment rentals from real estate and from personal property leased with the real estate, together with deductions attributable thereto, unless such rentals are received in the course of a trade or business as a real estate dealer.

Section 1.1402(a)-1(c)1(iii) of the Income Tax Regulations relating to rentals from real estate provides, in part, that 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, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rentals from real estate; consequently, such payments are included in determining net earnings from self-employment. See Rev. Rul 55-559, C. B. 1955-2, 315. 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, exits, stairways and lobbies, the collection of trash, etc., are not considered as services rendered to the occupant.

It is concluded that the various services rendered to the guests in the instant case, when considered in the aggregate, constitute services which are primarily for the convenience of the guests and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only within the meaning of the regulations. Accordingly, it is held that the rental income received by the individual under the circumstances does not constitute excluded rentals from real estate and such rental income should be included in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

(Also Sections 117; 1.117–4.) Rev. Rul. 57–127

An individual who receives payments from an institution receiving a grant from a governmental foundation, for the purpose of conducting a research project free from direction or control of the institution or foundation, is an independent contractor, and the payments under the grant are includible as compensation for personal services in determining net earnings from self-employment.

Advice has been requested whether amounts received by an individual under a research grant made by a governmental science foundation to a scientific institution constitute income from self-employment for Federal self-employment tax purposes.

The taxpayer is a biologist who has received from a scientific institution, with which she is associated, a portion of a grant made by a governmental scientific foundation. The grant was made to support a basic scientific research project. It was made for salary for herself, for supplies and equipment, for assistance (typing and drawing), if desired, and for overhead for the institution. The extent of the research and the place and manner of performance were determined by the grantee free from direction or control by the foundation or the institution. Unused funds upon revocation of the grant or completion of the project shall be returned to the grantor foundation which reserves certain rights in patents resulting from the research.

Section 1402 of the Internal Revenue Code provides in part as follows:

(a) * * * The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [Subtitle A] which are attributable to such trade or business, * * *.

The amounts received by the taxpayer and other individuals engaged to assist her constitute payments for personal services rendered and are therefore includible in gross income as compensation for Federal income tax purposes under section 61(a) of the Internal Revenue Code of 1954. Such payments are not scholarship or fellowship grants within the meaning of section 117 of the 1954 Code, because they are made primarily for services performed rather than for the furtherance of her education and training. The grantee carries out her research project as an independent contractor and the payments received by her are includible in determining net earnings from self-employment.

Accordingly, it is held that an individual who receives such payments for the purpose of conducting a research project free from direction or control of the grantor foundation or grantee institution is engaged in a trade or business as an independent contractor and the payments are includible in determining net earnings from self-employment.

Rev. Rul. 57–235

A ranchman who, at considerable expense, turns his ranch into a hunting preserve and sells hunting rights thereon at a certain fee per day, per week, or per hunting season, is engaged in a trade or business and the income derived from the sale of such rights is includible in computing his net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested whether a ranchman who sells hunting rights on his ranch, which he has developed into a hunting preserve, should include the income derived from the sale of such rights in computing his net earnings from self-employment under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, of the Internal Revenue Code of 1954).

The ranch, which consists of many sections of land, has been divided into designated hunting areas with boundaries conforming generally with the topography of the terrain. Fences have been installed for the convenience and safety of the hunters. Roads have been constructed from the ranch camp site to the shooting stand in each hunting area. An acre-wide strip of timber has been cut through the length of the entire ranch to provide a desirable deer range. The areas are baited from time to time in order to attract deer and wild turkeys. Each hunter pays a certain fee per day, per week, or per hunting season, for hunting rights on the portion of the preserve allotted to him. The payment of this fee entitles the hunter to daily transportation from the camp site to his hunting stand and return. There are several unfurnished cabins on the preserve for use by the hunters. Heating fuel and water are furnished for each cabin.

Section 1402 of the Act provides, in part, as follows:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business,* * *; except that in computing such gross income and deductions * * *—

(1) there shall be excluded rentals from real estate and personal property leased with the real estate * * * together with the deductions attributable thereto, unless such rentals are received in the course of a trade or business as a real estate dealer; * * *

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(c) TRADE OR BUSINESS.—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses) * * *

The term "rent" has been defined as a return or compensation for the possession of some corporeal inheritance, or as a certain profit, either in money, provisions, or labor, issuing out of lands and tenements, in return for their use.

It follows, therefore, that a hunter who merely receives permission to enter upon property for the purpose of hunting does not receive possession of the land and the fee paid cannot be considered as issuing out of the land and therefore, is not, rent. Accordingly, the income derived from such grants is not excludable from self-employment income in the case of a ranchman whose operations of this nature are extensive enough to constitute a trade or business.

Section 1.1402(c)-1 of the Income Tax Regulations provides, in general, that in order for an individual to have net earnings from self-employment, he must carry on a trade or business, either as an individual or as a member of a partnership. Whether an individual is engaged in a trade or business is dependent upon all the facts and circumstances existing in the particular case.

It may be stated as a general rule that a person who is regularly engaged in an occupation for profit which constitutes, in whole or in part, his livelihood may be considered to be conducting a trade or business. Such tests as continuity, regularity, and purpose of livelihood or profit may be helpful guides in determining the existence or nonexistence of a trade or business. Applying these principles to the facts of the instant case, it is clear that the establishment and development of the ranch into the hunting preserve reflect a considerable financial investment for purposes of profit, and the sale of hunting rights thereon during the hunting season constitute the carrying on of a trade or business for purposes of the tax on self-employment income.

In view of the foregoing, it is held that the income derived by the ranchman from the sale of hunting rights on his ranch under the circumstances stated, constitutes income from a trade or business which is includible in computing his net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Form 2190, Change In Method of Computing Net Farm Earnings From Self-Employment, is prescribed in certain cases in lieu of filing amended returns under the Self-Employment Contributions Act of 1954. See Rev. Proc. 57–14, page 744.

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26 CFR 1.1402(c)–1: Trade or business. Rev. Rul. 57–71
(Also Section 3121; 31.3121(a)–1.)

Tips are received by a waiter directly from customers of his employer for services performed as an employee. These tips are in no way accounted for by the waiter to his employer. *Held*, although the tips are includible in the gross income of the waiter for Federal income tax purposes they do not constitute "wages" for Federal employment tax purposes because they are *not accounted for* by the waiter to his employer. Sections 31.3121(a)–1 and 31.3306(b)–1 of the Employment Tax Regulations. *Held further*, since the tips are received while rendering services as an employee, they are not includible in computing net earnings from self-employment, in view of the provisions of section 1402(c)(2) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) which, with certain exceptions not material here, specifically exclude the performance of services by an individual as an employee from the term "trade or business" as used in the Act.

Rev. Rul. 57–107

Male graduates of a theological and divinity college, upon acceptance of assignments or calls as full-time teachers in parochial schools of a church denomination, are inducted into the teaching ministry as ministers of religion according to the solemn rites of the church and may be called upon to conduct religious worship in the absence of an "ordained" pastor. Female graduates, so assigned or called, are not installed as ministers of religion and do

not conduct religious services. *Held*, the male teachers' services constitute services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry as contemplated by section 1402(c)(4) of the Self-Employment Contributions Act of 1954. *Held further*, the services of the female teachers do not qualify as services performed within the contemplation of section 1402(c)(4) of the Act.

Effective for taxable years ending after 1954, such male teachers are eligible to elect coverage under Title II of the Social Security Act as self-employed individuals pursuant to the provisions of section 1402(e) of the Self-Employment Contributions Act of 1954. The waiver procedure set forth in section 3121(k) of the Code is applicable in the case of the female teachers.

Advice has been requested whether full-time male and female teachers in the parochial schools of a church denomination are eligible to elect social security coverage as self-employed persons under the authority contained in section 1402(e) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), as added by the Social Security Amendments of 1954, C. B. 1954-2, 603.

The teachers in question are graduates of a theological and divinity college conducted under the auspices of a church denomination for the express purpose of training full-time church workers. Upon graduation both the male and female teachers are recommended as candidates for the teaching ministry in the congregations of the church, and in its parochial schools. Candidates for the teaching ministry in such church are distributed or assigned by a "Committee on the Assignment of Calls" of the church to its various congregations and parochial schools. Upon acceptance of the call as full-time teachers in the parochial schools of the church denomination, the individuals are presented to their respective congregations and inducted into office in accordance with the solemn rites of the church, the male teachers as ministers of religion and the female teachers as teachers of religion. Their duties are specifically prescribed by the congregation in the solemn call. Although not ordained as "pastors," the male teachers' duties as full-time teachers in the parochial schools include the teaching and preaching of the religious principles of the church to the children and youth of the various congregations and the conducting of the musical portion of their religious services. They may also be called upon to function in the place of a pastor during his absence or together with him as the needs for the ministrations of the pastor increase. The female teachers' duties include all of the above prescribed functions except that they are never called upon to preach, or to take the place of, or assist a pastor in the conduct of religious services. Both the male and female teachers are called to their respective offices for life. Neither class is free to seek other calls, nor may either be removed from office for reasons other than those which would also apply to pastors.

Section 1402(a) of the Self-Employment Contributions Act of 1954 provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [subtitle A] which are attributable to such trade or business * * *.

Section 1402(c)(4) of the Act excludes from the term "trade or business" the performance of service 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.

Based on the above facts, it is held that the male teachers, although not duly ordained as "pastors," are, in performing full-time services for the church by teaching, preaching, and, when needed, acting for or assisting an ordained pastor in the conduct of religious services, "duly ordained, commissioned, or licensed ministers of a church" within the contemplation of section 1402(c)(4) of the Self-Employment Contributions Act of 1954, and that their services are performed in the exercise of their ministry. It is also held that the female teachers, whose services appear to be restricted to the teaching of the religious principles of the church and to the direction of the musical portion of the church services, do not qualify as "duly ordained, commissioned, or licensed ministers of a church" as contemplated by section 1402(c)(4) of the Act.

Section 1402(e) of the Act, as added by the Social Security Amendments of 1954 and effective for taxable years ending after 1954, authorizes coverage under Title II of the Social Security Act, on a voluntary basis, for duly ordained, commissioner, or licensed ministers of churches performing services in the exercise of their ministry. Accordingly, each male teacher involved may elect coverage as a self-employed individual within the period prescribed in section 1402(e), *supra*, by filing with the District Director of Internal Revenue for the district in which he files his Federal income tax returns, Form 2031, Waiver Certificate for Use of Ministers, Certain Members of Religious Orders, and Christian Science Practitioners Electing Coverage under Title II of the Social Security Act.

The employee services performed by the women teachers in the church schools may, in general, be covered under Title II of the Social Security Act under the waiver procedure provided in section 3121(k) of the 1954 Code. See section 31.3121(k)-1 of the Employment Tax Regulations.

An engineer performing services under contract for his former employer. See Rev. Rul. 57-10, page 314.

A schochet performing slaughtering services at a slaughter house and in his home. See Rev. Rul. 57-80, page 324.

Fees or honorariums received by supervisory committee members of a credit union. See Rev. Rul. 57-91, page 326.

A bookkeeeper who performs services on his clients' premises and in his own office. See Rev. Rul. 57-109, page 328.

A barber performing services in a barber shop under a "chair-rental" agreement. See Rev. Rul. 57–110, page 329.

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26 CFR 1.1402(e)–1: Election by ministers, members of religious orders, and Christian Science practitioners for self-employment coverage. Rev. Rul. 57–118

Procedures to be followed, pending the issuance of regulations under the Self-Employment Contributions Act of 1954, as amended by the Social Security Amendments of 1956, by a minister, a citizen of the United States, electing self-employment coverage with respect to earnings for services performed in the exercise of his ministry as a minister, in a foreign country, whose congregation is composed predominantly of citizens of the United States.

Advice has been requested as to the procedures to be followed by a minister, a citizen of the United States, in order to obtain self-employment coverage under the provisions of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), pursuant to the provisions of the Social Security Amendments of 1956, approved August 1, 1956, with respect to earnings for services performed in the exercise of his ministry as a minister, in a foreign country, whose congregation is composed predominantly of citizens of the United States.

Section 1402 of the Self-Employment Contributions Act of 1954 provides, in part, as follows:

(c) TRADE OR BUSINESS.—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses), except that such term shall not include —

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(4) the performance of service by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry * * *;

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The provisions of paragraph (4) shall not apply to service * * * performed by an individual during the period for which a certificate filed by such individual under subsection (e) is in effect. * * *

Section 1402(e) of the Self-Employment Contributions Act of 1954 provides, in part, as follows:

(1) WAIVER CERTIFICATE.—Any individual who is (A) a duly ordained, commissioned, or licensed minister of a church * * * 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 he elects to have the insurance system established by title II of the Social Security Act extended to service described in subsection (c)(4) * * *.

(2) TIME FOR FILING CERTIFICATE.—Any individual who desires to file a certificate pursuant to paragraph (1) must file such certificate on or before the due date of the return (including any extension thereof) for his second taxable year ending after 1954 for which he has net earnings from self-employment (computed, in the case of an individual referred to in paragraph (1)(A), without regard to subsection (c)(4) * * * of $400 or more, any part of which was derived from the performance of service described in subsection (c)(4), * * *.

(3) EFFECTIVE DATE OF CERTIFICATE.—A certificate filed pursuant to this subsection shall be effective for the first taxable year with respect to which it is filed (but in no case shall the certificate be effective for a taxable year with respect to which the period for filing a return has expired, or for a taxable year

ending prior to 1955) and all succeeding taxable years. An election made pursuant to this subsection shall be irrevocable.

Section 1402 of the Self-Employment Contributions Act of 1954 provides, in part, as follows:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual * * *; except that in computing such gross income * * *

(8) an individual who is—

(A) a duly ordained, commissioned, or licensed minister of a church * * *; and

(B) a citizen of the United States performing service described in subsection (c)(4) as an employee of an American employer (as defined in section 3121(h) *or as a minister in a foreign country who has a congregation which is composed predominantly of citizens of the United States*, [Underscored language added by section 201(g) of the Social Security Amendments of 1956.]

shall compute his net earnings from self-employment derived from the performance of service described in subsection (c)(4) without regard to section 911 (relating to earned income from sources without the United States) and section 931 (relating to income from sources within possessions of the United States.

Section 201(m) of the Social Security Amendments of 1956 reads, in part, as follows:

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(2)(A) Except as provided in subparagraph (B), the amendment made by subsection (g) shall apply only with respect to taxable years ending after 1956.

(B) Any individual who, for a taxable year ending after 1954 and prior to 1957, had income which by reason of the amendment made by subsection (g) would have been included within the meaning of "net earnings from self-employment" (as such term is defined in section 1402(a) of the Internal Revenue Code of 1954), if such income had been derived in a taxable year ending after 1956 by an individual who had filed a waiver certificate under section 1402(e) of such Code, may elect to have the amendment made by subsection (g) apply to his taxable years ending after 1954 and prior to 1957. No election made by any individual under this subparagraph shall be valid unless such individual has filed a waiver certificate under section 1402(e) of such Code prior to the making of such election or files a waiver certificate at the time he makes such election.

(C) Any individual described in subparagraph (B) who has filed a waiver certificate under section 1402(e) of such Code prior to the date of enactment of this Act, or who files a waiver certificate under such section on or before the due date of his return (including any extension thereof) for his last taxable year ending prior to 1957, must make such election on or before the due date of his return (including any extension thereof) for his last taxable year ending prior to 1957, or before April 16, 1957, whichever is the later.

(D) Any individual described in subparagraph (B) who has not filed a waiver certificate under section 1402(e) of such Code on or before the due date of his return (including any extension thereof) for his last taxable year ending prior to 1957 must make such election on or before the due date of his return (including any extension thereof) for his first taxable year ending after 1956. Any individual described in this subparagraph whose period for filing a waiver certificate under section 1402(e) of such Code has expired at the time he makes such election may, notwithstanding the provisions of paragraph (2) of such section, file a waiver certificate at the time he makes such election.

(E) An election under subparagraph (B) shall be made in such manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Notwithstanding the provisions of paragraph (3) of section 1402(c) of such Code, the waiver certificate filed by an individual who makes an election under subparagraph (B) (regardless of when filed) shall be effective for such individual's first taxable year ending after 1954 in which he had income which by reason of the amendment made by subsection (g) would have been included within the meaning of "net earnings from self-employment" (as such term is defined in section 1402(a) of such Code), if such income had been derived in a

taxable year ending afte. 1956 by an individual who had filed a waiver certificate under section 1402(e) of such Code, or for the taxable year prescribed by such paragraph (3) of section 1402(e), if such taxable year is earlier, and for all succeeding taxable years.

(F) No interest or penalty shall be assessed or collected for failure to file a return within the time prescribed by law, if such failure arises solely by reason of an election made by an individual under subparagraph (B), or for any underpayment of the tax imposed by section 1401 of such Code arising solely by reason of such election, for the period ending with the date such individual makes an election under subparagraph (B).

* * * * * * *

Prior to the enactment of the Social Security Amendments of 1956, the earnings derived by a minister, a citizen of the United States, for the performance of service in the exercise of his ministry outside of the United States generally, did not constitute "net earnings from self-employment" unless such service was performed in the employ of an "American employer," as that term is defined in section 3121(h) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954). Under the Amendments, a minister can now qualify on an elective basis for such coverage with respect to the performance of service in the exercise of his ministry if (1) he is a citizen of the United States performing services in the exercise of his ministry as a minister in a foreign country, (2) his congregation is composed predominantly of citizens of the United States, and (3) he files a properly executed waiver certificate on Form 2031.

The provisions of section 1402(a)(8)(B), as amended, apply with respect to the taxable years ending after 1956, except, that in order to place this newly included group of ministers on an equal footing with other ministers previously covered, provision is made in the Amendments whereby this newly included group of ministers may, for taxable years ending after 1954 and before 1957, elect retroactive self-employment coverage under the Act with respect to their earnings for such services in a foreign country.

A minister who is serving a congregation in a foreign country composed predominantly of citizens of the United States and who does not desire retroactive coverage with respect to earnings from any such services performed during taxable years ending after 1954 and before 1957 may elect coverage effective with the year 1957 by filing Form 2031 on or before the due date for filing his income tax return for that year or if he desires to elect coverage effective with the year 1958 he has until the due date for filing his tax return for that year to file his Form 2031.

Pending the issuance of the regulations, a minister who desires retroactive self-employment coverage for 1955 or 1956, or both, should make an election in the form of a written statement, addressed to the District Director of Internal Revenue, as hereinafter designated, indicating that, by reason of the Social Security Amendments of 1956, the minister desires to have the Federal insurance system established by Title II of the Social Security Act extended to his ministerial services beginning with the particular taxable years ending after 1954 and prior to 1957 for which he desires retroactive self-employment coverage. No such election shall be valid unless the individual making the election has filed a waiver certificate, Form 2031, pursuant to the provisions of section 1402(e) of the Act, prior to making such election or files a waiver certificate at the time he makes such

election. The statement should be dated and signed by the minister and should clearly state that it is an election for retroactive self-employment coverage under the Self-Employment Contributions Act of 1954. In addition, the statement should include the following:

(1) The name and address of the minister.
(2) His social security account number, if he has one.
(3) That he is a duly ordained, commissioned, or licensed minister of a church.
(4) That he is a citizen of the United States.
(5) That he is performing services in the exercise of his ministry in a foreign country.
(6) That his congregation is composed predominantly of citizens of the United States.
(7) (a) That he has filed a waiver certificate. (If so, he should state where and under what circumstances the certificate was filed and the taxable year for which it is effective.) ; or
(b) That he is filing a waiver certificate with his election for retroactive coverage. (If so, show the taxable year for which it is effective.)
(8) That he has or has not filed income tax returns. If he has filed such returns, state the years for which they were filed and indicate the District Director of Internal Revenue with whom they were filed.

The time limitation for electing retroactive self-employment coverage depends upon whether the minister has previously filed a waiver certificate. The following are the time limitations:

(1) A minister who has filed his waiver certificate before August 1, 1956, or who files his waiver certificate on or before the due date of his tax return (including any extension thereof) for his last taxable year ending prior to 1957, must, in order to obtain retroactive coverage, make his election on or before the due date of his return (including any extension thereof) for his last taxable year ending before 1957, or on or before April 15, 1957, whichever is later.

(2) A minister who has not filed his waiver certificate on or before the due date of his tax return (including any extension thereof) for his last taxable year ending before 1957 must, in order to obtain retroactive coverage, make his election on or before the due date of his tax return (including any extension thereof) for his first taxable year ending after 1956.

The waiver certificate on Form 2031 should be filed in triplicate with the District Director of Internal Revenue for the district in which is located the legal residence or principal place of business of the individual who executes the certificate. If such individual has no legal residence or principal place of business in the United States, Puerto Rico, or the Virgin Islands, such certificate should be filed with the office of the District Director of Internal Revenue, Baltimore 2, Maryland. A minister in the newly included group must report his self-employment income on Form 1040, U. S. Individual Income Tax Return, including completed Schedules C and SE. This filing must be done even though the minister is not subject to the Federal income tax. If a minister has previously filed an individual income tax return for a year for which he elects retroactive coverage, he should file an amended Form 1040, including completed Schedules C and SE.

A minister who elects retroactive coverage beginning with 1955 should file his income tax return or amended income tax return for 1955 with his district director of internal revenue at the same time he files his request for retroactive coverage and his waiver certificate, Form 2031 (if one has not already been filed). No interest or penalties will be assessed against a minister for late filing, if the failure to file a return within the time prescribed by law arises solely by reason of an election pursuant to the provisions of section 201(m)(2)(B) of the Social Security Amendments of 1956 for the period ending with the date the minister makes an election thereunder.

The instructions in 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.

Rev. Rul. 57-139

A minister who failed to file a waiver certificate on Form 2031 prior to April 17, 1956, but timely filed his Federal income tax return, including Schedule C, for the calendar year 1955 and paid the self-employment tax shown thereon to be due, will be considered to have met the requirements for self-employment coverage for 1955, provided a waiver certificate is filed without unnecessary delay.

Similarly, a minister who timely filed his return and paid the self-employment tax for 1955 may obtain coverage for such year, even though he had previously filed a waiver certificate designating his election of coverage to be effective for the calendar year 1956 or a subsequent year, provided a new waiver certificate designating 1955 as the correct taxable year is filed without unnecessary delay.

Numerous inquiries have been received by the Internal Revenue Service whether, in the absence of the filing of a waiver certificate on Form 2031 (Waiver Certificate for Use by Ministers, Certain Members of Religious Orders, and Christian Science Practitioners Electing Coverage Under Title II of the Social Security Act) prior to April 17, 1956, a duly ordained, commissioned, or licensed minister may obtain self-employment coverage for the calendar year 1955 if he timely filed his Federal income tax return, including Schedule C, for such year and paid the self-employment tax determined to be due under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954). Similar inquiries have been received whether a minister may obtain self-employment coverage for 1955 if he timely filed his income tax return, including Schedule C, for such year and paid his self-employment tax, but had on file a waiver certificate designating his election of self-employment coverage to be effective for 1956 or a subsequent year.

Section 1402 of the Self-Employment Contributions Act of 1954 provides, in part, as follows:

(c) TRADE OR BUSINESS.—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses), except that such term shall not include—

* * * * * * *

(4) the performance of service by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry * * *;

* * * * * * *

The provisions of paragraph (4) shall not apply to service * * * performed by an individual during the period for which a certificate filed by such individual under subsection (e) is in effect. * * *

Section 1402(e) of the above Act provides, in part, as follows:

> (1) WAIVER CERTIFICATE.—Any individual who is (A) a duly ordained, commissioned, or licensed minister of a church * * * 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 he elects to have the insurance system established by title II of the Social Security Act extended to service described in subsection (c)(4) * * *.
>
> (2) TIME FOR FILING CERTIFICATE.—Any individual who desires to file a certificate pursuant to paragraph (1) must file such certificate on or before the due date of the return (including any extension thereof) for his second taxable year ending after 1954 for which he has net earnings from self-employment (computed, in the case of an individual referred to in paragraph (1)(A), without regard to subsection (c)(4), * * * of $400 or more, any any part of which was derived from the performance of service described in subsection (c)(4), * * *.
>
> (3) EFFECTIVE DATE OF CERTIFICATE.—A certificate filed pursuant to this subsection shall be effective for the first taxable year with respect to which it is filed (but in no case shall the certificate be effective for a taxable year with respect to which the period for filing a return has expired, or for a taxable year ending prior to 1955) and all succeeding taxable years. An election made pursuant to this subsection shall be irrevocable.

Section 1.1402(e)-1 of the regulations issued under the Self-Employment Contributions Act of 1954 provides that the election shall be made by filing a waiver certificate on Form 2031. The regulations further provide that if a minister submits to a District Director of Internal Revenue a dated and signed statement indicating he is desirous of having the social security system extended to his ministerial services, the statement will be treated as a waiver certificate (if filed within the prescribed time), provided that without unnecessary delay the statement is supplemented by a properly executed Form 2031. The regulations point out, however, that the filing of an income tax return showing an amount representing self-employment income or self-employment tax shall not be construed to constitute an election of self-employment coverage. The regulations referred to herein were published in final form subsequent to the normal due date for filing Federal income tax returns for the calendar year 1955.

As a result of a general misunderstanding or lack of information as to the statutory requirements concerning the election for self-employment coverage for the calendar year 1955, many ministers failed to file Form 2031 prior to April 17, 1956. However, the action taken by the ministers in filing timely returns, paying the tax, and promptly filing Form 2031 upon being advised of the requirements of the law and regulations is clearly indicative of a desire for self-employment coverage.

In view of the foregoing, the Internal Revenue Service has adopted the position applicable only to 1955 that the action of ministers in filing returns and paying the self-employment tax for the calendar year 1955 will be considered to have met the requirements for self-employment coverage for 1955, provided that Form 2031 is filed without unnecessary delay. Accordingly, in such instances Form 2031 will be considered effective beginning with the calendar year 1955, notwithstanding its actual filing subsequent to April 17, 1956.

The above position is also applicable in any case where a minister timely filed his return and paid the self-employment tax for 1955,

even though he had previously filed a waiver certificate designating his election of coverage to be effective for the calendar year 1956 or a subsequent year, provided that a new waiver certificate designating 1955 as the correct taxable year is filed without unnecessary delay.

CHAPTER 3.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

SUBCHAPTER A.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SECTION 1441.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS

26 CFR 1.1441–1: Requirement for withholding of tax on nonresident aliens and foreign corporations. Rev. Rul. 57–245

The estate of a citizen of a foreign country domiciled therein or in another foreign country at the date of his death is classified as a nonresident alien entity, even though the will of the decedent was admitted to original probate by a court in the United States. Dividends derived by such an estate are subject to the withholding of United States income tax under section 1441 of the Internal Revenue Code of 1954.

Advice has been requested whether a domestic branch of a foreign bank doing business within the United States is required to withhold tax under section 1441 of the Internal Revenue Code of 1954 from dividends received by it for the benefit of a nonresident alien estate.

The bank holds shares of stock of United States corporations in safekeeping and as collateral for the account of an individual as the executor of the will of a decedent. The decedent was not a citizen of the United States and, at the time of his death, was domiciled in a foreign country. His will was admitted to original probate in this country because over 90 percent of his property was physically located in the United States at the date of his death and he owned few, if any, assets in the foreign country. The executor is a resident of the United States.

Section 1441(a) of the Code, relating to the withholding of tax on nonresident aliens, provides as follows:

(a) GENERAL RULE.—Except as otherwise provided in subsection (c), all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in section 1451 and except as otherwise provided in regulations prescribed by the Secretary or his delegate under section 874) deduct and withhold from such items a tax equal to 30 percent thereof.

Section 1 of the Code imposes a tax on the taxable income of "every individual" but section 5(a) refers to sections 871 and 1441 for the rates of tax and withholding on nonresident aliens. Because an estate is a separate taxable entity, the question arises whether the administration within the United States of an estate subject to domiciliary administration in a foreign country creates a new taxable entity within the United States, the income of which would not be subject to the withholding of tax under section 1441 of the Code.

The ancillary administration in the United States of the estate of a nonresident alien decedent which is subject to domiciliary administration in a foreign country does not change the status of the estate for Federal income tax purposes from that of a nonresident alien entity. In the instant case, the probate of the decedent's will in a court within the United States is an ancillary proceeding in the technical sense and, thus, the estate is a nonresident alien entity irrespective of the fact that more than 90 percent of the decedent's property was physically located in the United States at the date of his death. It was only through the exercise of discretion by a United States' court that the decedent's will was admitted to original probate in the United States. This was done in order to avoid the expense and inconvenience of probate at the decedent's domicile followed by ancillary proceedings in the United States. However, the procedure followed in the administration of this estate, while pertinent to the economy thereof, is not in point in connection with its tax-paying capacity. The Internal Revenue Service holds that the status of an executor as a resident or a nonresident alien is not controlling in determining the tax status of an estate as a resident or a nonresident entity. See I. T. 1885, C. B. II-2, 164 (1923).

In view of the foregoing, the decedent's estate is classified as a nonresident entity and dividends derived by such estate are subject to the withholding of United States income tax under the provisions of section 1441 of the Code.

Procedure necessary for an employer to refund tax withheld from wages paid to a nonresident alien employee. See Rev. Proc. 57-13, page 741.

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26 CFR 1.1441-4: Exemptions from withholding. T. D. 6229 [1]

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

Income Tax Regulations amended to conform to section 544(f) of the Mutual Security Act of 1954, as added by section 11(a) of the Mutual Security Act of 1956, so as to exempt from withholding amounts of per diem for subsistence received by certain nonresident alien trainees.

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 provisions of section 544(f) of the Mutual Security Act of 1954,

[1] 22 F. R. 2838.

as added by section 11(a) of the Mutual Security Act of 1956, approved July 18, 1956, exempting from withholding under chapter 3 of the Internal Revenue Code of 1954 amounts of per diem for subsistence received by certain nonresident alien trainees, such regulations are hereby amended as follows:

PARAGRAPH 1. Section 1.1441 is amended—

(A) By adding at the end of section 1441(c) the following new paragraph:

(6) *Per diem of certain aliens.*—No deduction or withholding under subsection (a) shall be required in the case of amounts of per diem for subsistence paid by the United States Government (directly or by contract) to any nonresident alien individual who is engaged in any program of training in the United States under the Mutual Security Act of 1954, as amended.

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

[Sec. 1441, I. R. C. 1954, as amended by sec. 544(f) of Mutual Security Act 1954 added by sec. 11(a), Mutual Security Act 1956]

PAR. 2. Section 1.1441–4 is amended by adding after paragraph (d) the following new paragraph:

(e) *Per diem of certain alien trainees.*—Effective with respect to payments made on and after July 18, 1956, withholding is not required under section 1441(a) or § 1.1441–1 in the case of amounts of per diem for subsistence paid by the United States Government (directly or by contract) to any nonresident alien individual who is engaged in any program of training in the United States under the Mutual Security Act of 1954, as amended (22 U. S. C. ch. 24). This rule shall apply even though such amounts are subject to tax under section 871.

Because this Treasury Decision merely exempts from withholding amounts of per diem for subsistence received by certain nonresident aliens, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said act.

(This Treasury Decision 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 April 18, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on April 22, 1957, 8:47 a. m., and published in the issue of the Federal Register for April 23, 1957, 22 F. R. 2838.)

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26 CFR 1.1441–5: Claiming United States citizenship or residence. T. D. 6238 [1]

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

Income Tax Regulations amended to change the procedure for filing proof of citizenship or residence for purposes of chapter 3 of the Internal Revenue Code of 1954.

[1] 22 F. R. 4078.

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 eliminate the 3-year limitation upon the validity of the statement of citizenship or residence, or of Form 1078 in the case of residence, presently prescribed in the Income Tax Regulations under chapter 3 of the Internal Revenue Code of 1954 and to relieve payees from the necessity of renewing any such statement or form previously filed with withholding agents, section 1.1441–5 of the Income Tax Regulations [T. D. 6187, C. B. 1956–2, 567] is hereby amended as follows:

(A) By striking out paragraph (c) thereof effective with respect to payments made after December 31, 1956.

(B) By redesignating paragraphs (d), (e), and (f) thereof as paragraphs (c), (d), and (e), respectively.

(C) By adding at the end of redesignated paragraph (e) thereof, relating to the effective date of section 1.1441–5, the following new sentence: "Nothing in this section shall be construed, however, to require the renewal of a statement of citizenship or residence, or of a Form 1078, which was filed in accordance with prior regulations in effect at the time of the filing, if such statement or form has been actively and continuously used, since such time, as a basis for determining the United States citizenship or residence of the payee involved."

Because this Treasury Decision merely relieves taxpayers and withholding agents from a requirement respecting the proof of citizenship or residence for purposes of chapter 3 of the Internal Revenue Code of 1954, 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved June 6, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on June 10, 1952, 8:53 a. m., and published in the issue of the Federal Register for June 11, 1957, 22 F. R. 4078.)

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. 57–3

Deactivation of an affiliated company and an increase in the activities of another affiliated company, occurring during a taxable year in the case of two members of an affiliated group of corporations which filed consolidated income tax returns for prior years, do not constitute good cause, within the meaning of section 1.1502–11 (a) (3) of the Income Tax Regulations, for granting to the affiliated group permission to file separate returns for such year in lieu of a consolidated return.

Advice has been requested whether the circumstances described below, involving members of an affiliated group of corporations which filed consolidated Federal income tax returns for calendar years prior to 1955, constitute good cause for granting to the affiliated group permission to file separate returns for the calendar year 1955.

M corporation is the parent corporation of an affiliated group which includes, among others, two corporations engaged in extracting and refining metal ore. The ore reserves of one of those two subsidiary corporations were exhausted in December, 1953, and the last sales of refined metal occurred early in 1954. Thereafter, the subsidiary became inactive, although it remained in existence. The second of the two ore extracting subsidiaries, which had been developing its mine since 1950, began producing from its mine in November, 1954. Regular sales of the refined metal therefrom began in 1955. The other subsidiaries in the affiliated group are engaged in the transportation of mine employees, operating company stores for employees, and the sale of the producing companies' mineral products. The taxable year 1955 reflected for the first time the full effect of the cessation of production by one of the producing subsidiaries and the beginning of sales in 1955 by the other producing subsidiary. The affiliated group filed consolidated returns for calendar years 1951 to 1954, inclusive.

Section 1.1502–11 of the Income Tax Regulations provides, in part, as follows:

(a) *Consolidated returns required for subsequent years.*—If a consolidated return is made under section 1502 for any taxable year, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless (1) a corporation (other than a corporation created or organized, directly or indirectly, by a member of the group) has become a member of the group during such subsequent taxable year, or (2) subsequent to the exercise of the election to make consolidated returns, Subtitle A of the Code to the extent applicable to corporations, or the regulations under section 1502 which have been consented to, have been amended and any such amendment is of a character which makes substantially less advantageous to affiliated groups as a class the continued filing of consolidated returns, regardless of the effective date of such amendment, or (3) the Commissioner, prior to the time of making the return, upon application made by the common parent corporation and for good cause shown, grants permission to change. For the purpose of (2), above, the expiration of a provision shall be considered as an amendment to the Code made on the date of such expiration.

* * * * * * *

(c) *When affiliated group remains in existence.*—For the purpose of the regulations under section 1502, an affiliated group shall be considered as remaining in existence if the common parent corporation remains as a common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have been subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

In this instance, a corporation did not become a member of the affiliated group during the taxable year 1955 within the intent of section 1.1502–11(a)(1) merely because the subsidiary which was a member of the affiliated group in prior years, when it was in the process of developing its mining properties, went into active production in 1955. No change in membership of the affiliated group took place in the taxable year 1955. With respect to changes in membership of an affiliated group which do occur, subsection (c) of section 1.1502–11 does not conflict with subsection (a) of that section, since subsection (c) merely sets forth the various situations under which an affiliated group shall be considered as remaining in existence, and it is not to be construed as determining whether a consolidated return may or must be filed.

Events, activities, economic conditions, etc., affecting individual members of an affiliated group are not considered material insofar as the inter-relationship of the members of the group is concerned. Such circumstances, including the shifting from a consolidated return basis to a separate return basis, in order to achieve temporary tax reductions or advantages, would not be considered "good cause." Thus, for Federal income tax purposes, the fact that a subsidiary may be liquidated or becomes inactive and other subsidiaries remain affiliated with the common parent corporation has no effect upon the affiliated group, or upon its requirement or right to file a consolidated return.

Accordingly, it is held that the deactivation of an affiliated company and an increase in the activities of another affiliated company, occurring during a taxable year in the case of two members of an affiliated group of corporations which filed consolidated income tax returns for prior taxable years, do not constitute good cause, within the meaning of section 1.1502–11(a)(3) of the Income Tax Regulations, for granting to the affiliated group permission to file separate returns for such year in lieu of a consolidated return.

Rev. Rul. 57–53

Where a member of an affiliated group of corporations which files consolidated income tax returns, exchanges shares of its treasury stock for all of the stock of another corporation, not created or organized directly or indirectly by any member of the affiliated group, for the purpose of acquiring all of its assets, and in the same taxable year receives all of such assets in a complete liquidation, the acquired corporation does not become a member of the affiliated group within the meaning of section 1.1502–11(a)(1) of the Income Tax Regulations. Consequently, such circumstances do not give rise to a new election by the member of the affiliated group to file separate income tax returns for such taxable year.

Rev. Rul. 56–271 C. B. 1956–1, 440, distinguished.

Advice has been requested whether the acquisition by the parent corporation of an affiliated group of corporations, which files consolidated income tax returns, of the stock of another corporation, for

the purpose of acquiring its assets, gives rise to a new election by the affiliated group to file separate income tax returns.

On May 31, 1956, *M* corporation, the parent corporation of an affiliated group of corporations, which filed consolidated income tax returns for the calendar years 1954 and 1955, acquired all of the stock of *N* corporation in exchange for treasury stock of *M*. Corporation *N* was not created or organized, directly or indirectly, by a member of the affiliated group, and no member of the group owned any stock in *N* before May 31, 1956. On June 30, 1956, *N* was liquidated and dissolved, and all of the property of *N* was distributed to *M*. The business purpose of *M* in entering into the transaction was to acquire retail outlets in the market area formerly served by *N*.

Section 1.1502–11(a)(1) of the Income Tax Regulations provides, in part, as follows:

> (a) CONSOLIDATED RETURNS REQUIRED FOR SUBSEQUENT YEARS.—If a consolidated return is made under section 1502 for any taxable year, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless (1) a corporation (other than a corporation created or organized, directly or indirectly, by a member of the group) has become a member of the group during such subsequent taxable year, * * *.

In Revenue Ruling 56–271, C. B. 1956–1, 440, a parent corporation of an affiliated group of corporations, which filed consolidated income tax returns, purchased for cash all of the stock of another corporation, for the purpose of acquiring a business activity to take the place of certain production activities of the parent corporation which were being terminated. Subsequently, in the same taxable year, the property of the acquired corporation was distributed to the parent corporation in a complete liquidation in which the bases of the property in the hands of the distributee corporation were determined according to the provisions of section 334(b)(2) of the Internal Revenue Code of 1954. The purchase of the stock and the subsequent liquidation of the acquired corporation were, under the circumstances, therein separate transactions. It was held in Revenue Ruling 56–271, *supra*, that since the acquisition of the stock and the liquidation of the acquired corporation were for bona fide business purposes, and not for the principal purpose of acquiring the right of a new election to file separate returns, the acquired corporation became a member of the affiliated group and such event gave rise to a new election by the affiliated group to file separate income tax returns.

It is a well established rule that, for Federal income tax purposes, the component steps of a single transaction will be examined and not be treated separately if in intent, purpose and result it is a single transaction. See *Prairie Oil & Gas Company* v. *Motter*, 66 Fed. (2d) 77, Ct. D. 767, C. B. XIII–1, 183 (1934); *Edgar W. Bassick et al.* v. *Commissioner*, 86 Fed. (2d) 8; *Commissioner* v. *Ashland Oil and Refining Company*, 99 Fed. (2d) 588; *Kimball-Diamond Milling Company* v. *Commissioner*, 14 T. C. 74, affirmed, 187 Fed. (2d) 718.

In the instant case, it was the intention of *M* to acquire the assets (retail facilities) of *N*. This was effected by an exchange of stock and liquidation of *N* one month later, in what is considered to be a single transaction constituting a reorganization within the meaning of section 368(a)(1)(C) of the 1954 Code. Such a situation is distinguishable from that of obtaining control of a corporation through purchase or exchange of stock and a subsequent liquidation, both for valid

business reasons. The mere fact of subsequent liquidation of an acquired subsidiary does not in itself necessarily terminate the right to change an election to file consolidated returns; it is merely evidentiary as to the taxpayer's intention. The controlling factors to be considered in making a determination of whether there is a right to a new election are the acquiring corporation's intention at the time of obtaining control of the acquired corporation's stock and its business purpose for so doing.

Based on the above facts and circumstances, it is held that where a member of an affiliated group of corporations, which files consolidated income tax returns, exchanged shares of its treasury stock for all of the stock of another corporation, not created or organized directly by any member of the affiliated group, for the purpose of acquiring all of its assets, and in the same taxable year received all of such assets in a complete liquidation, the acquired corporation does not become a member of the affiliated group within the meaning of section 1.1502–11 (a) (1) of the Income Tax Regulations. Consequently, such circumstances do not give rise to a new election by the members of the affiliated group to file separate income tax returns for such taxable year.

Existence of an affiliated group of corporations for consolidated return purposes after a reorganization of the parent corporation within the provisions of sections 368 (a) (1) (F) and 381 (b) of the 1954 Code. See Rev. Rul. 57–276, page 126.

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26 CFR 1.1502–16: Common parent corporation agent for subsidiaries. Rev. Rul. 57–20

> In the computation of consolidated taxable income, any election which must be made to determine a subsidiary corporation's separate taxable income, and which would be available to a corporation filing a separate income tax return, may be made by the common parent corporation on behalf of such subsidiary corporation. The scope of the agency of the common parent corporation includes the making of such elections on behalf of a subsidiary corporation as the subsidiary corporation could make without the expressed approval of the Commissioner, if separate income tax returns were filed. However, any change in an election previously made by a subsidiary corporation in the computation of its separate income, which would require the approval of the Commissioner if separate returns were filed, may not be made by the common parent corporation without obtaining the approval of the commissioner.

Advice has been requested as to the proper method of making elections in consolidated income tax returns.

In the instant case, a parent company and its subsidiary corporations contemplate filing a consolidated return for the taxable year 1956. The consolidated returns will involve the necessity of making elections with respect to methods of accounting, depreciation, inventories, and research and experimental expenditures.

Section 1.1502–31(b)(1) of the Income Tax Regulations, C. B. 1955–2, 317, at 345, provides that the taxable income of each member of an affiliated group filing a consolidated return shall be computed, with certain exceptions, in accordance with the provisions of the Internal Revenue Code covering the determination of taxable income

of separate corporations. Section 1.1502–31(a)(1) of those regulations defines consolidated taxable income to be the combined taxable income of the several affiliated corporations plus or minus the sum of specified items. Section 1.1502–16(a) of those regulations authorizes the common parent company to act as sole agent for each member of the affiliated group in all matters (other than the making of the subsidiary's consent required by section 1.1502–12(b) of such regulations) relating to the tax for which a consolidated return is made or required.

The concept of consolidated taxable income necessarily requires each subsidiary to compute its separate taxable income. Thus, an election would have to be made by or for each subsidiary with respect to matters for which elections are permitted by the Internal Revenue Code of 1954 in order to determine its separate taxable income. This is not to be interpreted as meaning that the consolidated return is required to contain signed statements by each subsidiary relating to its separate elections (other than those specifically required by the regulations governing consolidated returns), since the scope of the agency of the parent corporation, as provided for in section 1.1502–16(a), includes the making by the common parent corporation of such elections on behalf of its subsidiaries as the subsidiaries could make without the expressed approval of the Commissioner, of separate income tax returns were filed.

Accordingly, it is held that in the computation of consolidated taxable income, any election which must be made to determine a subsidiary corporation's separate taxable income, and which would be available to a corporation filing a separate income tax return, may be made by the common parent on behalf of such subsidiary corporation. However, any change in an election previously made by a subsidiary corporation in the computation of its separate income, which would require the approval of the Commissioner if separate returns were filed, may not be made by the common parent corporation without obtaining the approval of the Commissioner. The scope of the agency of the common parent corporation includes the making of such elections on behalf of a subsidiary corporation as the subsidiary corporation could make without the expressed approval of the Commissioner, if separate income tax returns were filed.

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26 CFR 1.1502–31: Bases of tax computation. Rev. Rul. 57–167
(Also Section 582; 1.582–1.)

> Transactions in bonds held for investment by members of an affiliated group of banks joining in the filing of a consolidated income tax return should be computed by each member bank on a separate basis. To the extent that such transactions of the several affiliated banks result in net capital gains, the gains and losses shall be aggregated for the purpose of determining the consolidated net income, as provided in section 1.1502.31(a)(9) of the Income Tax Regulations. If a member bank sustains an excess of losses over gains from its transactions in bonds, such gain and loss shall be treated as an ordinary gain and loss in the determination of the net income of that member, as provided in section 582(c) of the Internal Revenue Code of 1954.

Advice has been requested as to the proper method of determining, for consolidated income tax return purposes, net gains or losses of

member banks of an affiliated group resulting from transactions in bonds held for investment.

X corporation, a bank holding company, is the common parent of an affiliated group of banks operating in one state. In a consolidated return filed for the calendar year 1954, gains and losses on the sale of bonds held for investment were reported on a consolidated basis as net short-term capital gain of $10x$ dollars. The gain reported consisted of the excess of the total of short-term gains of $110x$ dollars over $100x$ dollars the total of long-term losses of the group.

Section 582(c) of the Internal Revenue Code of 1954 provides, in the case of a bank, that if the losses of the taxable year from sales or exchanges of bonds, debentures, notes, certificates, or other evidences of indebtedness issued by any corporation, or by a government or political subdivision thereof, with interest coupons attached or in registered form, exceed the gains from such sales or exchanges, no such sale or exchange shall be considered a sale or exchange of a capital asset.

Section 1.1502–31(b)(1) of the Income Tax Regulations provides for the computation of each corporation's net income in accordance with the provisions covering the determination of net income of separate corporations, with certain enumerated exceptions. Section 1.1502–31(a)(9) of the Regulations provides for aggregating the capital gains and capital losses of the several affiliated corporations for the purpose of determining the consolidated net income. The Regulations do not provide for separately aggregating the gains and losses provided for in section 582(c) of the Code.

Accordingly, it is held that transactions in bonds held for investment by members of an affiliated group of banks joining in the filing of a consolidated income tax return should be computed by each member bank on a separate basis. To the extent that such transactions of the several affiliated banks result in net capital gains, the gains shall be aggregated for the purpose of determining the consolidated net income. If a member bank sustains an excess of losses over gains from its bond transactions, each gain and loss shall be treated as an ordinary gain and loss in the determination of the net income of that member.

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26 CFR 1.1502–37: Liquidation; recognition of gain or loss. Rev. Rul. 57–201

> The gain accruing to a parent corporation from cancellation of its indebtedness to a subsidiary is recognized in computing consolidated taxable income. To the extent that the advances from the subsidiary, which are cancelled, exceed the basis of the subsidiary's stock in the hands of the parent, such excess, under the provisions of section 301(c) of the Internal Revenue Code of 1954, is taxable in the same manner as a gain from the sale or exchange of property.

Advice is requested whether the gain of a parent corporation resulting from cancellation of the parent's indebtedness to its subsidiary, such debt being in excess of the parent's basis of the subsidiary's stock which it holds, is included in computing consolidated taxable income.

P corporation owns all of the stock of *S* corporation. *S* corporation receives rental income from property that it owns, but, prin-

cipally due to the deduction for depreciation, it has no taxable income or earnings and profits for tax purposes. *S* corporation has made substantial advances of cash to *P* which are open account indebtedness of *P* to *S*. The amount of indebtedness exceeds the basis of *S*'s stock in the hands of *P*. In a taxable year with respect to which *P* and *S* file a consolidated return, *S* cancels *P*'s indebtedness.

For income tax purposes, the cancellation of indebtedness is regarded as a distribution of cash from *S* to *P* which is not a dividend since *S* has no earnings and profits. The question here is whether the gain on the distribution, that is, the amount distributed in excess of the basis of *S*'s stock in *P*'s hands, is included in computing the consolidated taxable income of the affiliated group.

In section 1502 of the Internal Revenue Code of 1954, Congress specifically set forth two purposes for which regulations were authorized: namely, (1) in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and (2) in order to prevent avoidance of such tax liability. Accordingly, any interpretation of the regulations under section 1502 must be made with a view to the Congressional intent as expressed in the statute.

The general design of the consolidated return regulations permits transfers of property between members of an affiliated group which files a consolidated return to be made without present tax consequences if no ultimate tax advantage is gained thereby. Thus, section 1.1502–31(b)(2)(iii)(a) of the Income Tax Regulations provides, in effect, that capital gains on sales or exchanges between members of an affiliated group shall be eliminated in determining consolidated taxable income. The possibility that this rule could lead to tax avoidance is obviated by section 1.1502–38(b) of the Income Tax Regulations which provides that the basis of property in the hands of one member of an affiliated group shall remain the same when it is transferred to another member of the group. Thus, the gain remains potentially taxable after the transfer of property and is recognized if the property is then sold outside of the affiliated group.

However, this safeguard would not be present if the gain which results from the distribution in the instant case where eliminated in computing consolidated taxable income. Since no property other than cash is transferred, there is, of course, no carry-over of basis; and, although the distribution reduces the basis of the subsidiary's stock in the hands of the parent to zero, there is no adjustment to reflect the amount of distribution in excess of the basis of such stock. If the parent sold the stock at a later date, any gain then recognized for income tax purposes would be less than the actual gain on its investment in the subsidiary.

Thus, if gain were not recognized upon the distribution, the excess of the distribution over *P*'s basis of the stock would completely escape taxation, contrary to the express purpose of Congress and the design of the regulations. Compare section 1.1502–37(a)(1)(ii) of the Regulations which provides for the inclusion of gain on the receipt of certain cash distributions from a member of an affiliated group in cancellation

or redemption of its stock. The distribution described in that section, although different in form, is identical in substance to the distribution in the instant case, and the underlying principle of that section applies to the instant case.

Accordingly, the gain accruing to *P* from cancellation of its indebtedness to *S* is recognized in computing consolidated taxable income. To the extent that the advances from *S* which are canceled exceed the basis of *S*'s stock in the hands of *P*, such excess, under the provisions of section 301(c) of the Code, is taxable in the same manner as a gain from the sale or exchange of property.

SUBCHAPTER B.—RELATED RULES

SECTION 1551.—DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT

26 CFR 1.1551–1: Disallowance of surtax exemption and accumulated earnings credit. Rev. Rul. 57–202

> Where pursuant to a lease agreement a parent corporation transfers its property for use to a newly formed, wholly-owned, subsidiary corporation (the latter corporation owning no physical assets of its own), the lease of such property constitutes a "transfer" of property within the purview of section 1551 of the Internal Revenue Code of 1954.

Advice has been requested whether a "transfer of property" between a parent corporation and its subsidiary corporation comes within the meaning of the above-quoted term as used in section 1551 of the Internal Revenue Code of 1954.

A certain corporation formed a wholly-owned subsidiary corporation for the purpose of acting as a sales agent for the parent on a commission basis. The subsidiary corporation owned no physical assets, the equipment and facilities needed to service the area being leased from the parent corporation for an indefinite period. The facilities lease and consignment agreement can be terminated by either party at any time on seven days' written notice.

At issue is the contention that no property, other than cash, was transferred from the parent to the subsidiary, since the parent retains ownership of the property used by the subsidiary in its performance as a sales agent under the consignment agreement.

Section 1551 of the Code provides in part:

"If any corporation *transfers* * * * *all or part of its property* (other than money) to another corporation which was created for the purpose of acquiring such property * * *, and if after such transfer the transferor corporation or its stockholders, or both, are in control of such transferee corporation during any part of the taxable year of such transferee corporation, then such transferee corporation shall not for such taxable * * * be allowed either the $25,000 exemption * * * or the $60,000 accumulated earnings credit * * *, unless * * *." (Italics supplied)

The words "transfers * * * all or part of its property" are considered to be sufficient to encompass the instant situation and are not to be interpreted to embrace only complete transfers of property

including passing of title, possession, ownership and control. The lease of the facilities effected a passage to the subsidiary of the use, possession, and control over the economic benefits to be derived from such facilities. See *Estate of Charles H. Sanford* v. *Commissioner*, 308 U. S. 39, Ct. D. 1426, C. B. 1939–2, 340, wherein it was noted that "the essence of a transfer is the passage of control over the economic benefits of property rather than any technical changes in its title."

In view of the foregoing, it is held that the lease arrangement constitutes a "transfer of property" within the purview of section 1551 of the Code.

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATE OF CITIZENS OR RESIDENTS

PART III.—GROSS ESTATE

SECTION 2042.—PROCEEDS OF LIFE INSURANCE

Rev. Rul. 57–54

Where a contract between an insurance carrier and the owner of an airplane provides for the payment of a sum certain to the personal representatives of any individual who dies as the result of an accident while a passenger on the airplane and that such payment shall be conditioned upon the execution of a release of all claims for damages against the insured, the proceeds thereof are not includible in the decedent's gross estate for Federal estate tax purposes under section 2042 of the Internal Revenue Code of 1954.

Advice has been requested whether any amounts paid under the terms of a contract entered into between an insurance carrier and the owner of an airplane are includible in the gross estate of a decedent who died as a result of an accident while a passenger on the airplane.

In the instant case, the decedent met her death as the result of an airplane accident while a passenger on the insured's airplane. The insured had purchased a combined aircraft policy of insurance from an insurance carrier (a standard liability policy) under the terms of which the insurance company agreed to pay, among other benefits, on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages, including death, sustained by any passenger as a result of an accident to the airplane. For an additional premium a so-called passenger voluntary settlement endorsement was made a part of the original policy. Under the terms of this endorsement, the insurance company agreed to offer settlement of a specified sum to an injured passenger or to the personal representatives of a passenger who dies as the result of an accident, without regard to the insured's legal liability for damages, provided the person or persons having a cause of action for injury or for the death shall execute a full release of all claims for

damages against the insured arising out of the airplane accident. The executor of the decedent's estate accepted the proceeds of the policy of insurance payable under the passenger voluntary settlement endorsement and executed a release of all claims for damages against the insured.

Section 2042 of the Internal Revenue Code of 1954 provides, in part, as follows:

> 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. * * *

Under the terms of the standard liability policy, the insurance company was not required to make any payment until the amount of the insured's obligation to pay had been definitely determined. Under the passenger voluntary settlement endorsement, the company agreed to offer settlement of a specified amount without regard to the insured's legal liability for damages provided the person or persons having a cause of action against the insured executed a full release for all claims for damages arising out of the accident.

The amount recoverable by the personal representatives under the standard liability policy as damages for the decedent's death under a proved claim does not represent insurance on the decedent's life within the meaning of section 2042(1) of the Internal Revenue Code of 1954. For the same reason, the amount received in settlement under the voluntary settlement endorsement does not become classifiable as insurance on the life of the passenger merely because it is payable in settlement without requiring proof of the insured's legal liability for damages. While the amount was paid pursuant to the terms of a contract between the insured and the insurance company, the decedent's personal representative could not, after accepting the payment, prosecute a claim for damages under any statute imposing a liability for wrongful death. The voluntary settlement endorsement provided that payment was to be conditioned upon the execution of a full release of all claims for damages for the death. The insurer is thus relieved from any liability under the standard liability policy.

In view of the foregoing, it is held that where a contract between an insurance carrier and the owner of an airplane provides for the payment of a sum certain to the personal representatives of any individual who dies as the result of an accident while a passenger on the airplane and that such payment shall be conditioned upon the execution of a release of all claims for damages against the insured, the proceeds thereof are not includible in the decedent's gross estate for Federal estate tax purposes under section 2042 of the Internal Revenue Code of 1954.

However, if the contract between the insurance carrier and the owner of the airplane had provided that the insurance company would unconditionally pay an agreed amount to the estate of any passenger who died as a result of an accident while a passenger on the airplane, the acceptance of such amount would have constituted insurance receivable by the executor of the decedent's estate and includible in the decedent's gross estate for Federal estate tax purposes under section 2042 of the Code.

PART V.—TAXABLE ESTATE

SECTION 2053.—EXPENSES, INDEBTEDNESS, AND TAXES

Rev. Rul. 57–78

Where income received by the decedent is included in a joint income tax return filed by the decedent's estate and his surviving spouse, the amount of income tax attributable to the decedent's income, for the purpose of determining the amount allowable as a deduction under section 2053 of the Internal Revenue Code of 1954, shall be considered to be that proportion of the joint tax liability determined for the period covered by the joint return which 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 amount of income tax for which the decedent and his spouse would have been liable if both spouses had filed separate returns for that period. For purposes of this computation, there is taken into account a tax computed on the income of the decedent for the part of the year immediately prior to the date of his death (a fractional year) and a tax computed on the income of the surviving spouse for the entire year.

Revenue Ruling 56–290, C. B. 1956–1, 445, clarified.

Clarification of Revenue Ruling 56–290, C. B. 1956–1, 445 has been requested with respect to the use of the term "for that period" in determining the amount of income tax attributable to the decedent allowable as a deduction under section 2053 of the Internal Revenue Code of 1954 where the income of the decedent has been included in a joint income tax return.

Revenue Ruling 56–290, *supra*, holds, in part, that where income received by the 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 the surviving spouse, the decedent's income tax liability for the period covered by the return shall be considered to be that proportion of the joint tax liability determined for that period which A (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 B (the total of the amount for which the decedent would have been liable and the amount for which the spouse would have been liable if both spouses had filed separate returns for that period).

It has been suggested that the term "for that period" is subject to two possible interpretations for the reason that, in computing the income tax for which the decedent's spouse would have been liable if she had filed a separate return, "for that period" could mean a like period ending with the decedent's death or could mean a period of 12 months.

Section 441(b) of the Internal Revenue Code of 1954 provides, in part, as follow:

> For purposes of this subtitle, the term "taxable years" means—
> * * * * * * *
> the period for which the return is made, if a return is made for a period of less than 12 months.

Section 6013(c) of the Code reads as follows:

> TREATMENT OF JOINT RETURN AFTER DEATH OF EITHER SPOUSE.—For purposes of section 21, 443, and 7851(a)(1)(A), where the husband and wife have different taxable years because of the death of either spouse, the joint return shall be treated as if the taxable years of both spouses ended on the date of the closing of the surviving spouse's taxable year.

For the purpose of section 2053 of the Code in determining the decedent's share of the tax liability shown on a joint return of the decedent and his spouse for the year in which he died, there is taken into account in the computation a tax computed on the income of the decedent for the part of the year immediately prior to the date of his death (a fractional year) and tax computed on the income of the surviving spouse for the entire year. For example, assume that on the basis of a separate return the income tax liability of a decedent on his income for the period prior to the date of his death would have been $4,000 and the income tax liability of his spouse on the basis of a separate return for the entire year would have been $8,000. The tax liability shown on the joint return which has been filed is $11,760. The decedent's share of the tax shown on the joint return is computed as follows:

$$\frac{\$\ 4{,}000}{\$12{,}000} \times \$11{,}760 = \$3{,}920$$

SUBTITLE C.—EMPLOYMENT

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER A.—TAX ON EMPLOYEES

SECTION 3102.—DEDUCTION OF TAX FROM WAGES

26 CFR 31.3102–1: Collection of, and liability for, employee tax.

The deduction of employee tax from wages by the employer. See Rev. Rul. 57–12, page 353.

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

26 CFR 31.3121(a)–1: Wages. Rev. Rul. 57–32

The *Y* corporation merged with the *X* corporation under conditions which qualify them as predecessor-successor employers within the contemplation of section 3121(a)(1) of the Federal Insurance Contributions Act. Upon completion of the merger, all of the employees of the *Y* corporation were immediately transferred to the employ of the *X* corporation. *C*, one of the employees involved, had also performed services for the *X* corporation during the same calendar year and prior to the merger. Each corporation had paid the maximum employer tax of $84 with respect to wages paid to *C* for his services. *Held*, neither corporation may obtain a refund of the employer tax paid by it prior to the merger with respect to *C*'s wages. Rev. Rul. 55–584, C. B. 1955–2, 394, modified.

Advice has been requested whether the *X* corporation would be entitled to a refund of the employer tax paid with respect to wages paid to an employee prior to its merger with the *Y* corporation under

the circumstances described below, in view of the provisions of section 3121(a)(1) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), relating to predecessor-successor employers.

On October 1, 1955, the *X* corporation purchased all of the outstanding capital stock of the *Y* corporation. Thereupon, the *Y* corporation was merged with and became a branch of the *X* corporation. The *X* corporation retained its corporate existence. All the employees of the *Y* corporation were immediately transferred to the payroll of the *X* corporation. One of the employees involved in the transfer, hereinafter referred to as *C*, had also performed services for the *X* corporation during the same calendar year and prior to the merger. At the time of the merger, each corporation had paid employer tax of $84 with respect to *C*'s wages. The corporations qualify as predecessor-successor employers within the contemplation of section 3121(a)(1), *supra*.

Under the provisions of section 3121(a)(1), a successor employer may combine the wages paid to an employee by a predecessor employer with the wages paid by it to the same employee during the calendar year in applying the $4,200 limitation on wages prescribed by such section. It is the position of the Internal Revenue Service that the relief afforded successor employers by that section from the multiple payment of taxes in those cases where the same employees are continued in service following a consolidation or merger of two or more employers is prospective rather than retrospective, that is, such relief will extend only to remuneration for employment paid by a successor employer for services performed subsequent to a merger or consolidation. Prior to the merger in the instant case, the employers were separate and distinct employing entities. An employee who performed services for both corporations prior to the merger is considered to have been engaged in multiple employment for purposes of the employee tax special refund provisions of section 6413(c)(1) of the Code.

However, there is no provision under the law or regulations whereby an employer may obtain a refund of any portion of the employer tax which attaches to the first $4,200 of remuneration paid by an employer to an employee during the calendar year except as contemplated by section 3121(a)(1) in the case of wages paid by a successor employer subsequent to the merger or consolidation. See Rev. Rul. 55–584, C. B. 1955–2, 394. Since the *X* corporation and the *Y* corporation, as separate and distinct employing entities prior to the merger, were each liable for the taxes imposed under the Act with respect to the first $4,200 of wages which each paid to *C* with respect to services performed prior to the merger, no portion of the employer tax paid by each corporation with respect to such wages is refundable to either corporation.

To the extent that Revenue Ruling 55–584, *supra*, may be construed to extend the benefits of section 3121(a)(1) of the Code to all cases involving predecessor and successor employers irrespective of whether the wage payments were made prior to or subsequent to the merger or consolidation, it is hereby modified.

(Also Sections 3306, 3401; 31.3306(b)-1.) Rev. Rul. 57-33

Certain payments made by employers direct to employees, pursuant to a union contract of employment, for the purpose of purchasing individual hospitalization and surgical insurance coverage, constitute "wages" for purposes of the Federal employment taxes.

Advice has been requested relative to the applicability of the taxes imposed by 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, respectively, subtitle C, Internal Revenue Code of 1954), to payments made by member employers of an employers' association to employees for use in the purchase of hospitalization and surgical insurance coverage.

Pursuant to the contract of employment entered into between the association on behalf of its members and the employees' union, the member employers are required to pay a stipulated sum weekly to each employee covered by the agreement for the purchase of individual hospitalization and surgical insurance coverage. Where less than a full week is worked, the agreed-upon amount is prorated on a percentage basis per shift worked. It is further agreed that in lieu of these weekly payments the member employers may provide individual hospitalization and surgical insurance benefits to their union employees under a company plan, provided written notice is given to the union.

As specifically agreed to by the parties concerned, the payment of the sum per week is for the express purpose of purchasing the hospitalization and surgical insurance benefits for covered employees. Where member employers have no existing company program to cover their employees, the union assumes the responsibility of making sure that its members spend the weekly payment for such benefits. The union has made direct arrangements with a hospital service for this purpose and in no instance are payments under the contract being made or used for a purpose other than providing the hospitalization and surgical insurance benefits.

For purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages, "wages" consist of all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash, with certain exceptions not here material.

The payments in the instant case are required under the terms of a labor agreement governing employee relations of the employers here involved, they are directly related to the units of services performed by the employees, and they are paid directly to the employees by the employers. Thus, they constitute a basic part of the compensation of each employee involved. Accordingly, it is held that such payments which are made by the employers directly to the employees constitute "wages" for "employment" for purposes of the Federal employment taxes (chapters 21, 23, and 24, *supra*) and are includible in the gross income of the employees under section 61 of the 1954 Code.

The fact that the union assumes the responsibility for the disposition of such payments by the employees and the purchase of hospitalization and surgical insurance is immaterial.

In reaching these conclusions, consideration was given to S. S. T. 146, C. B. 1937-1, 443, S. S. T. 234, C. B. 1937-2, 458, and I. T. 3738,

C. B. 1945, 90, which hold that the payments by the employers under the circumstances present in those rulings do not constitute wages. It is believed that the facts in the instant case are distinguishable from the facts and circumstances in those rulings and, therefore, justify the conclusions reached herein.

(Also Sections 3306, 3401; 31.3306 (b)-1.) Rev. Rul. 57-55

A payment made by an employer to an employee, who has been reinstated and granted back pay for time lost, pursuant to an order issued by the National Labor Relations Board, constitutes "wages" for Federal employment tax purposes. In the case of a payment of back pay to an employee under an order of the Board which makes the employer and a labor organization jointly and severally liable, such payment will, for Federal employment tax purposes, be treated as "wages" paid by the employer regardless of whether the actual payment is made by the employer or the labor organization; however, where the order of the Board is directed exclusively to a labor organization, the payment of the back pay award will not be treated as a payment of "wages."

The Internal Revenue Service has been requested to determine whether certain payments made to employees by their employer or by a labor organization, pursuant to "back pay orders" issued by the National Labor Relations Board, constitute "wages" for Federal employment tax purposes.

The National Labor Relations Act, 61 Stat. 136, 29 U. S. C. 160, as amended, empowers the National Labor Relations Board to remedy the illegal discharge of an employee by directing reinstatement and requiring the payment of back pay by the employer or labor organization, as the case may be, responsible for such improper discharge.

In a proceeding under the National Labor Relations Act, an employer and a labor organization may be made joint respondents by a complainant employee with respect to particular discriminatory acts alleged in the complaint. In some instances, however, a labor organization may be the sole respondent in an action designed to obtain redress for the alleged misconduct of the labor organization in causing an employer to discriminate against employees in violation of section 8(b)(2) of the Act. In other cases, the sole respondent may be the employer, who is charged with discriminatory conduct against an employee or employees in violation of section 8(a)(3) of the Act. In any event, the Board's jurisdiction in a particular case is limited to the particular party or parties against whom a complaint has been brought.

Where an employer and a labor union are joint respondents, the Board makes them jointly and severally liable for the payment of any award of back pay. Where the order with respect to back pay is issued in a case involving both the employer and a labor organization, the Board is not concerned under a joint and several order as to who might make the back payment. The parties may make the payment to the employee under any arrangements they might see fit. The Board's sole concern is that the employee receive the proper amount. Accordingly, payment might be made in various ways. For example, the employer or the labor organization might pay with

or without contribution by the other. Again, either might pay the required amount to the employee directly, after contribution by the other. Still again, each may pay a part directly to the employee.

With certain exceptions not here material, section 3121 of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) defines the term "wages" as "all remuneration for employment," and the term "employment" as "any service, of whatever nature, performed by an employee for the person employing him."

On the basis of the decision of the Supreme Court of the United States in the case of *Social Security Board* v. *Joseph Nierotko*, 327 U. S. 358, it is the position of the Internal Revenue Service that in situations involving an employer-respondent alone, the amounts received by an aggrieved employee of such employer under a "back pay award" order by the National Labor Relations Board constitute "wages" for Federal Insurance Contributions Act purposes. In such situations, a wrongfully discharged employee should be treated, for the period of wrongful discharge, as an "employee" of the employer who had wrongfully discharged him. See Mim. 6040, C. B. 1946–2, 155.

It is necessary to identify amounts paid to an individual as remuneration for services rendered in an employer-employee relationship existing between the parties in order to subject such payments to the taxes imposed under the Federal employment tax statutes. In the situation described herein, where the payment is made by the employer, both the requisite relationship and the payment are present. These factors also are considered to be present in the situation where an employer and a labor organization are joint respondents, regardless of the arrangements between the employer and the labor organization as to who will make the actual payment to the employee. However, a payment of a back pay award made by a labor organization, pursuant to an order by the National Labor Relations Board, directed exclusively to the labor organization as a result of a proceeding to which the employer is not a party, cannot be considered as a payment by the employer, or on behalf of the employer, since the requisite relationship does not exist.

It is therefore the further position of the Internal Revenue Service that in the case of a payment of back pay to an employee, pursuant to an order of the National Labor Relations Board which makes both the employer and a labor organization jointly and severally liable, such payment will, for Federal Insurance Contributions Act purposes, be treated as "wages" paid by the employer regardless of whether the actual payment to the employee was made by the employer or by the labor organization. However, a payment of back pay by a labor organization, pursuant to an order of the Board directed exclusively to such labor organization and in a proceeding to which the individual's employer is not a party, will not be treated as a payment of "wages" for such purposes.

The above conclusions are also applicable with respect to the tax imposed by the Federal Unemployment Tax Act and for purposes of the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

(Also Section 3306; 31.3306(b)-1.) Rev. Rul. 57-92

Bonuses attributible to services performed as employees, but paid in installments to former employees after termination of the employment relationship are remuneration for services performed in "employment" and, therefore, constitute "wages" at the time of payment, for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

Any bonuses received by such former employees after they have attained the age of 65 are not excluded from "wages" under sections 3121(a)(9) and 3306(b)(8), respectively, of the above Acts.

Advice has been requested relative to the treatment for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (subtitle C, chapters 21 and 23, respectively, Internal Revenue Code of 1954) of certain bonus payments made by a company under its bonus plan to former employees subsequent to the termination of their employment relationship. Advice also has been requested whether any different treatment will be accorded these bonus payments if the recipient has attained the age of 65.

The company inaugurated a bonus plan for the purpose of providing greater incentive for employees by rewarding them with additional cash compensation. Pursuant to the plan, bonuses in the form of cash, common stock of the company, or cash to be invested in such stock, are awarded to those employees who have contributed in an unusual degree to the success of the company by their inventions, ability, industry, and loyalty. A bonus fund is maintained by the company for this purpose.

Bonus awards are payable to the recipients thereof in installments. The first payment, representing one-fourth of any such award, is payable at the time the award is made, while the balance thereof generally is payable in equal annual installments. The company's bonus custodian is required under the plan to open an account for each beneficiary to whom a bonus is awarded, crediting him immediately with one-fourth of the bonus award, either in shares of stock or cash, as the case may be. The remaining three-fourths is credited to the account of such beneficiary at a specified percentage each month.

If the beneficiary leaves the service of the company or is dismissed, he receives any undelivered portion of his award which was credited to his account. The part of the award which was not credited to his account is forfeited; however, the employee may continue as a beneficiary and participate in the award to such extent and under such conditions as the company's bonus and salary committee or the executive committee may determine. Beneficiaries retired on pensions do not forfeit any rights with respect to the bonus awards. Thus, a pensioner receives his undelivered bonus at the same time and under the same conditions as he would have received it had he remained in the service of the company.

Forfeiture of the bonus award is also usually waived in the case of employees who leave because of disability and are not eligible for a pension, or those who are dismissed through no fault of their own due to lack of work, such as where a plant may be discontinued.

Section 3121(a) of the Federal Insurance Contributions Act provides, in part, as follows:

WAGES.—For purposes of this chapter the term "wages" means all remuneration for employment, including the cash value of all re-

muneration paid in any medium other than cash; except that such term shall not include—

* * * * * * *

(9) Any payment (other than vacation or sick pay) made to an employee after the month in which he attains the age of 65, if he did not work for the employer in the period for which such payment is made; * * *

Section 3306(b)(8) of the Federal Unemployment Tax Act contains provisions identical to those quoted above.

In the instant case, it is concluded that the bonus plan maintained by the company contemplates payment of the bonus awards to former employees in consideration of past services. Accordingly, it is held that the bonus awards paid under the plan to former employees subsequent to the termination of their employment relationship, constitute renumeration for services performed in "employment," and, therefore, are "wages" at the time of payment for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

Sections 31.3121(a)(9)-1 and 31.3306(b)(8)-1 of the Employment Tax Regulations, applicable to the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, provide that the term "wages" does not include any payment (other than vacation or sick pay) made by an employer to an employee after the calendar month in which the employee attains age 65, if: (1) such employee does no work (other than being subject to call for the performance of work) for such employer in the period for which such payment is made; and (2) the employer-employee relationship exists between the employer and employee throughout the period for which such payment is made. Since the bonus awards are made in the instant case in consideration of the past services rendered by the recipients, it cannot be said that they did not work for the employer in the period, or periods, for which such payments are made. Accordingly, it is held further that the bonus awards received by those former employees who have attained the age of 65 are not excluded from "wages" by virtue of the provisions of sections 3121(a)(9) and 3306(b)(8) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively.

(Also Sections 61, 3401.) Rev. Rul. 57-135

Amounts remitted to a religious organization by a hospital for services performed for the hospital by volunteer unpaid workers, who are assigned by the religious organization to render such services, do not constitute "wages" for Federal Insurance Contributions Act and income tax withholding purposes and are not includible in the gross income of the volunteer workers.

Advice has been requested whether amounts paid by a hospital to an official church committee constitute "wages," for purposes of the Federal Insurance Contributions Act and the Collection of Income Tax at Source on Wages (chapter 21 and 24, respectively, subtitle C, Internal Revenue Code of 1954), of volunteer workers with respect to whose services the amounts are paid.

The committee in the instant case is the official organization of the churches of a particular religious denomination to carry on a relief

and rehabilitation program throughout the world, as well as an assistance program within the United States. The committee directs a "volunteer service program" under which young people from the member churches serve on a gratuitous basis. These unpaid volunteers are sent by the committee to perform services in connection with community projects, mental hospitals, reform schools, institutions for handicapped individuals, and similar establishments and projects. The committee receives no remuneration for the services which these volunteers render for some of the establishments; however, it does receive a contribution for such services from some of the others, the amount of which is based primarily on the prevailing pay scale which individuals receive for such work in such institutions. The volunteers do not receive any remuneration for the services which they render.

For purposes of the Federal Insurance Contributions Act and the withholding of income tax, "wages" constitute all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash, with certain exceptions not here material.

The hospital is not considered the employer of the volunteer workers sent to perform the services here involved. Consequently, the hospital is not liable for the taxes under the Federal Insurance Contributions Act with respect to the amounts paid to the committee; neither is it required to withhold any tax therefrom for income tax withholding purposes.

Because the services are rendered directly and gratuitously to an organization of the type described in section 170(c) of the Internal Revenue Code of 1954, the amounts paid to the committee by the hospital do not constitute gross income to the volunteer workers who perform the services. Compare Rev. Rul. 71, C. B. 1953–1, 18.

Strike benefits received by members of a labor union. See Rev. Rul. 57–1, page 15.

Noncash remuneration paid to retail commission salesmen. See Rev. Rul. 57–18, page 354.

Contributions by an employer to separate and individual trusts each providing certain unemployment benefits to a designated employee. See Rev. Rul. 57–37, page 18.

Tips received by a waiter for the performance of services as an employee. See Rev. Rul. 57–71, page 277.

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26 CFR 31.3121(b)(7)(1): Services in employ of States or their political subdivisions or instrumentalities. (Also Section 3306; 31.3306(c)(7)-1.) — Rev. Rul. 57–56

Services performed by individuals under the jurisdiction of the *N* association, which is engaged in conducting an agricultural fair for *M* county, a political subdivision of the State of California, subject to a contract with the county, are excepted from "employment"

by sections 3121(b)(7) and 3306(c)(7) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively.

Advice has been requested as to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of individuals who perform services under the jurisdiction of the *N* association where the association is conducting an agricultural fair for *M* county under the circumstances set forth below.

Sections 25905 and 25906 of the Government Code of the State of California authorize any county of such State to enter into a contract with a nonprofit association for such association to hold and operate a county agricultural fair as the agent of the county. Pursuant to such statutory provisions, the *M* county, a political subdivision of the State of California, entered into a contract with the *N* association, a nonprofit organization, whereby the latter agreed to hold and conduct an annual county agricultural fair on the county's fair grounds. Such contract covers a period of five consecutive years. Under the contract, the county constitutes and appoints the association as its agent to manage the fair and to use and possess the fair grounds during the contractual period.

The contract recites that the agency therein created is for the public benefit and that the association shall assume executive management and control of the fair, subject, however, to the direction, supervision, and ultimate control of the county. The association agrees to assume all obligations and to pay all expenses incurred by it in the operation of the fair and fair grounds except those expenses for which funds are allocated or appropriated by the county and state for certain specific purposes. In return, the county authorizes the association to retain and use all monies received by the association from the operation of the fair and the fair grounds to meet such obligations and to pay such expenses. The association agrees to deposit within 60 days after the conclusion of each fair all net proceeds received by it, from whatever source, with the county treasurer. The association is also required to submit its annual budget for the approval of the county board of supervisors, showing the estimated revenues and proposed expenditures from all sources during the ensuing calendar year. The contract further provides that the association shall file with the county a complete itemized statement of all receipts and disbursements for each fair held and to maintain any record retained by it as public records. The operations in the instant case were carried out in accordance with the terms of the contract.

Sections 25905 and 25906, *supra*, provide that upon the dissolution of any such corporation or association all property and assets thereof within the county with which it contracts shall be paid to such county.

Section 3121(b)(7) of the Federal Insurance Contributions Act excepts from "employment" service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing, which is wholly owned by one or more states or political subdivisions.

Section 3306(c)(7) of the Federal Unemployment Tax Act contains a similar provision.

It is held that the *N* association is acting as agent of *M* county and that the individuals who perform services under the jurisdiction of the association in connection with the fair are employees of the county. It is also held that such services are excepted from "employment" by sections 3121(b)(7) and 3306(c)(7) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, and the taxes imposed by the Acts are not applicable to the remuneration for such services.

See Revenue Ruling 55–319, C. B. 1955–1, 119, relative to coverage of state employees under the Social Security Act.

(Also Sections 3306, 3402; 31.3306(c)(7)–1.) Rev. Rul. 57–120

The *N* soil conservation district, organized pursuant to chapter 40, Minnesota Statutes 1953, for the purpose of carrying out a state soil conservation program in cooperation with the Soil Conservation Service of the United States Department of Agriculture and operated by a board of supervisors elected or appointed in accordance with state law, is a political subdivision of the State of Minnesota. Services performed in its employ are excepted from "employment" under sections 3121(b)(7) and 3306(c)(7) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively.

Personnel furnished to the district by the Soil Conservation Service of the Department of Agriculture are employees of that Service, and no liability under the Acts is incurred by the district with respect to the services of such personnel.

Advice has been requested whether a soil conservation district organized and operated pursuant to chapter 40, Minnesota Statutes, 1953, is a political subdivision of the State for Federal employment tax purposes.

The *N* soil conservation district was organized for the purpose of carrying out a state soil conservation program in cooperation with the Soil Conservation Service of the United States Department of Agriculture. The Minnesota statutes declare that the conservation of the soil and soil resources of the State is for the public welfare, health, and safety of the people of Minnesota and provide for the establishment of soil conservation districts for carrying out such purposes. Under the law each conservation district so organized is declared to constitute a government subdivision of the State, and a public body, corporate and politic, exercising such public powers as are granted to it by statute. The membership of the *N* soil conservation district is composed of occupiers of lands located within its boundaries. The district is governed by a board of five supervisors, elected or appointed in accordance with the provisions of the law. The Soil Conservation Service of the United States Department of Agriculture furnished the district with certain technical and clerical personnel. The disbursements of the district are made from fees collected from members for services rendered, from funds allocated by the United States Department of Agriculture and from State appropriations. The disbursements of such funds is subject to State audit. In the event of dissolution, all funds and the proceeds from the sale of all property belonging to the district will be covered into the State treasury.

Section 3121(b) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), excepts from the term "employment," as that term is defined in the Act:

(7) service * * * performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions; * * *

Section 3306(c)(7) of the Federal Unemployment Tax Act (chapter 24, subtitle C, Code of 1954) contains a similar provision.

In view of the foregoing, it is concluded that the *N* soil conservation district is a political subdivision of the State of Minnesota. Services performed in its employ are excepted from "employment" by sections 3121(b)(7) and 3306(c)(7) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, and the taxes imposed by these Acts are not applicable to the remuneration for such services. However, under chapter 24, subtitle C, 1954 Code (Collection of Income Tax at Source on Wages), the district is responsible for withholding income tax from wages paid its employees.

It is further concluded that the individuals furnished the district by the Soil Conservation Service of the United States Department of Agriculture are employees of such Service. No liability is incurred by the *N* soil conservation district for the payment of Federal Insurance Contributions Act and Federal Unemployment Tax Act taxes with respect to the services of such individuals.

See Rev. Rul. 55–319, C. B. 1955–1, 119, relative to coverage of state employees under the Social Security Act.

(Also Sections 3306; 31.3306(c)(7)–1.) Rev. Rul. 57–128

An association organized and operated by the heads of the insurance departments of the several states, pursuant to express or implied statutory authority for the purpose of performing a governmental function in connection with the administration of state insurance laws, is an instrumentality wholly owned by the the several states. Services performed in the employ of such association are excepted from "employment" by section 3121(b)(7) of the Federal Insurance Contributions Act and section 3306(c)(7) of the Federal Unemployment Tax Act and the remuneration therefor is not subject to the taxes imposed under such Acts.

Advice has been requested concerning the status for Federal employment tax purposes of an association organized and operated by the heads of the insurance departments of the several states in connection with the administration of the state insurance laws.

The instant association is a voluntary unincorporated organization formed by state insurance officials to promote uniformity in legislation affecting insurance, to encourage uniformity in departmental rulings under the insurance laws of the several states, to disseminate information to insurance supervisory officials, and to protect the interests of insurance policyholders of the various states, territories, and insular possessions of the United States. The membership of the association consists of commissioners, directors, superintendents, or other officials who by law are charged with the responsibility of supervising the insurance business within their respective states, territories, etc. The

officers of the association are selected from members and their duties are prescribed by the bylaws. The managment of its affairs is vested in an executive committee consisting of eight members and ex officio the officers of the association. The income is derived principally from amounts assessed agains insurance companies by the insurance departments of the various states and by state contributions. A small part of the income is derived from the sale of data prepared by the association on security valuations. No part of the net profits of the association inures to the benefit of any private individual.

Section 3121(b)(7) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) excepts from "employment" service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing, which is wholly owned by one or more states or political subdivisions. Section 3306(c)(7) of the Federal Unemployment Tax Act (chapter 23, subtitle C of the Code) contains a similar provision.

In cases involving the status of an organization as an instrumentality of one or more states or political subdivisions, the following factors are taken into consideration: (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses.

The association was formed and is used to further the governmental function of supervising the insurance business. It serves as a central unit in the performance of duties common to each member in his official capacity as head of the insurance department of his state. Further, it takes the place of a comparable administrative unit which would otherwise have to be maintained in the insurance department of each state. Consequently, it appears that the association constitutes a part of the state governmental machinery for the administration of the insurance laws of the respective states. No proprietary interest in the association exists other than those of the states themselves, which through the membership of their officers have the powers and interests of an owner. The states, through their officers, have the right collectively to dispose of the assets of the association. Therefore, it follows that the association is an instrumentality wholly owned by the states.

Accordingly, it is held that the association is an instrumentality wholly owned by the states and services performed in its employ are excepted from "employment" by reason of the provisions of section 3121(b)(7) of the Federal Insurance Contributions Act and section 3306(c)(7) of the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954). Therefore, the remuneration for such services is not subject to the taxes imposed by such Acts. However, such remuneration is subject to the withholding of income tax under section 3402 of the code.

26 CFR 31.3121(b)(8)-1: Services performed by a minister of a church or a member of a religious order. (Also Section 3401.) Rev. Rul. 57-129

Status, for Federal employment tax purposes, of duly ordained, commissioned, or licensed ministers performing secular services in the headquarters' office of a church denomination.

The Internal Revenue Service has been requested to determine whether certain services performed for a church denomination in its headquarters office by its duly ordained, commissioned or licensed ministers, under the circumstances described below, constitute services "in the exercise of their ministry" and, accordingly, are excepted from "employment" for Federal employment tax purposes.

The denomination for which the services in question are performed was incorporated as a religious body dedicated to the furtherance of the gospel. Such work is carried on by various district organizations, each of which is under the supervision of the parent organization's national headquarters. In connection therewith, the denomination owns and operates a publishing house for the publication of religious periodicals and other literature. In the operation of its headquarters' office the denomination employs approximately 500 individuals of whom 75 are duly ordained or licensed ministers. Eight of these ministers constitute the executive staff and are elected officers of the church denomination and officers of the corporation. All of the other ministers serve under the supervision of the executive staff. Certain administrative positions in the headquarters' various departments are filled by ministers. Among those ministers serving as departmental administrators are the foreign field secretaries and the editor of the church periodical, as well as the secretaries of the following department: radio, Sunday School literature, finance, education, evangelism, Sunday Schools, and youth work. Other ministers perform services as stenographers, mail clerks, file clerks, and janitors. All of the above ministers have the authority to conduct religious worship and to perform sacerdotal functions even though they are engaged by the denomination to perform what is considered "secular work." Although they devote full time to their appointed tasks and no longer act as pastors of churches, some of them, upon invitation, speak in neighboring churches and others have regular preaching appointments in small churches that do not engage full-time pastors. All of the ministers are free to accept or reject offers of employment in the headquarters office. While the executive staff may seek qualified persons for certain tasks, no arbitrary authority is given to ecclesiastical superiors to appoint ministers to any departmental work.

The organization (the church denomination corporation) has been granted exemption from Federal income tax as a religious organization of the character described in section 501(c)(3) of the Internal Revenue Code of 1954. However, exemption under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) has been waived in order to provide coverage for its employees under Title II of the Social Security Act, as amended.

Section 3121(b)(8)(A) of the Federal Insurance Contributions Act excepts from "employment" services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry.

Section 31.3121(b)(8)-1 of the Employment Tax Regulations provides, in part, as follows:

(b) SERVICE BY A MINISTER IN THE EXERCISE OF HIS MINISTRY.—* * * service performed by a minister in the exercise of his ministery *includes* 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. (Emphasis supplied)

It is the opinion of the Internal Revenue Service that the ministers serving in the headquarters office of the organization as members of the executive staff and those serving as departmental secretaries are performing services in the control, conduct, and maintenance of the organization, that is, services which relate to directing, managing, or promoting its activities. The term "maintenance" as used in the preceding sentence does not relate to the upkeep of property, machinery, or equipment, but rather to the overall management and supervision necessary for effectuating the purposes and aims of an organization. It is the further opinion of the Service that services of a routine office nature, such as those performed by ministers engaged by the organization as stenographers, mail clerks, file clerks, and janitors, do not constitute services in the control, conduct, and maintenance of the organization as contemplated by the above cited section of the Employment Tax Regulations.

In view of the foregoing, it is concluded that the services performed for the organization in the instant case by ministers as members of the executive staff and by those as departmental secretaries constitute services "in the exercise of their ministry" and are excepted from "employment" under the Federal Insurance Contributions Act. Such ministers may, if they desire social security coverage, file Form 2031, Waiver Certificate for use by Ministers, Certain Members of Religious Orders, and Christian Science Practitioners Electing Coverage Under Title II of the Social Security Act, with the appropriate district director of internal revenue, pursuant to the provisions of section 1402 (e) of the Self-Employment Contributions Act of 1954, as amended.

It is further concluded that the services performed by ministers as stenographers, mail clerks, file clerks, and janitors for the organization do not constitute "services in the exercise of their ministry" and are therefore not excepted from "employment" by reason of section 3121 (b)(8)(A) of the Federal Insurance Contributions Act. Such ministers may obtain coverage only through the waiver of exemption procedure provided under section 3121(k) of such Act.

The conclusions set forth above are also applicable for purposes of the Collection of Income Tax at Source on Wages (chapter 24, subtitle C, Internal Revenue Code of 1954).

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26 CFR 31.3121(d)-1: Who are employees. (Also Section 1402; 1.1402(c)-1.) Rev. Rul. 57-10

An engineer was retired from the service of his employer, a corporation, on December 31, 1954, and was engaged immediately thereafter by the corporation to render services, beginning in 1955, similar to those performed for it prior to his retirement. The services are performed in the engineer's own research laboratory. Due to the circumstances involved, the engineer renders services solely for the

corporation. *Held*, under the particular facts in this case, the engineer is not an employee of the corporation for Federal employment tax purposes.

The engineer is engaged in a trade or business, the income from which should be considered in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

The Internal Revenue Service has been requested to determine the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of an engineer performing services for his former employer under the circumstances described below.

The engineer had performed engineering services in the employ of a corporation for 35 years. He attained retirement age during the month of December 1954 and, in accordance with the rules of the corporation, was required to retire from its service at the end of that month. However, being in good physical condition and desiring to continue actively in business, he decided to open his own engineering research laboratory. Because of that and in view of his experience in the corporation's type of work, the corporation desired to avail itself of his services. Accordingly, an agreement was entered into immediately upon his retirement under which the corporation engaged him as an engineer consultant for a period of one year beginning in 1955, to work on such engineering problems as it would refer to him.

Under the terms of the contract, the corporation agreed to pay him a stipulated fee for his services (the amount of which equaled one-half of his former annual salary); to reimburse him for all costs, up to a stated amount, incurred by him in connection with its work provided the corporation's approval is obtained prior to renting any office, laboratory, or other space; and to supply him with a revolving petty cash fund of a limited amount. The engineer agreed to keep true and accurate records of all costs incurred by him in connection with the corporation's work and to permit the corporation to examine such records for auditing purposes; to submit monthly invoices, in such form and reasonable detail as the corporation may require, showing all items of cost for which he seeks reimbursement; to be accountable for the petty cash fund and return it to the corporation upon completion of the contract; to furnish monthly progress reports to the corporation; not to disclose to any one, other than his own staff and the corporation's organization, any confidential information pertaining to the corporation's affairs; to assign to the corporation all right, title and interest in and to any inventions conceived or made by him or his employees in the performance of work for the corporation; to furnish the corporation with complete information as to each such invention and to execute all appropriate assignments, patent applications, and other instruments or papers necessary to enable the corporation to obtain patents on such inventions; to devote at least 50 percent of his occupational time to the work and problems referred to him by the corporation; to comply with all reasonable instructions and requests in connection with the work received from the corporation; and to cooperate and work with engineers and technical employees assigned to work with him by the corporation. The corporation retained the right to cancel the contract or any extension of it upon 60-days written notice to the engineer. Upon receipt of such a notice, the engineer agreed not to incur any further expenses in connection with

work being performed for the corporation. In the event of a cancellation, the corporation's financial liability will be restricted to the stipulated fee it agreed to pay the engineer for his services.

Although the contract is for one year, the corporation retained the right to continue it for an additional year. Any extension beyond that time will be on a month-to-month basis, terminable at any time by either party by giving proper notice to the other. Information regarding actual operations under the contract indicates that the engineer is operating his laboratory as an "engineering consultant" and has four employees working with him on the corporation's work. Although the contract permits him to solicit work from other clients, he has not done so because of the satisfactory volume of work he is receiving from the corporation.

Section 3121(d) of the Federal Insurance Contributions Act provides, among other things, that 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. The guides for determining whether under such common law rules an employer-employee relationship exists are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

Whether an individual is an independent contractor or an employee is largely a question to be determined upon the consideration of the particular facts in each case. On the basis of the agreement between the parties as set forth above, it appears that the corporation's sole interest is in the results obtained by the engineer and that the stipulations of the contract in question merely define the contractual obligations of the parties, rather than requiring or permitting the degree of direction and control over the engineer's daily operations as is necessary to establish an employer-employee relationship between such parties. Accordingly, it is held that the engineer is not an employee of the corporation for purposes of the Federal Insurance Contributions Act. Compare Rev. Rul. 55, 695, C. B. 1955–2, 410.

Section 1402 of the Self-Employment Contributions Act of 1954, as amended (Chapter 2, Subtitle A, Internal Revenue Code of 1954), provides in part:

> (a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [subtitle A] which are attributable to such trade or business, * * *
>
> * * * * * * *
>
> (c) TRADE OR BUSINESS.—The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 * * *.

As a general rule, a person who is engaged in an occupation or profession for profit and who is not an employee for purposes of the Federal Insurance Contributions Act taxes, is engaged in a "trade or business."

The activities conducted by the engineer in the instant case constitute a "trade or business" within the meaning of the above-quoted section of the Self-Employment Contributions Act of 1954 and the income derived therefrom should be considered in computing net earnings from self-employment for purposes of such Act.

(Also Sections 3306, 3401; 31.3306(i)–1.) Rev. Rul. 57–21

A licensed physician who does not have a private practice is "in residency" at a hospital. His services are made available to an organization, on a part-time basis and as a part of his clinical training, through special arrangements with the hospital. The services are performed during certain hours on two days of each week, and he is paid a stated amount each month. His services may be terminated at any time. *Held*, the physician is an employee of the organization for Federal employment tax purposes.

Advice has been requested relative to the status for Federal employment tax purposes of a licensed physician who performs services for an organization on a part-time basis.

The physician is "in residency" at a hospital and his services are made available to the organization, as a part of his clinical training, under special arrangements with the hospital. The physician does not have a private practice. He works for the organization from eight o'clock to ten o'clock in the morning on Monday and Thursday of each week. As staff physician of the organization, he prescribes medication and recommends treatment for the organization's handicapped workers. He directs the nurse in her duties and suggests phases of development of the organization's medical program. He is paid 1x dollars a month for his services and such services may be terminated at any time.

In defining the term "employee" under the usual common law rules, section 31.3121(d)–1(c) of the Employment Tax Regulations provides that, generally, the legal relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer.

Physicians and other individuals engaged in the pursuit of an independent trade, business, or profession, in which they offer their services to the public, are independent contractors and not employees. However, if the requisite relationship exists between a physician and another, he is an employee rather than an independent contractor with respect to any services performed under such circumstances. As pointed out above, one of the major factors to be considered in determining the existence of an employment relationship is the right of direction and control. In determining what constitutes the requisite degree of direction and control, it must be borne in mind that the methods by which professional men work are prescribed by the techniques and standards of their professions, and the high degree of skill required by a professional sometimes makes it difficult or impossible for the employer to supervise his services. Therefore, the control of an employer over the manner in which professional employees shall conduct the duties of their positions must necessarily be more general than the control over nonprofessional employees. See *Wendell E. and Evelyn C. James* v. *Commissioner*, 25 T. C. 1296.

In Revenue Ruling 84, C. B. 1953–1, 404, it is held that physicians engaged in the private practice of medicine who, in connection there-

with, examine and treat employees of a company as a part-time service for the company, are not its employees within the meaning of section 1426(d) and 1607(i) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (subchapters A and C, respectively, chapter 9, of the Internal Revenue Code of 1939). Sections 1426(d) and 1607(i) now constitute sections 3121(d) and 3306(i) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, subtitle C, Internal Revenue code of 1954), without substantial change. The facts in Revenue Ruling 84, *supra*, indicate that direct control and supervision by the company of the physicians' services were not contemplated and that the physicians were free to leave the premises of the company if emergencies should arise in connection with their private practice.

The facts in the instant case are distinguishable from the facts in Revenue Ruling 84 in that the physician in the instant case does not make his services available to the organization in connection with a private practice as a physician. Instead he is engaged for definite periods each week, apart from his regular employment at the hospital, in performing services for the organization in the furtherance of its rehabilitation program, for which he is remunerated at a regular rate each week. Under such circumstances, it is concluded that the organization retains the right to direct and control him in his activities. Accordingly, it is held that the physician is an employee of the organization for purposes of the taxes imposed by the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

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 of the 1954 Code).

(Also Section 3402.) Rev. Rul. 57–22

A State and the Geological Survey, United States Department of the Interior, agreed to investigate the water resources of the State. The agreement provides that the field and office work of the project shall be under the direction of the Geological Survey, that generally its methods of investigation shall be followed, and that, as far as may be mutually agreeable, all expenses shall be paid in the first instance by the Geological Survey. Some of the individuals engaged on the project are carried on a payroll of the State. However, the States does not select such individuals and its control with respect to them is limited to its approval of the payroll claim prepared by the Geological Survey. *Held*, the individuals who perform services on the project and who are paid by the State are employees of the Geological Survey for purposes of the Federal Insurance Contributions Act. Therefore, the determination whether the services of such individuals constitute "employment" under the Act is to be made by the Secretary of the Interior or his agent.

Inasmuch as the State has control of the wages paid to the individuals, it is required, in view of section 3401(d)(1) of the Internal Revenue Code of 1954, to withhold the Federal income tax from such wages and to make return and payment of the tax so withheld.

Advice has been requested as to the status, 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), of certain individuals engaged on projects conducted under a cooperative agreement between the Geological Survey, United States Department of the Interior, and a State.

The Geological Survey, United States Department of the Interior, and the particular State here involved entered into an agreement to cooperate in making an investigation of the water resources of the State, subject to the availability of funds and in accordance with their respective authorities. Under the terms of the agreement, each party pays a certain amount of the expenses of the project and must furnish to the other party such statements and reports as may be needed to satisfy fiscal requirements. The agreement also provides that the field and office work pertaining to the investigation shall be under the direction of an authorized representative of the Geological Survey. The area to be investigated and the scope of the investigation shall be determined by mutual agreement. The methods of investigation shall be those usually followed by the Geological Survey, subject to modifications by agreement. All operations of either party pertaining to the investigation shall be open to the inspection of the other party and if found not to be mutually satisfactory, either party may terminate the agreement upon 60 days written notice to the other party. The State agreed to carry the individuals on its payroll and make payment to them for their services.

It is stated that the individuals here involved meet Federal standards as to ability, experience, grade, and salary better than they do the State requirements; that they are, in fact, under the control and direction of the Geological Survey, except that the State payroll claim, as made up in the office of Geological Survey, must be approved by an officer of the State; and that the State does not select, or have any voice in the selection of, the individuals performing the services.

It is further stated that, with the exception of the remuneration paid directly by the State to certain employees, the money for a project carried on in cooperation with the State is advanced by the Federal Government and is spent by the Geological Survey. The State is then billed for its portion, credit being given for the amounts paid directly by the State to employees and certified to the Geological Survey. The individuals who are paid by the State are said to work for, take orders from, and be controlled by the Geological Survey. In the performance of their services, they are under the supervision of the district engineer and geologist of the Geological Survey.

Under section 3121(d) of the Federal Insurance Contributions Act, the term "employee" means any individual who, under the usual common law rules applicable in determining an employer-employee relationship, has the status of an employee. 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 information presented, it is concluded that the Geological Survey, United States Department of the Interior, has and exercises the right to control and direct the individuals who perform the services on the project conducted under the agreement so as to constitute such individuals employees of the Geological Survey under the applicable common law rules. Accordingly, it is the opinion of the

Internal Revenue Service that the individuals are employees of the Geological Survey, United States Department of the Interior, for purposes of the Federal Insurance Contributions Act, and it devolves upon the head of that Department, or his agent, to make the determinations set forth in section 3122 of the Act. See Rev. Rul. 55–96, C. B. 1955–1, 488.

The remuneration of the individuals is subject to the withholding of Federal income tax under section 3402 of the Internal Revenue Code of 1954. Since the State, rather than the Geological Survey, has control over the payment of wages for the services performed and actually pays the wages to the individuals, in view of section 3401(d)(1) of the Code, it is required to withhold the income tax from such wages and to file returns and pay the tax so withheld.

(Also Sections 3306, 3401; 31.3306(i)–1.) Rev. Rul. 57–42

Reporters who perform services in connection with the private reporting business of a court reporter, in an office provided by the court reporter, and who receive as remuneration a stated percentage of the receipts derived from their services, are employees of the court reporter for Federal employment tax purposes.

Advice is requested whether reporters who perform services under the circumstances described below are employees for Federal employment tax purposes.

B, an official court reporter, is permitted to engage in private reporting in addition to his official duties. He maintains an office in which to conduct his private reporting business and engages two reporters to perform outside reporting services, consisting of reporting depositions and various hearings and the furnishing of required transcriptions. *B* pays the rent and expenses of the office and furnishes the reporters with desk space, telephone and some supplies. Calls for reporter's services are received by *B* who assigns the jobs to the reporters. He handles all the billing for services performed by the reporters.

The reporters furnish their own reporting machines, typewriters and paper. Their arrangement with *B* contemplates that all the services will be performed by them. The reporters might on occasion request advice of *B* in matters that arise in connection with the work; however, their skill is such that he does not require them to comply with his suggestions if they follow an alternative course satisfactory to him. The reporters do not hold themselves out to the public for similar work, nor do they perform services for anyone other than *B*. However, when not working on an assignment, a reporter's time is his own. The taking of depositions, etc., is done at the place designated by the person for whom the service is performed, but dictating and transcribing are done in *B*'s office. The services are performed generally during regular business hours although occasionally a call is received requiring services to be rendered in the evening. If statements for services are not paid, the reporter endeavors to collect them for *B*.

Payment for services performed by the reporters is remitted to *B*, who deducts a fixed amount for each page of typing done for the reporter by the typist in his office plus a fixed percentage of the gross

billings for work performed by such reporter, and pays the balance to the reporter as his compensation. The reporters are not guaranteed a minimum salary nor are they reimbursed for their expenses.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides, among other things, that 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 depends upon the particular facts in each case. The guides for determining whether an employer-employee relationship exists are found in section 31.3121(d)-1(c) of the Employment Tax Regulations.

Under the above conditions, *B* has the right to exercise over the reporters in the performance of their services the control and direction requisite to establish the relationship of employer and employee. Their earnings are derived not as independent contractors serving their own clients, but rather from services performed for and on behalf of *B*. Such latitude and freedom of action as may be permitted the reporters in their work is due to the nature of the services performed by them and the circumstances under which *B* conducts his office. It is held that the reporters are employees of *B* for purposes of the taxes imposed under the Federal Insurance Contributions Act. This conclusion is applicable also 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). Compare S. S. T. 260, C. B. 1938-1, 399.

(Also Sections 3306, 3401; 31.3306(i)-1.) Rev. Rul. 57-63

Individuals sell ice cream products for a corporation from refrigerated trucks furnished and serviced by it. They perform the services personally and receive as remuneration therefor a percentage of their gross sales. They are assigned designated territories and are required to devote their full time to the business of the corporation. Their services may be terminated by the corporation for failure to produce an adequate volume of business or for improper conduct on the job. The corporation pays all operating expenses of the trucks. *Held*, such individuals are employees of the corporation for Federal employment tax purposes.

Other individuals sell ice cream products which they obtain from a distributor on consignment. These individuals rent the trucks used in such activity from the distributor on a day-to-day basis and pay for the gasoline consumed. The trucks are loaded daily at the distributor's plant with merchandise selected by such individuals. They endeavor to sell the merchandise at fixed prices in residential areas chosen by them. They are remunerated on a commission basis and are not required to give the distributor first call on their services. *Held*, such individuals are not employees of the distributor for Federal employment tax purposes.

The Internal Revenue Service has been requested to determine the status, for Federal employment tax purposes, of individuals engaged in selling ice cream products at retail from refrigerated trucks under the conditions described below.

Case 1.

In this case, a corporation is engaged in the business of selling ice cream products through vendors who are engaged after personal ap-

plication on their part. These vendors sell the ice cream products from refrigerated trucks, usually in residential areas. The corporation furnishes the trucks and hucksters' licenses and pays all operating expenses of the trucks. The vendors are required to be licensed and experienced drivers, perform the services personally, and conduct themselves in an exemplary manner in dealing with the public. Each vendor is assigned a truck and is required to report to the corporation's plant by noon of each day for loading, icing, and servicing the truck. Each vendor signs for the merchandise when loaded on his truck and turns in to the corporation the receipts of the previous day. The vendors are paid a stated percentage of their gross sales each week. They are not allowed advances or a drawing account. They are expected to devote their full time to the business of the corporation. Although they are assigned designated territories, they may cover adjacent territories if on a particular day it is found that business is poor in the assigned territory. The corporation may terminate the agreement with a vendor at any time for failure to produce an adequate volume of business or for improper conduct on the job. Also, the vendor may terminate his agreement with the corporation at any time.

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.[1] 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.

Upon application of the provisions of section 3121(d)(2) of the Act and the regulations referred to above, it is concluded that the corporation exercises such direction and control over the vendors in the performance of their services as is necessary, under the usual common law rules, to constitute an employer-employee relationship and that such individuals are employees of the corporation for purposes of the Federal Insurance Contributions Act, *supra*.

Case 2.

In this case, the distributor of ice cream products engages vendors to sell its products in residential and other areas. Each vendor pays a daily rental charge for the use of a refrigerated truck furnished by the distributor. The vendor also pays for the gasoline used in the operation of the truck. He reports to the distributor's plant each morning to pick up and load his truck with merchandise selected in accordance with his own order. The vendor then drives the truck to residential areas where he endeavors to sell the merchandise at prices fixed by the distributor. He is not required to observe regular working hours, sell a minimum quota of merchandise, or to restrict his sales activities to a specified territory. The merchandise is accepted by the vendor on consignment and he is compensated on a commission basis. The vendor settles for the merchandise sold and returns any unsold merchandise when he returns to the distributor's plant each evening. The vendors work on a day-to-day basis and the distributor does not have preferred call on their services.

[1] The provisions of section 3121(d)(3)(A) of the Act do not apply to either Case 1 or Case 2 for the reason that ice cream products are not within the classification of products specified in that section.

Applying the provisions of section 3121(d)(2) of the Act and the applicable regulations referred to above to the factual situation in *Case 2*, it is held that the distributor neither exercises nor has the right to exercise such control over the vendors in the performance of their services as is necessary under the usual common law rules to establish the employer-employee relationship. Accordingly, the individuals are not employees of the distributor for purposes of the Federal Insurance Contributions Act.

These conclusions are 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).

Rev. Rul 57–79

A schochet engaged by a poultry company to slaughter poultry in accordance with the dietary laws of the Hebrew faith is an employee of the company for Federal employment tax purposes in a case in which he was hired through a union agreement, performs his services on the company's premises, and is required to work during prescribed hours on specified days each week.

Advice has been requested regarding the status, for Federal employment tax purposes, of a schochet engaged by a poultry company to perform slaughtering services in accordance with the dietary laws of the Hebrew faith.

The company is engaged in the business of buying and selling live and dressed poultry. A small portion of its business involves the sale of poultry that must be killed in accordance with the dietary laws of the Hebrew faith. To accommodate that particular trade, the company has engaged a schochet to perform such services for it on a part-time basis.

The services of the schochet were acquired through a union and under the terms of an agreement between the company and the union. Under the agreement, which is a continuing one from year to year, the company may employ, as a schochet, any member of the union who is in good standing, and the union will furnish the company the schochet needed in the operation of its business, provided the earnings, working conditions, and working hours are mutually satisfactory. The company may not discharge the schochet without first notifying the union and stating the reasons therefor. If the schochet is ill and unable to work for the company on any day, a substitute schochet will be furnished by the union. The schochet is to be remunerated for his services on a piecework basis.

In the instant case, the company requires the schochet to work on its premises during prescribed hours on three specified days each week. His work is integrated with the work of other employees of the company; however, the company may not require him to perform duties other than those normally required of a schochet. The company does not give him any instructions as to the manner in which he is to perform his services. As is customary in this industry, the schochet furnishes his own equipment needed by him. Also, under the dietary laws of the Hebrew faith, he may reject any poultry which is not acceptable to him. The relationship between the company and the schochet in the instant case has been a continuing one for the past eight years.

On the remaining three days per week, the schochet holds himself out to undertake similar work for others and, in that undertaking, operates from his own home.

It is contended that the schochet is not an employee of the company, for Federal employment tax purposes, for the reason that the company does not supervise or control the schochet's services.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides that the term "employee" means, among other things, any individual, who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. 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 position occupied by a schochet in establishments such as that operated by the poultry company in the instant case is not, aside from the religious factors involved, materially different from that occupied by individuals, admittedly employees, who customarily perform slaughtering services in establishments which do not deal in kosher poultry. Although, under the agreement with the union, the company does not have the right to choose or select its own schochet and may not require that the schochet perform services other than those normally performed by a schochet, the services of that individual have been rendered during prescribed hours on three specified days each week, on the company's premises, and constitute a necessary incident to the conduct of the company's business. Thus, by the nature of the services and the circumstances under which they are performed, the company necessarily retains an implied right to direct and control the schochet in the performance of his services, although it may not actually choose to do so. The requirement that the company must first advise the union of its reasons, prior to the discharge of a schochet, does not necessarily imply a relinquishment by the company of its right to effect such discharge.

It is concluded that the services performed by the schochet for the poultry company, on its premises and under the circumstances set forth above, are subject to the right of direction and control by the company to an extent sufficient to constitute the company the employer of the schochet for purposes of the Federal Insurance Contributions Act.

This conclusion is also applicable for purposes of the Federal Unemployment Tax Act and for purposes of the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

See Rev. Rul. 57–80, below.

(Also sections 1402, 3306, 3401; 1.1402(c)–1, 31.3306(i)–1) Rev. Rul. 57–80

A schochet who performs slaughtering services, in accordance with the Hebrew dietary laws, for a meat market operator, off the premises of such operator at the schochet's convenience and on a piecework basis, and who also performs similar services for persons who bring poultry to him, is not an employee for Federal employment tax

purposes of the meat market operator or the other persons for whom such services are performed.

The schochet is engaged in a "trade or business," the income from which is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested relative to the status, for Federal employment tax purposes, of a schochet who performs slaughtering services, in accordance with the dietary laws of the Hebrew faith, for an operator of a kosher meat market and for other persons.

In the instant case, the schochet hold himself out to the public to undertake the slaughtering of poultry in accordance with the dietary laws of the Hebrew faith, operating from his own premises for this purpose. He has regular customers who bring poultry to him for his services. In addition he has entered into an agreement with the operator of a kosher meat market, pursuant to which he slaughters, at a slaughter house owned by a third party, all poultry purchased by the meat market operator. As a matter of practice, the schochet calls at the slaughter house several times each week to see if the operator has purchased any poultry to be slaughtered; determines his own work schedule; has not committed himself to any priority of services to the operator: receives no instructions in the performance of his services, but is guided solely by the requirements of the Hebrew dietary laws; provides whatever equipment is necessary in his work; may reject any poultry which is not acceptable to him; is paid for his services on a piecework basis; and performs no other services for the operator.

Under section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), the term "employee" means, among other things, 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.

Under circumstances such as those present in the instant case, where a schochet performs slaughtering services for a meat market operator off the operator's premises, in accordance with his own working schedule, and with no supervision or instructions by such operator, his only guidance being the requirements set forth by Hebrew dietary law, there does not exist, under the usual common law rules, a sufficient right of control to establish a relationship of employer and employee. The same is true for the slaughtering services described above performed by the schochet on his own premises for other persons. Accordingly, the schochet is not an employee of either the market operator, or the other persons for whom he performs slaughtering services, for purposes of the Federal Insurance Contributions Act.

This conclusion is also applicable for purposes of the Federal Unemployment Tax Act and for purposes of the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

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Section 1402 of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [Subtitle A] which are attributable to such trade or business, * * *

* * * * * * *

(c) TRADE OR BUSINESS.—The term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162, * * *

Whether a certain activity constitutes engaging in a "trade or business" is dependent upon all the facts and circumstances in the particular case. As a general rule, when a person is regularly engaged in an occupation or profession for profit and, as to such occupation or profession, is not regarded as an employee for purposes of the taxes imposed by the Federal Insurance Contributions Act or otherwise excluded from the self-employment provisions, he is engaged in a "trade or business."

In the instant case, it is held that in performing services as a schochet, as set forth above, such person is engaged in a "trade or business," the income from which is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

See Rev. Rul. 57–79, page 323, this Bulletin, setting forth circumstances under which a schochet performing slaughtering services for a poultry dealer is held to be an employee.

(Also Section 1402; 1.1402(c)–1.) Rev. Rul. 57–91

Members of the supervisory committee of a credit union elected by the membership of the credit union pursuant to a state law, which requires such a committee and which specifies the powers and duties thereof, are not, in their capacity as such members, employees of the credit union for Federal employment tax purposes. The fees or honorariums received by them as compensation for their services as such members are includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of the members of the supervisory committee of a credit union.

The credit union was organized and is operated pursuant to provisions of state statutes relating to credit unions which provide that there shall be prescribed in the bylaws of a credit union the number of members of its supervisory committee and the powers and duties of such committee. It is provided that at the annual meeting the members of the credit union shall elect, among others, a supervisory committee of not less than three members who shall hold their offices until such time as may be determined by the bylaws. The members of the supervisory committee may receive such compensation as the members of the credit union may authorize subject to the final approval of the state bank commissioner. Specific powers and duties of the supervisory

committee are set forth in the law. The supervisory committee is empowered, among other things, to order a special meeting of the credit union, and is required to inspect the securities, cash, and accounts of the corporation. The supervisory committee shall fill vacancies occurring in its membership until the next regular meeting of the members of the credit union. At any time, by unanimous vote, the supervisory committee may recommend to the board of directors the suspension from office of any member of the credit committee, any member of the board of directors, or any officer elected by the board. It is the duty of the supervisory committee to forward to the bank commissioner of the state a copy of all recommendations, charges, and findings presented to the board of directors.

The supervisory committee of the instant credit union consists of six active members and two ex officio members whose duties are specified in the bylaws of the credit union. The committee meets approximately once a week at a time and during hours of their own choosing. Each member receives an honorarium based on the number of meetings he attends. The members of the supervisory committee examine all applications for loans made during the period under examination and satisfy themselves that for each loan made an application is on file and that each application states the purpose for which the loan is made, a description of the security offered, and that it bears the unanimous approval of the members of the credit committee present at its passing. At least one member of the committee attest to the correctness of the balance sheet which the treasurer is required by the bylaws to prepare each month.

Section 3121(d)(2) of the Act provides that 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. The rules for determining whether, under the usual common law rules, an employer-employee relationship exists are found in section 31.3121(d)-1(c) of the Employment Tax Regulations.

In the instant case, it is concluded that the credit union neither exercises nor has the right to exercise the control over the members of its supervisory committee in the performance of their services that is necessary, under the common law rule, to establish the relationship of employer and employee for Federal employment tax purposes, and that the committee members, in their capacity as such, are not employees of the credit union for Federal employment tax purposes.

Section 1402(c) of the Self-Employment Contributions Act of 1954 provides 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 of the Code (relating to trade or business expenses), with certain exceptions not here material.

Generally, a person who is not an employee for Federal employment tax purposes, who is regularly engaged in an occupation or profession for profit which constitutes all or part of his livelihood, is engaged in a "trade or business."

It is held that in performing their duties as members of the supervisory committee such members are engaged in a "trade or business" with respect to such services and the income derived there from is in-

cludible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

(Also Section 3401.) Rev. Rul. 57–93

A at frequent intervals performs stenographic and secretarial services for *B* and *C* pursuant to a continuing informal agreement with each of them. Each pays her on an hourly basis. She reports to their respective offices on call when needed. Occasionally she performs the services in her home but does not maintain an office for such purpose. She is subject to the usual control with respect to the accuracy of her work and all details connected with the performance of the services. She also performs similar services for others on an irregular basis, but does not advertise or hold herself out generally as a public stenographer. The work which *A* performs for *B* and *C* is a necessary adjunct to the business in which they are engaged. *Held*, *B* and *C* either exercise or retain the right to exercise over *A*, in the performance of her services, the direction and control necessary to establish the relationship of employer and employee under the usual common law rules applicable in determining such relationship. Accordingly, *A*, is an employee of each of such individuals and they are liable as separate employers for the taxes imposed by the Federal Insurance Contributions Act and the withholding of income tax under section 3402 of the Internal Revenue Code of 1954 on amounts paid to *A* for her services.

(Also Section 1402; 26 CFR 1.1402(c)–1.) Rev. Rul. 57–109

An individual is engaged on a part-time basis to perform bookkeeping and tax services for a corporation and to advise in connection with its collection efforts and credit policy. He performs the services on the corporation's premises; determines his own working hours; performs the services at his own discretion and without corporate direction or supervision; is compensated on the basis of services performed; and is not guaranteed a minimum compensation. He maintains an office of his own and performs similar services for others. *Held*, the individual is not an employee of the corporation, for Federal employment tax purposes, with respect to the services performed for it.

The individual is engaged in a "trade or business," the income from which should be considered in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

Advice has been requested relative to the status, for Federal employment tax purposes, of an individual performing bookkeeping and other related services for a corporation.

The individual was engaged by the corporation to perform its bookkeeping and tax work and to advise in connection with its collection efforts and credit policy. Pursuant to an agreement entered into between the parties, the work is performed on the corporation's premises on a part-time or intermittent basis. No regular hours are prescribed by the corporation and the individual performs the services at his own discretion. He is permitted the use of the corporation's office machines without charge, but provides his own working papers and other necessary materials and pays all of his own expenses. The

corporation does not supervise his work, its only concern being that the work is completed. The individual is compensated on the basis of services performed, is not guaranteed a minimum amount of compensation, and is not allowed drawing account privileges. He operates a business office in his own home, advertises his services in the city directory and in newspapers, and has a regular clientele of business firms for whom he performs similar services.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides, among other things, that 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. 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.

Whether an individual is an independent contractor or an employee is largely a question to be determined upon consideration of the particular facts in each case. In the instant case, it is determined that the corporation neither exercises nor has the right to exercise such control over the individual in the performance of his services as is necessary under the usual common law rules to establish the relationship of employer and employee. Accordingly, it is concluded that the individual is not an employee of the corporation for Federal Insurance Contributions Act purposes.

This conclusion is also applicable with respect to the tax imposed by the Federal Unemployment Tax Act and for purposes of the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

It is further concluded that the individual is an independent contractor and is engaged in a "trade or business" for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), the income from which should be considered in computing net earnings from self-employment as contemplated by that Act.

(Also Section 1402; 26 CFR 1.1402(c)-1.) Rev. Rul. 57-110

A barber rents a chair in a barber shop for a fixed weekly fee for which in addition to the chair the shop owner furnishes heat, light, water, and supplies. The barber furnishes his own barbering tools, is licensed in his own name by the state board of barber examiners, determines his own work routine, and is not required to perform a minimum amount of work, nor to be on duty a specific number of hours. All fees collected by the individual are retained by him and no accounting is made to the shop owner. The rental agreement may be terminated by either party at any time upon proper notice. *Held*, the barber is not an employee of the shop owner for Federal employment tax purposes.

Such individual is engaged in a "trade or business," the income from which should be considered in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

S. S. T. 236, C. B. 1937-2, 399, distinguished.

Advice is requested relative to the status, for Federal employment tax purposes, of an individual who performs barbering services in the barber shop of another under a "chair-rental" agreement.

Under the agreement, the individual pays the shop owner (also a barber) a regular weekly rental for the use of a chair in his shop. In addition to the chair, the owner furnishes heat, light, water, and all of the usual barber supplies such as towels, lotions, and soap. The individual furnishes his own tools of the trade and has obtained a license in his own name from the state board of barber examiners. He determines his own work routine and is not required to perform a minimum amount of work nor to be on duty a specific number of hours per day or week. Because of the nature of his services, he naturally has an established routine in order to be available for customers desiring his services. All fees collected by him for his services are retained by him and no accounting of such collections is made to the shop owner. While the individual has no set hours for his work, he usually tries to arrange his absences from the shop to occur at times when the shop owner is present, in consideration and for the convenience of the customers. The agreement may be terminated by either party at any time upon proper notice.

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. 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.

Whether an individual is an independent contractor or an employee is largely a question to be determined upon consideration of the particular facts in each case. In the instant case, it appears that the barber shop owner, in entering into the "chair-rental" agreement with the individual in question, is primarily interested in having an additional barber in his shop, both for his convenience and for the convenience of the shop's customers. While the furnishing of supplies and a place to work is a factor to be considered in determining an employer-employee relationship, the existence of that factor alone is not sufficient to establish such a relationship for Federal employment tax purposes.

In view of the foregoing, it is concluded that the individual is not subject to such direction and control by the barber shop owner as is necessary, under the usual common law rules, to establish an employer-employee relationship for Federal employment tax purposes. Accordingly, it is held that the individual is not an employee of the shop owner for purposes of the Federal Insurance Contributions Act.

This conclusion is also applicable with respect to the tax imposed by the Federal Unemployment Tax Act and for purposes of the Collection of Income Tax at Source on Wages (chapters 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954).

It is further concluded that the individual is engaged in a "trade or business" for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954), the income from which should be considered in computing net earnings from self-employment as contemplated by that Act.

The facts in this case are distinguishable from the facts in S. S. T. 236, C. B. 1937-2, 399, which holds that barbers performing services for the *M* barber shop under a so-called "lease agreement" are

employees of the shop. The facts in that case show that the barbers receive for their services a percentage of the receipts and that they are required to perform their services in accordance with shop rules which determine their conduct while working, their hours of work, length of lunch period, and the type of uniforms they wear while working. Also, their "leases" may be terminated without notice for breach of such rules.

(Also Sections 3306, 3401; 31.3306(i)-1.) Rev. Rul. 57-119

An athletic association composed of colleges and universities is the employer for Federal employment tax purposes of officials whom it engages, trains and generally supervises to officiate at intercollegiate athletic contests participated in by members of the association.

Advice has been requested with respect to the status for Federal employment tax purposes of officials who are engaged by an athletic association composed of colleges and universities to officiate at intercollegiate athletic contests participated in by members of the association.

The association is a nonprofit organization composed of several colleges and universities. It was organized to control and manage intercollegiate athletics in the institutions comprising its membership. Its funds are derived from gate receipts from pre-season games, certain radio and television receipts and a percentage of the gate receipts of post-season games. The bylaws of the association provide that it shall select, train and assign officials for all intercollegiate contests, supervise all conference meets and tournaments, and be responsible for all receipts and disbursements.

The association conducts clinics prior to and during the playing season for the purpose of familiarizing the officials with the rules and regulations governing intercollegiate athletics participated in by members of the association. The officials are required to attend these clinics. Each official is furnished a schedule of the season games he is expected to work. They are required to make a report to the secretary of the association after each game, listing all infractions of the rules and showing the type of sportsmanship exhibited by the players and coaches. A representative of the association attends one game each week for the purpose of observing the work of the officials assigned to that game. The services of the officials may be terminated at any time during the playing season by the association, except that once a particular game starts the officials are in complete charge and cannot be removed from the game. The colleges and universities served have no control over the services performed by the officials.

The officials are compensated on a fixed-fee basis for each game worked. The officials for the pre-season games are paid from the funds of the association while the officials for the regular season games are paid by the schools from the gate receipts.

Section 3121(d) of the Federal Insurance Contributions Act defines an employee as any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The rules for determining whether under the usual common law rules, an employer-employee

relationship exists are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

On the basis of the information presented, it is held that the association exercises or has the right to exercise control over the officials selected, trained and assigned by it to an extent sufficient to establish the relationship of employer and employee for purposes of the taxes imposed by the Federal Insurance Contributions Act. Accordingly, these officials are employees of the association for such purposes.

This conclusion is applicable also 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).

The association is liable for the return and payment of all taxes due under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act with respect to the fees received by the officials for officiating at games under its direction and control.

The association also is liable for the return and payment of the income tax required to be withheld from the fees paid by it to the officials. However, by reason of the provisions of section 3401(d)(1) of the Code, the schools which have control of the payment of fees to the officials are responsible for the return and payment of the income tax required to be withheld from such wages. See Rev. Rul. 54–471, C. B. 1954–2, 348.

Athletic associations, which have been held by the Internal Revenue Service to be exempt from Federal income tax as organizations of the type described in section 501(c)(3) of the Code, will not be liable for the return and payment of taxes due under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act by reason of sections 3121(b)(8)(B) and 3306(c)(8) respectively, in the situations herein discussed. Such organizations are, however, liable for income tax withholding, and may bring their employees under social security coverage under the waiver procedures provided by section 3121(k) of the Code.

(Also Sections 3306, 3401; 31.3306(i)–1.) Rev. Rul. 57–145

A firm of architects which prepared building plans for a corporation is required periodically to check the construction of the building to see that the job is being done in accordance with plans and specifications. The corporation, in order to have constant supervision of this type, has engaged several individuals, known in the building trade as "clerks of the works." These individuals are responsible to the corporation for the performance of their services, must report directly to the corporations, and may be dismissed at any time by the corporation. The architects pay these individuals from their own funds and are reimbursed therefor by the corporation. *Held*, the "clerks of the works" are employees of the corporation for purposes of the Federal Insurance Contributions Act. The architectural firm, which has control of the payments of "wages" to the "clerks," is responsible for the withholding of Federal income tax from such "wages."

Advice has been requested relative to the status, for Federal employment tax purposes, of individuals performing supervisory services under the circumstances set forth below.

A corporation contracted with a construction company to construct a building in accordance with plans prepared by a firm of architects. The corporation has retained a firm of architects to visit the project and check the progress of the construction from time to time to see that the job is being done according to plans and specifications. The firm is remunerated for such services by the corporation. However, in order to have constant supervision of the type furnished by the architects, the corporation engaged several individuals known in the building trade as "clerks of the works," at salaries agreed upon between it and the individuals. These individuals are responsible to the corporation to assure that the construction work and materials used are of a quality commensurate with the expenditure therefor and that overpayments are avoided. The "clerks" make their reports directly to the corporation. They may be dismissed for cause by the corporation at any time. They have no responsibility to the architectural firm and are not required to perform any services on behalf of the firm. At the request of the corporation, the architectural firm pays the "clerks" from its own funds and is reimbursed by the corporation for the amounts advanced.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides, among other things, that 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. 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.

Under the circumstances stated, it is concluded that the corporation exercises or has the right to exercise over the "clerks" in the performance of their services the direction and control necessary to establish the relationship of employer and employee. Accordingly, it is held that the "clerks of the works" are employees of the corporation for purposes of the above Act. The fact that their salaries are actually paid them by the architectural firm is immaterial, since their remuneration may properly be ascribed to the corporation.

This conclusion is also applicable with respect to the tax imposed by the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954).

The architectural firm, having control of the payment of wages to the "clerks," is responsible for the withholding of Federal income tax from such wages. See Rev. Rul. 54–471, C. B. 1954–2, 348 at 350.

(Also Sections 3306, 3401; 31.3306(i)–1.) Rev. Rul. 57–155

An actress, a narrator, and a commercial artist are engaged by a film company in connection with its production of industrial and commercial motion pictures for sale to its clients. The actress provides her own costume and delivers a few lines of dialogue from a script furnished to her. She is given technical instructions by the company and is paid at the prevailing rate for actors. The narrator is given technical instructions by the company and, on rare occasions, by the client. He is paid by the company on a "prevailing rate" or a flat fee basis. The artist holds himself out to the public

as a commercial artist, supplies his own materials and equipment, and usually performs the services in his home studio. He may delegate the work to other individuals of his own choosing. *Held*, the actress and the narrator are employees of the company and the artist is not an employee of the company, for Federal employment tax purposes.

Advice has been requested as to the status, under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) of an actress, a narrator, and an artist with respect to services performed for a company engaged in the production of industrial and commercial motion pictures and slide films for its clients.

A film company is engaged in the production of industrial and commercial films for sale to its clients. It retains no right of ownership in the films after final payment therefor has been received. The company also produces such films for other film producers whose facilities are limited and for advertising agencies which are not the ultimate owners of the films. Most of the films produced are used as one medium in a general or over-all program of advertising and sales promotion. They are always shown admission-free to club school, and church groups and at conventions, fairs, demonstrations, and exhibits.

The company's clients, whether they are the owners of the films, advertising agencies, or other producers, always participate to some degree in the production operation. Such participation is very active in some instances, less active in others. Some clients desire to be present during all important operations in the making of a film, such as script planning, "shooting," sound recording, and editing. However, this presence is primarily to observe the making of the film. A client makes decisions where alternatives exist, but seldom initiates an "order" in matters of camera angle, lighting, etc. Even when such initiative is assumed by a client, he is willing to defer to the judgment of the company in technical considerations.

In the production of the motion picture, ordinarily the first step involved is the preparation of a script outline. This script outline becomes the basis of more detailed planning and is usually revised several times before it is written in its final form. The company sometimes writes the script, but in most cases it is written either by a professional script writer or by the client. This is a natural procedure since industrial films are primarily factual and sometimes concern unusual products or complex processes. Also, policy matters are involved and are best handled, scriptwise, by the client or his representative. Upon receiving a rough draft of the story the client wants to tell in the film, the company is in a position to suggest additions or changes which should be made from a technical standpoint. A "shooting" script results from these first conferences and then a rough "shooting" schedule is established.

Dramatic effect is of no real concern in the film production. Actors are used chiefly for the purpose of adding interest to factual exposition and to lend realism to the presentation of the client's film message. Supervision and direction of actors in rehearsals and final "shooting" may only be of a technical nature. Accordingly, actors may be directed only as to position relative to camera and micro-

phone, and as to voice quality or level, so as to achieve a natural, realistic, and accurate delivery of the lines provided in the script. The coordination of music and narration is an operation performed with little or no client participation. Also, the synchronization of the narrative sound track is an editing problem and is a function which the company is hired to perform, on the assumption that its experience, technical knowledge and judgment render it best able to perform these services.

The company maintains a file of available talent, listing pertinent information as to experience, background, and physical specifications. The actors and other talent to be used in a production are selected from this file, either by the client or by the company. Once the selection is made, the company contacts the talent and discusses the scheduling with them, and they are engaged under oral agreements. The actors provide their own costumes unless special costumes are required, in which case they are provided by the company.

A, an actress engaged by the company from time to time in connection with its productions, is also engaged in business as a television writer and producer. Her services for the company in one instance, which is typical of other instances, were rendered in making a part of a motion picture consisting of one scene with a simple set. The scene involved no other actors. She provided her own costume and delivered a few sentences of dialogue from a script written by a professional writer. She was given technical instructions and was paid by the company at the rate prevailing for actors for the time involved. The client was not present during the making of the film. No breakdown was made for talent costs on the invoice for the production presented to the client.

B, performs services for the company as a narrator. He may be given no instructions regarding diction, interpretation, or delivery, and the speed or pacing of his delivery is ultimately determined by the length of the scenes on which the narration is based. He is given instruction by the company in technical matters. Also, special instructions are given to him by the client, on occasion, as to the pronunciation of technical, medical, or foreign words. He is paid by the company at the rate prescribed for narrators, or on a flat fee basis.

C, a commercial artist, holds himself out to the public as such and performs services for many persons. The company cannot require him to give preference to its work or prevent him from delegating the work to other individuals and exercising exclusive rights with respect to their selection, remuneration, and discharge. The instructions given to *C* when he is engaged by the company for a work assignment are given at a conference in which the art requirements are discussed very generally. The company passes along any ideas of its own or those that the client may have as to colors, background, general effect to be achieved by the titles, etc. *C* supplies his own materials and equipment and usually performs the work in his home studio. At times he provides sketches before producing the finished work or he may follow a draft supplied by the client, usually in connection with an emblem or trade mark. Otherwise, he is not asked to adhere to any style established by, or associated with, the client

and is never required to follow a style established by the company. Any of his work which is not acceptable due to an error on his part is done over with no charge for corrections. At times his charges are determined on a time basis, at others on a job basis.

The guides for determining, under the usual common law rules, whether an employer-employee relationship exists, are found in section 31.3121(d)–1(c) of the Employment Tax Regulations.

The Internal Revenue Service holds, that actors and other performers participating in the production of "studio built" radio programs for advertising purposes are employees of the producers for Federal employment tax purposes. See S. S. T. 335, C. B. 1938–2, 294. The producers in such cases formulate the overall plan for the undertaking; select the performers necessary to effectuate their ideas; determine all details of the services to be performed by them; instruct them concerning the interpretation, execution, and timing of the material assigned to them for rendition; and maintain continuing supervision over all phases of production to knit the individual efforts of each performer into the integrated whole contemplated by the original plans.

The facts established in the instant case indicate that the company operates in a manner not materially different from the producers of motion picture and radio advertising programs considered in the aforementioned published ruling. The instant company exercises or has the right to exercise such control over *A* and *B* in the performance of their services as is necessary under the usual common law rules to establish the relationship of employer and employee for Federal employment tax purposes. Accordingly, it is held that, for such purposes, *A* and *B* are employees of the company.

The facts established also indicate that the company does not exercise or have the right to exercise such control over *C* in the performance of his services as is necessary under the usual common law rules to establish the relationship of employer and employee for Federal employment tax purposes. Accordingly, it is held that *C* is not, for such purposes, an employee of the company.

In a ruling published as S. S. T. 333, C. B. 1938–2, 291, it is held that individuals engaged in the production of a radio broadcast arranged by an advertising agency, for the sponsor of the program, are employees of the sponsor for Federal employment tax purposes. Such ruling is distinguishable from the ruling in the instant case in that the advertising agency, pursuant to a sponsor-agency contract, acted in an advisory capacity in regard to the advertising problems of the sponsor; engaged the individuals on behalf of and for the account of the sponsor; and secured its approval, not only of each phase of the program to be broadcast, but also of the program as a whole. After the entire program was completed, the advertising agency entered into a contract with a broadcasting company under which its facilities were engaged for the broadcasting of the program arranged by the advertising agency on behalf of the sponsor.

The above conclusions are 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).

(Also Sections 3306, 3401; 31.3306(i)-1.) Rev. Rul. 57-168

"Company fishermen" and "independent fishermen" both supply salmon to the *M* packers association in Alaska under a union agreement. The "company fishermen" must be acceptable to the association, use the association's fishing vessels, are furnished all necessary marine and fishing gear, fuel and supplies, and all licenses required under Territorial law and must, with certain exceptions, not pertinent here, deliver all fish caught to the association. The "independent fishermen" furnish their own boats and gear, bear the expenses of operation, and may deliver fish to any cannery they choose. *Held*, (1) the "company fishermen" are employees of the association for Federal employment tax purposes; and (2) the "independent fishermen" are not employees of the association for such purposes.

The Internal Revenue Service has been requested to determine the status, for Federal employment tax purposes, of individuals performing services as so-called "company fisherman" and "independent fisherman" under the facts and circumstances described below, which were submitted to the Service as typical of the manner in which and the arrangement under which their operations are carried out.

The terms "company fisherman" and "independent fisherman" are used throughout the Alaska fishing industry to divide into two general classifications the fisherman who catch the salmon which are canned in Alaska. The "independent fishermen" use their own boats and gear, while the "company fishermen" are furnished boats and gear by the organization to which they supply fish. The operations of both classes are generally governed by the provisions of an agreement entered into between a trade association, representing its members composed of packers on the one hand, and the fishermen's unions on the other.

Under the terms of an agreement entered into in the instant case between the *M* packers association and the representatives of a fishermen's union, the "company fishermen", as well as the captain who assembles them, must be acceptable to the association. In addition to the fishing vessel, the association furnishes the "company fishermen" all the necessary marine and fishing gear and maintenance therof, fuel and supplies, free mess hall services ashore, and the licenses required under Territorial law by the captain and the crew. The captain is charged with the responsibility of seeing that the vessel is operated in accordance with laws and regulations pertaining to such fishing operations and activities, and he is required to deliver to the association all fish obtained from the vessel's operation, except in situations where the salmon on board the vessel is in danger of becoming unsuitable for delivery according to the association's standards. In such event, the fish may be sold to any party willing to receive them and payment therefor is made to the association and not to the captain. The "independent fishermen" furnish their own boats and gear and bear the expense of upkeep incident to the operation of their equipment and can, if they so desire, deliver fish caught by them to any cannery they choose. They receive higher prices for their fish than those paid "company fishermen", the differential being based on the fact that they furnish their own equipment.

The agreement further provides, with respect to both classes of fishermen, that the association reserves the right to restrict or stop all

fishing entirely during any period their canneries are shut down due to the laws, rules, or regulations put into force by the Burea of Fisheries, or strikes, fires, breakdowns, or any other cause beyond its control; that the crew of each fishing boat shall discharge its own fish and make deliveries once in each twenty-four hour period; that all salmon must be in good condition in the judgment of the association; that, in case of a labor dispute between the association and other unions, the fishermen reserve the right to refuse to go through a picket line authorized by a recognized labor union. Since canned salmon is subject to rigid inspection and confiscation by the Federal government, the fishermen, either by contract or custom, are required to submit to the rigid inspection of their boats and gear as well as of the fish which they catch and offer for delivery to the cannery.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle c, Internal Revenue Code of 1954) provides, among other things, that 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. The guides for determining, under the usual common law rules, whether an employer-employee relationship exists are found in section 31.3121(d)-1(c) of the Employment Tax Regulations.

Whether an individual is an independent contractor or an employee is largely a question of fact to be determined upon consideration of the particular facts in each case.

In the instant case, it is determined that the association exercises or has the right to exercise such control over the "company fishermen" using its vessels and equipment as is necessary under the usual common law rules to establish an employer-employee relationship. Accordingly, it is held that the "company fishermen" are employees of the association for Federal Insurance Contributions Act purposes.

With respect to the "independent fishermen" who furnish their own boats and gear, pay their own operating expenses, and deliver their fish to the cannery of their choice, it is determined that the association neither exercises nor has the right to exercise such control over them in the performance of their services as is necessary under such rules to establish the relationship of employer and employee for purposes of such Act. Therefore, they are not employees of the association for Federal Insurance Contribution Act purposes.

These conclusions are also applicable for the purposes of the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages.

(Also Sections 3306, 3401; 31.3306(i)-1.) Rev. Rul. 57-246

Certain members of a corporation's board of directors, including the chairman of the board and the president, are also members of the corporation's executive committee. The committee is vested with all the powers of the board during intervals when the board is not in session. It considers questions of policy and administrative matters and its members are required to be available for consultations involving corporate activities and to undertake tasks involving corporate planning and operations. The committee members each receive an annual remuneration in payment for their services as committee members and members of the board of directors. The committee chairman, in addition to his duties in presiding

at committee meetings, represents the corporation as a member of a foreign trade council and appears before legislative committees on the corporation's behalf. *Held*, the members of the executive committee are not, while performing committee functions and attending committee meetings, employees of the corporation for Federal employment tax purposes. *Held further*, any services performed by the chairman as an officer of the corporation, and distinguishable from his services as committee chairman, are considered as services performed in an employee status for the above purposes.

The Internal Revenue Service has been requested to determine the status, for Federal employment tax purposes, of certain directors with respect to their services performed as members of a committee created pursuant to the bylaws of a corporation.

The bylaws provide for an executive committee composed of the chairman of the board of directors, the president, and four additional members of the board who are appointed by the president with the approval of the board. The bylaws further provide that the board of directors is authorized to elect from their number certain officers of the corporation, one of which is a chairman of the executive committee. The committee is vested with all of the powers of the board of directors during intervals when the board is not in session, but the committee is required to report its proceedings and acts to the board in each case at its next succeeding meeting. The executive committee is authorized to adopt such rules and regulations as it deems desirable for the order and conduct of its meetings. Each member of the committee is also a member of the board of directors.

The members in question each receive $200x$ dollars per year, on a monthly basis, in payment for their services as committee members and as members of the board of directors. Their duties require attendance at regular board of directors' meetings, usually held two to four times a year, and attendance at all executive committee meetings, which are usually held six to eight times per year, with no extra fees paid for such attendance. In addition to questions of policy, the executive committee considers in detail administrative matters in which the officers of the corporation desire an opinion, such as the employment of personnel, labor problems, purchase of equipment, conduct of litigation, etc. The members are individually required to be available for consultation with management at all times, both on matters of policy and on current corporate activities, and to undertake any specific tasks or duties requested of them in connection with corporate planning and operations. They also may be called upon to make trips from time to time to inspect the corporation's plants, to observe operations of such plants, and to report thereon and make recommendations for future action and policies. Biweekly reports of progress in operations, of financial statements, and of other pertinent matters are furnished the members of the committee in order that they may be currently acquainted with corporate business affairs. No direction or instructions are issued by the board of directors to the committee except in infrequent instances and when issued, they normally relate to matters of unusual importance. The actions of the committee are subject to review by the board.

As pointed out above, the chairman of the executive committee, as such, is an officer of the corporation, as specified in the corporate

bylaws. He holds no other office except that of a director. He does, however, perform services, in addition to his usual duty of presiding at executive committee meetings, which appear to be of the type which an officer, rather than a director, would generally perform. Examples of such additional duties are his services of representing the corporation as an active member of a foreign trade council and his duty, when called upon, to appear before various legislative committees. He receives a salary plus his out-of-pocket expenses for his services as chairman of the committee.

Section 3121(d) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) provides, in part, that the term "employee" means:

> (1) any officer of a corporation; or
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; * * *

Section 31.3121(d)-1(b) of the Employment Tax Regulations provides that, generally, an officer of a corporation is an employee of the corporation. However, under such section an officer of a corporation who, as such, does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation. It is further provided that a director of a corporation, in his capacity as such, is not an employee of the corporation. See also Mim. 6381, C. B. 1949-1, 179.

It is the position of the Internal Revenue Service that fees received by a director of a corporation for performing services as such constitute self-employment income, and it is immaterial whether such remuneration is received for attending directors' meetings or for serving on committees. I. T. 4077, C. B. 1952-1, 149, at 150. Accordingly, services performed by directors in attending committee meetings are deemed to be services performed in the capacity of director, *as such*, and ordinarily do not constitute employment. Whether a director of a corporation can be an employee of the corporation depends primarily upon whether or not he performs services which are not directorial in nature, and whether or not those services are performed under an employer-employee relationship. The guides for determining whether a common law employment relationship exists are found in section 31.3121(d)-1(c) of the regulations.

From the facts present in the instant case, it appears that the executive committee of the corporation is concerned with matters of policy relating to the conduct and management of the affairs of the corporation; that the duties of the committee are directorial in nature; and that in the performance of such duties the committee is functioning in lieu of the board of directors. Accordingly, it is held that the members of the executive committee, including the chairman and the president, are not, while performing committee functions and attending committee meetings, employees within the meaning of the Federal Insurance Contributions Act.

It is further concluded that any services performed by the chairman strictly as an officer of the corporation, and distinguishable from his services performed as committee chairman, are to be considered as services performed in an employee status, and any remuneration paid

to him which is attributable to his duties solely as an officer constitutes "wages" subject to the Federal employment taxes. The same conclusion is applicable to the president of the corporation.

The conclusions expressed in this Revenue Ruling are also applicable with respect to 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).

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26 CFR 31.3121(g)-1: Agricultural labor. Rev. Rul. 57-41

A corporation grows mushrooms in standard mushroom houses and in an abandoned limestone mine. *Held*, the "surface" and "mine" areas where operations relating to the growing of mushrooms are conducted constitute a "farm" for purposes of the taxes under the Federal Insurance Contributions Act. *Held, also*, services performed by the corporation's employees in connection with its mushroom growing operations constitute "agricultural labor" as defined in that Act.

S. S. T. 293, C. B. 1938-1, 432, distinguished.

The Internal Revenue Service has been requested to determine the extent to which services performed in connection with the growing of mushrooms constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

A corporation owns and raises mushrooms in an abandoned limestone mine located on a large acreage. It also raises mushrooms in so-called "standard mushroom houses" located on the surface area of the property and plants and cultivates field crops on the property to produce the hay and top soil used in the mushroom growing beds.

The mushrooms are grown in a compost consisting principally of stable manure purchased from racing stables. This is brought to the corporation's compost area and piled in windrows to undergo a natural heating and fermentation process, during which time it is turned several times by special equipment. The compost is then taken to a filling machine, a specially designed, custom built machine, which fills the growing trays with a uniform layer of compost. The filled trays are stacked in a pasteurization house and held at a high temperature for several days to kill all insects and harmful organisms. Mushroom spawn is then spread evenly over the compost layer and the trays are held at a constant temperature for a "growing" period of three weeks while the spawn spreads through the compost. The trays are taken from the pasteurization house to the "casing" machine, where a one-inch layer of top soil, which has been produced on the corporation's property and cleaned and processed by special equipment, is spread over the compost. The trays are then ready for placing in the growing houses and growing areas of the mine tunnels.

Mushrooms ordinarily are grown in buildings of a specialized design to give control over such factors as light, heat, ventilation and humidity. The corporation has constructed growing houses of that specialized design. The limestone mine, mentioned above, provides natural control facilities and, accordingly, the corporation has installed in the mine tunnels growing equipment identical to that installed in its growing houses. The growing methods followed in both

locations are identical. After the mushrooms are harvested they are cooled, packed in pint boxes for delivery to stores, or in three pound baskets for hotel and restaurant use, and loaded into and delivered to market by the corporation's refrigerator trucks.

Some of the corporation's employees perform services directly associated with the mushroom growing operations, while other employees are engaged in cleaning the areas, maintaining and repairing buildings and equipment, and performing administrative services, all within the boundaries of the corporation's property.

In S. S. T. 231, C. B. 1937–2, 417, it was held that services performed in the growing of mushrooms on a farm of which the employer is owner or tenant constitute "agricultural labor" within the meaning of sections 811(b) (1) and 907(c) (1), Titles VIII and IX, respectively, of the Social Security Act. In arriving at this holding, it was recognized that mushrooms are generally grown in sheds, cellars, caves, or barns and not under general field conditions. In a prior ruling, it had been held that services performed by an employee in the growing of vegetables in greenhouses located on a farm of which the employer is owner or tenant constitute "agricultural labor." It was reasoned that no valid distinction could be made between the growing of products in greenhouses located on a farm and the growing of products in cellars, caves, barns, or specially constructed sheds which were located on a farm. Since mushrooms are by definition somewhat closely related to those vegetables which are produced for food, it was concluded that services performed in the growing of mushrooms should be classified as "agricultural labor," provided they were performed on a farm in the ordinarily accepted sense of that word.

Titles VIII and IX of the Social Security Act did not define the terms "agricultural labor" and "farm" and, in the absence of a statutory definition, it was necessary to define those terms by regulation. Article 6 of Regulations 91 and article 206(1) of Regulations 90 provided, in part, that the term "agricultural labor" includes all service performed by an employee, on a farm, in connection with the cultivation of the soil and the raising and harvesting of crops and that the term "farm" embraces the farm in the ordinarily accepted sense and includes stock, dairy, poultry, fruit, and truck farms, plantations, ranches, ranges, and orchards. The ruling stated in S. S. T. 231, *supra*, was based upon this provision of the regulations and the Service has not receded therefrom.

Section 3121(g) of the Federal Insurance Contributions Act provides that as used therein the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities and orchards. That section also sets forth the types of services and the conditions under which services of the prescribed types must be performed to come within the meaning of the term "agricultural labor."

Pursuant to section 3121(g) of the Federal Insurance Contributions Act, it is the position of the Service that any plot of ground or other area used primarily for the raising of an agricultural or horticultural commodity constitutes a "farm" within the meaning of that section, irrespective of its size or location or the extent to which the soil actually is used in connection with the operations being con-

ducted. See Rev. Rul. 54–310. C. B. 1954–2, 264; Rev. Rul. 54–587, C. B. 1954–2, 359; and Rev. Rul. 55–456, C. B. 1955–2, 418. It is the position of the Service, furthermore, that mushrooms are "agricultural or horticultural commodities" within the meaning of that term as used in section 3121 (g). See Rev. Rul. 56–560, C. B. 1956–2, 698. Accordingly, a structure used primarily to raise mushrooms, whether a standard mushroom house or any similar structure, such as a building which has been remodeled to provide the controls needed to raise mushrooms, constitutes a "farm" within the meaning of that section. Furthermore, any area utilized in connection with the raising operations, such as areas used for compost, producing top soil, etc., also constitutes a component part of such mushroom "farm."

In the instant case, the corporation grows mushrooms both in standard mushroom houses and in its mine property. Identical growing equipment is installed in both locations, identical processes are followed to produce identical crops and the corporation's election to use the mine property was to utilize the natural control facilities therein available instead of constructing additional houses. Under these circumstances, the Service is of the opinion that it would be impracticable to attempt to distinguish between the "surface" and "mine" areas. Accordingly, it is held that the areas utilized in connection with the mushroom growing operations conducted by the corporation constitute a "farm" within the meaning of section 3121(g) of the Federal Insurance Contributions Act. It is further held that the services described above as being performed by the corporation's employees constitute "agricultural labor" within the meaning of that section.

In a ruling published as S. S. T. 293, C. B. 1938–1, 432, it was held that services performed by employees in the growing of mushrooms in natural caves located within the corporate limits of a city do not constitute "agricultural labor" for the reason that the caves are neither located on nor operated as a "farm" in the ordinarily accepted sense. However, that ruling was issued under the taxing provisions of the Social Security Act in effect for periods prior to 1940. The Act contained no definition of the word "farm," that term being defined by Article 6 of Regulations 91. The holding in S. S. T. 293 still represents the position of the Service on this matter, but only for periods prior to 1940.

(Also Sections 3306, 3401; 31.3306(k)–1.) Rev. Rul. 57–217

The term "agricultural labor," as defined in section 3121(g) of the Federal Insurance Contributions Act, includes services performed by employees on a farm in connection with raising, feeding, and caring for mink. However, the mere maintenance of a natural environment is not considered to be the operation or maintenance of a farm and, generally, the services performed in connection therewith, including services relating to the guarding of the property and the trapping or taking of fur-bearing animals and wildlife therefrom, do not constitute "agricultural labor" within the meaning of such section.

Advice has been requested whether services performed by employees in connection with the raising of mink unconfined and in their natural environment constitute "agricultural labor" within the meaning of

section 3121(g) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

Section 3121(g), *supra*, provides, in part, that the term "agricultural labor" includes all services performed on a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry and fur-bearing animals and wildlife. Such section also provides that, as used therein, the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards. For purposes of such section, any plot of ground or other area, including structures, used primarily for the raising of fur-bearing animals (including mink) is a "farm," irrespective of its size or location or without reference to the extent to which the soil is used in connection with mink raising operations. See Rev. Rul. 54–310, C. B. 1954–2, 264, regarding the raising, etc., of poultry.

Accordingly, services performed by employees on a farm in connection with raising, feeding, and caring for mink constitute "agricultural labor" as defined in section 3121(g), *supra*. However, a natural environment which is a fur-bearing animal or wildlife preserve, or is used primarily for fishing, hunting, or trapping, is not a "farm" and services performed in guarding or maintaining such property, or in taking fur-bearing animals or wildlife therefrom, do not constitute "agricultural labor" within the meaning of section 3121(g) of the Act. Thus, services performed in connection with the general care of animals in such an area during emergency periods, such as feeding, watering, etc., during extremely inclement weather and, at any time, in guarding the property or taking fur-bearing animals therefrom, do not constitute "agricultural labor" within the meaning of that section.

This ruling is applicable also 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).

"Agricultural labor" performed on a farm by employees in connection with raising, feeding, and caring for mink is not excepted from "employment" for purposes of the taxes imposed by the Federal Insurance Contributions Act, and cash remuneration paid for such labor is subject to the taxes imposed by that Act except as provided in section 3121(a)(8)(B) thereof.

Although this Revenue Ruling has specific reference to services performed in raising, feeding and caring for mink, it also applies to such services in connection with other wild fur-bearing animals.

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26 CFR 31.3121(k)–1: Waiver of exemption from taxes. Rev. Rul. 57–11

(Also Part II, Section 1426(l); Section 408.216, Regulations 128.)

Procedures to be followed, pending the issuance of regulations under the Federal Insurance Contributions Act, in applying those provisions of section 403(a) and (b) of the Social Security Amend-

ments of 1954 and section 3121(k) of the Federal Insurance Contributions Act, as amended by the Social Security Amendments of 1956, which provide for the social security coverage of individuals employed by certain exempt organizations.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to set forth changes in procedures under section 3121(k) of the Federal Insurance Contributions Act (chapter 21, subtitle C, of the Internal Revenue Code of 1954, as amended by the Social Security Amendments of 1954) and section 403(a) and (b) of the Social Security Amendments of 1954, resulting from the amendment of those sections by the Social Security Amendments of 1956, approved August 1, 1956.

SEC. 2. SCOPE

The instructions in 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. 3. STATUTORY PROVISIONS.

.01 Section 3121(k) of the Federal Insurance Contributions Act, as amended by the Social Security Amendments of 1956, provides, in part, as follows:

(k) EXEMPTION OF RELIGIOUS, CHARITABLE, AND CERTAIN OTHER ORGANIZATIONS.—

(1) WAIVER OF EXEMPTION BY ORGANIZATION.—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 first calendar quarter for which the certificate is in effect, or at any time prior to January 1, 1959, whichever is the later, 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. 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 the first day of the calendar quarter in which such certificate is filed or the first day of the succeeding calendar quarter, as may be specified in the certificate, except that, in the case of service performed by an individual whose name appears on a supplemental list filed after the first month following the first calendar quarter for which the certificate is in effect, the certificate shall be in effect, for purposes of such subsection (b)(8) and for purposes of section 210(a)(8) of the Social Security Act, only with respect to service performed by such individual after the calendar quarter in which such supplemental list is filed.

.02 Section 403 of the Social Security Amendments of 1954, as amended by the Social Security Amendments of 1956, 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 has failed to file prior to the enactment of the Social Security Amendments of 1956 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 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;

(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 upon the assumption that a valid waiver certificate had been filed by it under section 1426(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.

SEC. 4. SUPPLEMENTAL LISTS FILED UNDER SECTION 3121(k), AS AMENDED.

.01 *In general.*—Pursuant to section 3121(k), as amended by section 201(k) of the Social Security Amendments of 1956, a properly completed and signed supplemental list on Form SS–15a Supplement, Amendment to List on Form SS–15a, filed on or after August 1, 1956, will be accepted as a valid amendment to the list on Form SS–15a, List to Accompany Certificate on Form SS–15 Waiving Exemption From Taxes Under the Federal Insurance Contributions Act, if it is filed before the end of the twenty-fourth month following the first calendar quarter for which the certificate on Form SS–15, Certificate Waiving Exemption From Taxes Under the Federal Insurance Contributions Act, is in effect, or at any time prior to January 1, 1959, whichever is the later.

.02 *Supplemental lists filed prior to August 1, 1956.*—Section 3121(k) in effect prior to the enactment of the Social Security Amendments of 1956, August 1, 1956, provided that a supplemental list, in order to constitute a valid amendment to the list on Form SS–15a, must be filed within the 24-month period prescribed by such section. The language "or at any time prior to January 1, 1959, whichever is the later," which was added to section 3121(k) by the Social Security Amendments of 1956, has no application to supplemental lists filed prior to August 1, 1956. Accordingly, the provisions of section 31.3121(k)–1 of the regulations issued under the Federal Insurance Contributions Act are applicable in the case of a supplemental list filed prior to August 1, 1956.

.03 *Supplemental lists filed on or after August 1, 1956.*—Section 201(k) of the Social Security Amendments of 1956 amended section 3121(k) to the extent that any supplemental list filed on or after August 1, 1956, and prior to January 1, 1959 (regardless of the effective date of the certificate previously filed by the organization), will constitute a valid amendment even though the supplemental list is not filed within the 24-month period. If a supplemental list is filed prior to the end of the first month following the first calendar quarter for which the certificate is in effect, the certificate will be effective, in the case of any individual whose name appears on such supplemental list, with respect to services performed on and after the effective date of the certificate. If the supplemental list is filed after the first month following the first calendar quarter for which the certificate is in effect, the certificate will be effective, in the case of an individual whose name appears on such supplemental list, with respect to services performed after the calendar quarter in which the supplemental list is filed.

.04 *Reopening of cases involving prior invalid amendments.*—District Directors of Internal Revenue are not required to initiate any action with respect to the reopening of cases involving supplemental lists filed prior to August 1, 1956, which were invalid for the reason that they were not filed within the 24-month period. However, the amendment of section 3121(k) now makes it possible for organizations to submit new supplemental lists at any time prior to January 1, 1959.

SEC. 5. CERTIFICATES FILED UNDER SECTION 3121(k), AS AMENDED.

.01 *In general.*—Pursuant to section 3121(k), as amended by section 201(l) of the Social Security Amendments of 1956 a certificate on Form SS–15 shall be in effect for the period beginning with the first day of the calendar quarter in which it is filed or the first day of the succeeding calendar quarter, whichever is specified by the organization. The amendment is effective with respect to certificates filed after 1956.

.02 *Certificates filed prior to January 1, 1957.*—A certificate filed prior to January 1, 1957, is in effect for the period beginning with the first day of the calendar quarter following the close of the calendar quarter in which it is filed. The language "the first day of the calendar quarter in which such certificate is filed," which was added to section 3121(k) by the Social Security Amendments of 1956, has no application to certificates filed prior to January 1, 1957.

.03 *Certificates filed on or after January 1, 1957.*—An organization which files a certificate on or after January 1, 1957, shall specify whether the certificate is to be in effect for the period beginning with the first day of the calendar quarter in which it is filed or the first day of the succeeding calendar quarter. Form SS–15 (Revised January 1957), which will be available from District Directors on January 1, 1957, will provide a space for the insertion of the appropriate date.

SEC. 6. REQUESTS OF INDIVIDUALS UNDER SECTION 403(a) AS AMENDED BY SOCIAL SECURITY AMENDMENTS OF 1956.

.01 *In general.*—Pursuant to section 403(a) of the Social Security Amendments of 1954, as amended, an individual who, as an employee, performed services after December 31, 1950, and prior to August 1, 1956, for an organization which failed to file prior to August 1, 1956, a valid certificate on Form SS–15 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.

.02 *Procedure and rules applicable to the filing of the requests under section 403(a), as amended.*—In general, the procedures and rules outlined in section 408.216(c) of Regulations 128, as added by Treasury Decision 6176, approved May 24, 1956, C.B. 1956–1,661, relating to the execution and filing of requests under section 403(a) of the Social Security Amendments of 1954, the optional tax payments by the organization, and the effect of the requests, are equally applicable to requests filed under section 403(a), as amended. However, in applying these provisions it should be borne in mind that section 403(a), as amended, is applicable to services performed by an individual prior to January 1, 1957 (if some service was performed by the individual prior to August 1, 1956), and that the organization must have failed to file a valid waiver certificate prior to August 1, 1956.

SEC. 7. REQUESTS OF INDIVIDUALS UNDER SECTION 403(b) AS AMENDED BY THE SOCIAL SECURITY AMENDMENTS OF 1956.

.01 *In general.*—Pursuant to section 403(b) of the Social Security Amendments of 1954, as amended, an individual who, as an employee, performed services after December 31, 1950, and prior to August 1,

1956, for an organization which filed a valid certificate but who failed to sign the list of concurring employees, may, under certain circumstances, 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 under the Federal Insurance Contributions Act and for purposs of title II of the Social Security Act.

.02 *Procedure and rules applicable to the filing of the requests under section 403(b), as amended.*—In general, the procedures and rules outlined in section 408.216(d) of Regulations 128, as added by Treasury Decision 6176, *supra*, relating to the execution and filing of requests under section 403(b) of the Social Security Amendments of 1954 and the effect of such requests, are equally applicable to requests filed under section 403(b), as amended. However, in applying these provisions it should be borne in mind that section 403(b), as amended, is applicable to services performed by an individual prior to August 1, 1956, and that the individual has until January 1, 1959, within which to file his request.

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26 CFR 36.3121(l)–1: Agreements entered into by domestic corporation with respect to foreign subsidiaries. Rev. Rul. 57–216

Procedure to be followed by a domestic corporation, as successor to the assets and liabilities of a dissolved domestic corporation, to continue social security coverage, as provided by section 3121 (l) of the Federal Insurance Contributions Act, of United States citizen employees of a foreign subsidiary of the predecessor domestic corporation prior to its dissolution.

The Internal Revenue Service has received an inquiry concerning the procedure to be followed by a domestic corporation in order to continue the social security coverage provided by section 3121(l) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of employees of a foreign subsidiary who are United States citizens, under the circumstances set forth below.

The *M* domestic corporation which was wholly owned by *N*, also a domestic corporation, entered into an agreement with a District Director of Internal Revenue, effective January 1, 1955, pursuant to the provisions of section 3121(l) of the Act, to extend social security coverage to employees, who are United States citizens of *X* company, a foreign subsidiary of *M*, within the meaning of section 3121(l)(8)(A) of the Act. Effective October 7, 1956, the *M* corporation dissolved and transferred all of its assets, subject to all of its liabilities, to the *N* corporation, which is now the owner of more than fifty percent of the voting stock of the *X* company. The *N* corporation desires to continue in effect the extension of social security coverage of the employees covered by the agreement. The *N* corporation does not have in effect an agreement with respect to employees of any foreign subsidiary.

Section 3121(l)(3) of the Act provides, in part, that the period for which an agreement entered into by a domestic corporation under section 3121(l) of such Act is effective, with respect to any foreign corporation, shall terminate at the end of any calendar quarter in which the foreign corporation, at any time in such quarter, ceases to be

a foreign subsidiary of the domestic corporation. By virtue of the dissolution of the *M* corporation on October 7, 1956, the *X* company ceased to be a foreign subsidiary of that corporation. Thus, the agreement was automatically terminated as of December 31, 1956, the end of the quarter in which the relationship terminated. See section 36.3121(l)(3)–1 of the Regulations Relating to Contract Coverage of Employees of Foreign Subsidiaries. However, by reason of such agreement, amounts equivalent to the tax imposed under the Federal Insurance Contributions Act are payable by the *M* corporation only with respect to remuneration paid for services rendered before October 8, 1956.

In order to continue in effect the extension of social security coverage to the qualified employees of the *X* company, and to insure that there is no break in quarters of coverage or diminution of benefits because of low earnings, the *N* corporation would have to enter into a new agreement on Form 2032, Contract Coverage Under Title II of the Social Security Act as Amended, with the District Director for its district, prior to January 1, 1957, pursuant to section 3121(l) of the Act, covering the employees involved, effective October 1, 1956. Such agreement would be applicable only with respect to services performed after October 7, 1956, the date of dissolution of the *M* corporation. An agreement entered into subsequent to December 31, 1956, would become effective as of the first day of the calendar quarter in which the agreement is signed by the District Director, or the first day of the calendar quarter following the calendar quarter in which the agreement is signed by the District Director, whichever is specified in the agreement.

Assuming that the conditions set forth in section 3121(a)(l) of the Act, relating to successor and predecessor employers, are met in connection with the transfer of assets of the *M* corporation, the *N* corporation may, in computing its liability under the agreement, treat the remuneration paid to the employees of the *X* company during 1956, with respect to which amounts equivalent to the taxes imposed by the Federal Insurance Contributions Act were paid by the *M* corporation prior to its dissolution, as having been paid by it (*N* corporation) in determining the $4,200 limitation on remuneration paid to an employee of a foreign subsidiary covered by its (*N* corporation) agreement on Form 2032, which may be regarded as wages for purposes of the Federal Insurance Contributions Act.

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3306.—DEFINITIONS

Contributions by an employer to separate and individual trusts each providing certain unemployment benefits to a designated employee. See Rev. Rul. 57–37, page 18.

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26 CFR 31.3306(b)–1: Wages.

Strike benefits received by members of a labor union. See Rev. Rul. 57–1, page 15.

Noncash remuneration paid to retail commission salesmen. See Rev. Rul. 57–18, page 354.

Payments made direct to employees for the purchase of hospitalization and surgical insurance coverage. See Rev. Rul. 57–33, page 303.

Payments made to employees by their employers or by a labor organization pursuant to "back pay orders" issued by the National Labor Relations Board. See Rev. Rul. 57–55, page 304.

Bonuses paid to former employees. See Rev. Rul. 57–92, page 306.

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26 CFR 31.3306(c)(7)–1: Services in employ of States or their political subdivisions or instrumentalities.

Services performed by individuals under the jurisdiction of an agent of the employer. See Rev. Rul. 57–56, page 308.

A soil conservation district engaged in carrying out a state conservation program. See Rev. Rul. 57–120, page 310.

An association organized and operated by state insurance departments. See Rev. Rul. 57–128, page 311.

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26 CFR 31.3306(i)–1: Who are employees.

Physician engaged on a part-time basis. See Rev. Rul. 57–21, page 317.

Services performed by reporters for a private law reporting business. See Rev. Rul. 57–42, page 320.

Vendors of ice cream products. See Rev. Rul. 57–63, page 321.

A schochet performing slaughtering services at a slaughter house and in his home. See Rev. Rul. 57–80, page 324.

Fees received by officials who officiate at intercollegiate athletic contests. See Rev. Rul. 57–119, page 331.

"Clerks of the works" engaged by a private corporation to supervise its building project. See Rev. Rul. 57–145, page 332.

An actress, narrator and artist engaged by a film company in the production of industrial and commercial motion pictures. See Rev. Rul. 57–155, page 333.

"Company fishermen" and "independent fishermen" supplying salmon to a packers association. See Rev. Rul. 57–168, page 337.

Status, for Federal employment tax purposes, of directors performing services as members of an executive committee. See Rev. Rul. 57–246, page 338.

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26 CFR 31.3306(k)–1: Agricultural labor.

Services performed by employees in connection with the raising of mink. See Rev. Rul. 57–217, page 343.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

Strike benefits received by members of a labor union. See Rev. Rul. 57–1, page 15.

Physician engaged on a part-time basis. See Rev. Rul. 57–21, page 317.

Payments made direct to employees for the purchase of hospitalization and surgical insurance coverage. See Rev. Rul. 57–33, page 303.

Contributions by an employer to separate and individual trusts each providing certain unemployment benefits to a designated employee. See Rev. Rul. 57–37, page 18.

Remuneration for services performed by reporters for a private law reporting business. See Rev. Rul. 57–42, page 320.

Payments made to employees by their employers or by a labor organization pursuant to "back pay orders" issued by the National Labor Relations Board. See Rev. Rul. 57–55, page 304.

Vendors of ice cream products. See Rev. Rul. 57–63, page 321.

A schochet performing slaughtering services at a slaughter house and in his home. See Rev. Rul. 57–80, page 324.

Stenographer engaged to perform part-time services. See Rev. Rul. 57–93, page 328.

Fees received by officials who officiate at intercollegiate athletic contests. See Rev. Rul. 57–119, page 331.

Ministers whose services for an organization are excepted from "employment," and others whose services constitute "employment." See Rev. Rul. 57–129, page 313.

Payments made with respect to services performed by volunteer unpaid workers. See Rev. Rul. 57–135, page 307.

An architectural firm which pays "wages" to "clerks of the works" on behalf of one of its clients. See Rev. Rul. 57–145, page 332.

An actress, narrator and artist engaged by a film company in the production of industrial and commercial motion pictures. See Rev. Rul. 57–155, page 333.

"Company fishermen" and "independent fishermen" supplying salmon to a packers association. See Rev. Rul. 57–168, page 337.

Services performed by employees in connection with the raising of mink. See Rev. Rul. 57–217, page 343.

Status, for Federal employment tax purposes, of an officer-director serving as a member of an executive committee. See Rev. Rul. 57–246, page 338.

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26 CFR 31.3401(a)–1: Wages.

Conditions for attaching statement to support excludable sick pay to individual income tax returns. See Rev. Proc. 57–1, page 721.

(Also Section 3102; 26 CFR 31.3102–1.) Rev. Rul. 57–12

The *N* company, a motor freight carrier, is unable to use its regular employees to unload its trucks in certain areas because of local employment conditions. It engages members of local unions for unloading its trucks at delivery points in such areas. These individuals are engaged and perform their services on an irregular basis, but under circumstances which constitute them employees of the company. They are paid daily by the company at hourly rates fixed by the union for this type of work. Because of the irregular nature of the work of a particular employee, the frequency with which wage payments are

made to the many employees involved, and the small amounts of the individual wage payments, a question has been raised relative to the necessity of having the Federal income tax and the employee tax (social security tax) deducted and withheld therefrom. *Held*, the *N* company, as the employer, is required to deduct and withhold the Federal income tax under section 3402 of the Internal Revenue Code of 1954 and the employee tax imposed under section 3101 of the Federal Insurance Contributions Act (chapter 21, subtitle C, of the 1954 Code) from the "wages," as that term is defined in sections 3401 and 3121 of the Code, paid by it to such employees for their services, irrespective of the frequency of the payments and the small amount of each individual wage payment. The *N* company is responsible for the return and payment of such taxes, whether or not collected from the employee. See Rev. Rul. 55–543, C. B. 1955–2, 400. There are no provisions in the statute to relieve the employer from his liability for withholding of the Federal income and the employee social security taxes from the "wages" paid and for making the returns and payments with respect to such taxes.

(Also Sections 3121, 3306; 26 CFR 31.3121(a)–1; 31.3306(b)–1.) Rev. Rul. 57–18

Interim instructions or use in applying the provisions of section 3402 of the Internal Revenue Code of 1954, as amended by the Act of August 9, 1955, Public Law 306, 84th Cong., 69 Stat. 605, C. B. 1955–2, 759, with respect to the income tax withholding requirements for noncash remuneration paid to retail commission salesmen.

The purpose of this Revenue Ruling is to outline the requirements for income tax withholding under section 3402 of the Internal Revenue Code of 1954, as amended by the Act of August 9, 1955, Public Law 306, 84th Cong., 69 Stat. 605, C. B. 1955–2, 759, with respect to noncash remuneration paid to retail commission salesmen.

Section 3402 of the Code, as amended by Public Law 306, reads, in part, as follows:

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) REQUIREMENT OF WITHHOLDING.—Every employer making payment of wages shall deduct and withhold upon such wages (except as provided in subsection (j)) a tax equal to 18 percent of the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in subsection (b)(1).

* * * * * * *

(j) NONCASH REMUNERATION TO RETAIL COMMISSION SALESMEN.—In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter [chapter] with respect to such remuneration, provided that such employer files with the Secretary or his delegate such information with respect to such remuneration as the Secretary or his delegate may by regulations prescribe.

The term "wages," as used in section 3402, *supra*, is defined in section 3401(a) of the Code to mean all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash, with certain exceptions not here material. The effect of Public Law 306, *supra*,

is to relieve an employer from the requirement of withholding income tax from wages paid after August 9, 1955, in a medium other than cash, to a retail salesman who is ordinarily remunerated solely by way of cash commission, provided the requisite information is furnished with respect to such noncash remuneration. Merchandise prizes awarded to a salesman for exceeding his sales quota or for achieving outstanding sales results are illustrative of the type of remuneration payments to which the amendment applies.

Section 3402(j) of the Code, which was added by Public Law 306, *supra*, is applicable with respect to noncash remuneration paid to retail commission salesmen after August 9, 1955. Pending the issuance of regulations pursuant to such provision of law, an employer who after August 9, 1955, makes a payment of noncash remuneration to an employee of the character described therein will not be required to withhold income tax from such noncash remuneration. However, the fair market value of such remuneration must be included in the total wages reported on the Withholding Tax Statement, Form W–2, furnished by the employer to the employee with respect to wages paid during the calendar year. The value of noncash remuneration required to be reported on Forms W–2 pursuant to this Revenue Ruling should *not* be reported on the separate Forms 1099 which accompany the U. S. Annual Information Return, Form 1096, which the employer may otherwise be required to file. Employers who do not withhold on such noncash remuneration in accordance with this Revenue Ruling will not be held liable by the Internal Revenue Service for failure to withhold should a different rule be prescribed by the regulations to be issued under section 3402(j), *supra*.

Although an employer, by reason of the provisions of Public Law 306, *supra*, is not required to deduct or withhold income tax under the conditions prescribed by this Revenue Ruling, with respect to noncash remuneration paid to a retail commission salesman, such provision of law neither relieves such a salesman of liability for income tax with respect to his noncash remuneration nor does it affect in any manner the treatment of noncash remuneration for purposes of the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, of the Internal Revenue Code of 1954).

Rev. Rul. 57–236

Remuneration for services performed on the high seas or in the territorial waters of the United States by employees who are residents of Puerto Rico and who are citizens of both Puerto Rico and the United States is subject to the withholding of income tax for the United States under section 3402 of the Internal Revenue Code of 1954, since such services are not performed "in a possession" of the United States within the meaning of section 3401(a)(8)(A)(ii) of the Code or "within Puerto Rico" within the meaning of section 3401(a)(8)(C) of the Code.

Advice has been requested as to the liability of an employer for withholding Federal income tax, as required by section 3402 of the Internal Revenue Code of 1954, with respect to remuneration paid to certain residents of Puerto Rico as crew members of a fishing vessel for services performed in the situations indicated below.

A corporation organized under the laws of Puerto Rico to engage in the fishing industry has its principal place of business in Puerto Rico. Most of its catch is delivered to canneries in Puerto Rico, but occasional deliveries are made to canneries in the United States. The corporation owns and operates one vessel. Members of the crew are paid a percentage of the value of the catch when it is sold. Some of the permanent members of the crew are citizens and residents of the United States. The other crew members are citizens and residents of Puerto Rico.

Section 3401(a)(8)(C) of the Code excepts from the term "wages" subject to the withholding of income tax under section 3402 of the Code remuneration paid for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that the employee will be a bona fide resident of Puerto Rico during the entire calendar year. Under section 3401(a)(8)(A)(ii) of the Code, an employer (other than the United States or any agency thereof) is not required to withhold income tax from remuneration paid for services performed in a foreign country or in a possession of the United States by a citizen of the United States if, at the time of payment of such remuneration, the employer is required by the law of any foreign country, or possession of the United States, to withhold income tax upon such remuneration. See Rev. Rul. 56–37, C. B. 1956–1, 499. The term "possession," as used in this section, includes the land area of Puerto Rico, its territorial waters, and the air space over such territory.

If the corporation is required by the laws of Puerto Rico to withhold tax at the time of the payment of remuneration to its employees who are citizens and residents of the United States for services performed in Puerto Rico, no witholding is required for the United States by reason of section 3401(a)(8)(A)(ii) of the Code. However, the wages attributable to services performed by such employees, both permanent and temporary, on the high seas and in the territorial waters of the United States are subject to the withholding of income tax for the United States under section 3402 of the Code.

In the event any of the corporation's employees who are citizens and residents of Puerto Rico are not also citizens of the United States, no witholding of income tax from their remuneration is required under section 3402 of the Code.

The wages paid employees, who are residents of Puerto Rico during the entire calendar year and are citizens of both Puerto Rico and the United States, attributable to services performed on the high seas and in the territorial waters of the United States, are subject to withholding of income tax for the United States since such services are not performed "in a possession" of the United States within the meaning of section 3401(a)(8)(A)(ii) of the Code or "within Puerto Rico" within the meaning of section 3401(a)(8)(C) of the Code and are not excepted from withholding under any other subsection of section 3401 of the Code. The remuneration paid such employees for services performed within Puerto Rico is not subject to withholding of income tax for the United States.

Where the corporation is required to withhold income tax for both Puerto Rico and the United States from the remuneration of an em-

ployee, the tax to be withheld for the United States should be computed in accordance with the provisions of section 3402 of the Code and without regard for the amount of the tax withheld for Puerto Rico. Under section 901 of the Code, and subject to the limitations of section 904, an employee subject to withholding of income tax for both Puerto Rico and the United States may claim credit on his Federal income tax return for the tax paid or accrued for the taxable year to the Government of Puerto Rico, provided he does not use the standard deduction or tax table in computing his tax liability. However, if he choose to any extent to take the benefits of section 901 of the Code, the taxpayer may not claim such tax as a deduction under section 164 of the Code.

Withholding of income tax by a person having control of the payment of wages other than the actual employer.
See Rev. Rul. 57–22, page 318.

Wages paid to employees of a state conservation district. See Rev. Rul. 57–120, page 310.

Lump-sum readjustment payments made pursuant to section 265 of the Armed Forces Reserve Act. See Rev. Rul. 57–164, page 26.

SUBTITLE D.—MISCELLANEOUS EXCISE TAXES

CHAPTER 31.—RETAILERS EXCISE TAX

SUBCHAPTER A.—JEWELRY AND RELATED ITEMS

SECTION 4001.—IMPOSITION OF TAX

Rev. Rul. 57–14

An insurance company paid a claim on the loss of insured jewelry. Subsequently, the jewelry was recovered and sold by the company to a private consumer. *Held*, an occasional sale by an insurance company to a private customer, solely as an incident to the company's insurance business, is not a sale at retail within the meaning of section 4001 of the Internal Revenue Code of 1954 and is not subject to the retailers excise tax.

Rev. Rul. 57–23

An individual pledged certain articles of jewelry as collateral for a bank loan. The bank acquired title to the jewelry by foreclosure and then disposed of the jewelry by private sale, by offering it to any person willing to satisfy the loan. *Held*, since the sale of the jewelry is solely an incident to the bank's business, the sale is not subject to the retailers excise tax imposed by section 4001 of the Internal Revenue

Code of 1954. However, under the provisions of section 4002 of the Code, if the jewelry had been sold on behalf of the bank by an auctioneer or other agent in the course of his business, the sale would have been subject to the retailers excise tax, and the auctioneer or other agent would be considered the person who sells at retail.

Rev. Rul. 57–43

A dining room serving table, decorated with a silver border on the top and a silver ornamentation one inch by one-half inch on each leg, was sold at retail. *Held*, tables of this type are not considered to be articles made of, ornamented, mounted, or fitted with precious metals or imitations thereof within the meaning of section 4001 of the Internal Revenue Code of 1954. Accordingly, sales of such tables are not subject to the retailers excise tax.

(Also Section 4201) Rev. Rul. 57–64

Pocket cigarette lighters ornamented with rhinestones or colored stones which imitate or simulate precious or semi-precious stones, are considered to be articles of jewelry within the meaning of section 4001 of the Internal Revenue Code of 1954, and sales of such articles are subject to the retailers excise tax imposed by that section. Cigarette lighters which are considered to be articles of jewelry are exempt from the manufacturers excise tax.

Advice has been requested whether pocket cigarette lighters ornamented with rhinestones or with colored stones, which imitate or simulate precious or semi-precious stones, are subject to the manufacturers excise tax or to the retailers excise tax.

Section 4201 of the Internal Revenue Code of 1954 imposes a tax upon the sale by the manufacturer, producer, or importer, of mechanical lighters for cigarettes, cigars, and pipes. Section 4221 of the Code provides that the manufacturers excise tax shall not be imposed on any article subject to the retailers excise tax on jewelry and related items.

Section 4001 of the Code imposes a tax on all articles commonly or commercially known as jewelry, whether real or imitation, when sold at retail. Jewelry as defined in section 320.31 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, includes articles designed to be carried in the hand, or hung on the arm, or carried or worn on the person, whether in pocket or bag or under the outer garment, such as cigarette cases, eyeglass cases, pencils, powder boxes, garter buckles, canes, purses, or handbags, if made of, or ornamented, mounted or fitted with pearls, precious or semi-precious stones, or imitations thereof.

It is held that pocket cigarette lighters ornamented with rhinestones or with colored stones, which imitate or simulate precious or semi-precious stones, are articles of jewelry within the meaning of the Code, and, therefore, are subject to tax when sold by the retailer. Because such cigarette lighters are subject to the retailers excise tax, they are exempt from the manufacturers excise tax.

Rev. Rul.-57-94

"Nickel silver," or "German silver," is not a precious metal or imitation thereof; therefore, the retailers excise tax does not apply to photograph frames, book ends, ash trays, and similar articles made of, or ornamented, mounted, or fitted with "nickel silver."

Advice has been requested whether photograph frames, bookends, ash trays, and similar articles made of "nickel silver" are taxable when sold at retail.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on articles made of, or ornamented, mounted, or fitted with precious metals or imitations thereof, when sold at retail.

Section 320.33 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 defines the term "imitations thereof" to include platings and alloys of such metals. "Nickel silver" sometimes known as "German silver," is an alloy of nickel with copper and zinc and does not contain gold, silver, platinum, or other metal of similar or greater value. It has a silver-white appearance. However, the fact that a substance is processed to resemble a precious metal in color or appearance does not make such substance an "imitation" of that precious metal for purposes of the retailers excise tax. That determination depends upon whether the substance actually includes a plating or alloy of gold, silver, platinum, or other metal of similar or greater value.

Accordingly, it is held that "nickel silver" is not an imitation of a precious metal. Therefore, the retailers excise tax does not apply to sales of photograph frames, book ends, ash trays, and similar articles made of, or ornamented, mounted, or fitted with "nickel silver."

Rev. Rul. 57–146

Identification tags and bracelets, designed to be worn on the wrist, are considered to be articles worn for adornment and are subject to retailers excise tax regardless of the substance of which they are made.

Advice has been requested whether certain identification tags and bracelets, designed to be worn on the wrist, are subject to the retailers excise tax.

A retailer sells identification tags, each of which consists of a chain attached to a metal disc on which is engraved the name and address of the wearer. The tags are designed to be worn on the wrist. They are not of the type prescribed for use in connection with the uniforms of members of the Armed Forces of the United States, although many of the tags are sold to members of the Armed Forces as well as to the general public.

The retailer also sells identification bracelets, some of which are made of precious metals, such as silver, while others are made of nonprecious metals, such as aluminum, chromium, or bronze.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on all articles commonly or commercially known as jewelry, whether real or imitation, when sold at retail. Section 4003 of the Code pro-

vides that this tax shall not apply to certain articles, including buttons, insignia, cap devices, chin straps, and other devices prescribed for use in connection with the uniforms of the Armed Forces of the United States.

Section 320.31 of Regulations 51, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines jewelry to include articles designed to be worn on the person for adornment and which are customarily worn so as to be displayed. The regulations further provide that such articles are taxable regardless of the substance of which made and without reference to their utilitarian value or purpose, unless for a purpose specifically exempted by law.

It is held, therefore, that identification tags and bracelets, designed to be worn on the wrist, are considered to be articles worn for adornment and are subject to the retailers excise tax regardless of the substance of which they are made.

Rev. Rul. 57–247

The retailers excise tax on jewelry and related items, imposed by section 4001 of the Internal Revenue Code of 1954, is applicable to the sale at retail of a cultured pearl contained in the natural oyster shell, which is packed and sold in a tin can.

Advice has been requested concerning the applicability of the retailers excise tax on jewelry and related items with respect to a cultured pearl in the natural oyster shell packaged and sold in a tin can.

A retailer sells cultured pearls which are contained in natural oyster shells. A shell containing the oyster and cultured pearl is packed in water in a tin can. The oyster is merely a medium for cultivating the cultured pearl and is to be discarded after the pearl is removed. Thus, it has no marketable value as such.

Section 4001 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of pearls and other precious and semiprecious stones, and imitations thereof, and the tax attaches to the total price for which the article is sold at retail.

Under the provisions of section 4051 of the Code, any charges for coverings and containers of whatever nature, and any charges incident to placing the article in condition packed ready for shipment, shall be included as a part of the sales price for the purpose of computing the tax.

It is held that a cultured pearl is a "pearl" as that term is used in section 4001 of the Code. It is held further that the retailers excise tax imposed by that section attaches to the total price for which the above-described cultured pearl is sold at retail, without reduction for any charge which might be allocable to the tin can or the oyster.

(Also Sections 4031, 4223.) Rev. Rul. 57–248

The retailers excise taxes imposed by sections 4001 and 4031 of the Internal Revenue Code of 1954 are applicable to articles sold at retail by Indians.

Advice has been requested whether certain articles sold by Indians are subject to the retailers excise taxes. The articles referred to include beaded earbobs, lapel pins, cuff links, and purses and bags of the drawstring type.

Earbobs or earrings, lapel pins, and cuff links fall within the classification of jewelry and are subject to the tax imposed by section 4001 of the Internal Revenue Code of 1954 when sold at retail, regardless of the material of which made. Purses and handbags are specifically named in section 4031 of the Code as being subject to the tax imposed thereunder regardless of the material of which made or the method of closure.

Section 4223 of the Code exempts from the *manufacturers* excise taxes, imposed under chapter 32 of the Code, all articles 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. However, there is no similar provision under chapter 31 of the Code exempting articles from the *retailers* excise taxes even though they are sold by Indians.

Therefore, it is held that taxable articles sold at retail by Indians are subject to the retailers excise taxes.

Rev. Rul. 57–262

Gold coins, as such, are not considered to be articles made of precious metals within the meaning of section 4001 of the Internal Revenue Code of 1954. Accordingly, sales of gold coins, as such, are not subject to the retailers excise tax imposed by that section. However, where gold coins are affixed to, or made a part of, an article whereby the article becomes ornamented, mounted, or fitted with a precious metal, the tax will apply to the total price for which such article is sold at retail.

Rev. Rul.–57–280

The retailers excise tax on jewelry and related items applies to retail sales of all binoculars, regardless of price or quality, but does not apply to so-called "binoculars" which are, in fact, toys.

Advice has been requested whether the retailers excise tax on jewelry and related items applies to the sales of toy "binoculars."

Section 4001 of the Internal Revenue Code of 1954 imposes a tax on articles of jewelry and related items when sold at retail. Included in the enumeration of articles are marine glasses, field glasses, and binoculars.

It is held that binoculars are subject to the tax on jewelry and related items when sold at retail, regardless of the price or quality. However, though an article may be called "binoculars" and have the shape and form thereof, if it has little or no magnifying power or other utility but is manufactured and sold as a toy for the amusement of a child or for his use in play, it will not be deemed to be "binoculars" within the meaning of section 4001 of the Code.

SUBCHAPTER B.—FURS

SECTION 4011.—IMPOSITION OF TAX

Rev. Rul. 57-136

A fur article which had been mailed to a prospective customer for inspection was returned to the retailer by parcel post insured. In transit it was lost. A thorough search was made; however, it was never recovered. The amount received as insurance proceeds, which was less than the retail sales price of the article, was turned over to the retailer who negotiated with the customer for an equitable adjustment of the balance.. *Held*, this transaction is not a sale within the meaning of section 4011 of the Internal Revenue Code of 1954. Therefore, the retailers excise tax does not apply.

SUBCHAPTER D.—LUGGAGE, HANDBAGS, ETC.

SECTION 4031.—IMPOSITION OF TAX

Rev. Rul. 57-192

A hotel has accumulated unclaimed baggage and baggage which has been forfeited for nonpayment of hotel bills. The hotel disposes of this baggage periodically. *Held*, such occasional sales, by a hotel, for the sole purpose of disposing of unclaimed baggage or baggage forfeited for the nonpayment of hotel bills 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.

Rev. Rul. 57-249

A child's "Tote Bag" is subject to the retailers excise tax on luggage, handbags, etc., when sold at retail, regardless of the material from which made.

Advice has been requested whether the retailers excise tax on luggage, handbags, etc., applies to the sale of a child's "Tote Bag" which is six and one-half inches long, three inches wide, five inches high, and which is constructed of cloth-covered cardboard, lined with rayon fabric, and equipped with plastic strap handles.

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon the sale at retail of articles enumerated therein (including in each case fittings or accessories therefor sold on or in connection with the sale thereof). The enumeration of articles includes handbags and bags for use in carrying toilet articles.

Accordingly, it is held that a child's "Tote Bag" is either a handbag or a bag for use in carrying toilet articles. Therefore, such an article is subject to the retailers excise tax on luggage, handbags, etc., when sold at retail, regardless of the material from which made.

Rev. Rul. 57–264

Official Boy Scout Packs which are suitable for carrying wearing apparel or toilet articles are subject to the retailers excise tax on luggage, handbags, etc. However, the Cub Pack and the Official Day Hike Bag, which have built-in partitions or special fittings for carrying cooking utensils and other equipment precluding their use for carrying wearing apparel or toilet articles are not taxable.

Advice has been requested regarding the applicability of the retailers excise tax on luggage, handbags, etc., to the sale of the following receptacles which are especially designed, advertised, and sold as official equipment for use by Boy Scouts in activities of the organization:

1. Cub Pack (blue)—No. 1024
2. Official Day Hike Bag—No. 1225
3. Official Haversack—No. 573
4. Official Yucca Bag—No. 574
5. Norwegian Packsack—No. 1238
6. Duffel Bags—No. 1072, 1073, and 1386
7. Rover Pack—No. 1434
8. Official Musette Bag—No. 1320

Section 4031 of the Internal Revenue Code of 1954 imposes a tax upon the retail sale of all cases, bags, and kits (without regard to size, shape, construction, or material from which made) for use in carrying toilet articles or articles of wearing apparel. Revenue Rulings 56–695 and 56–696, C. B. 1956–2, 790, holds that the taxability of a case, bag, kit, etc., depends upon whether the receptacle is suitable for use in carrying toilet articles or articles of wearing apparel and not upon the purpose for which it is manufactured, advertised, or sold.

The Cub Pack and the Official Day Hike Bag are constructed for use solely by the Boy Scouts in carrying cooking utensils and other equipment required on hikes. These receptacles are equipped with built-in partitions or special fittings which preclude their suitability for use in carrying toilet articles or articles of wearing apparel. It is therefore held that the Cub Pack and the Official Day Hike Bag are not subject to the retailers excise tax imposed by section 4031 of the Code.

The Official Haversack, Official Yucca Bag, Norwegian Packsack, Duffel Bags, Rover Pack, and Official Musette Bag are not equipped with any built-in partitions or special fittings which preclude their suitability for use in carrying wearing apparel or toilet articles. Accordingly, it is held that the tax on luggage, handbags, etc., imposed by section 4031 of the Code applies to the retail sale of these articles. There is no provision of law under which these articles may be exempt from the retailers excise tax merely because they are especially designed and are sold for use by Boy Scouts in official activities of the organization.

Taxability of articles sold by Indians at retail. See Rev. Rul. 57–248, page 360.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO RETAILERS TAX

SECTION 4055.—STATE AND LOCAL GOVERNMENT EXEMPTION

(Also Sections 4224, 4292.) Rev. Rul. 57–193

Electric and telephone membership corporations established under chapter 117 of the General Statutes of North Carolina are considered to come within the scope of the exemptions from certain Federal excise taxes provided for states or political subdivisions thereof.

Advice has been requested whether electric and telephone membership corporations established under the General Statutes of North Carolina are considered to come within the scope of the exemption from certain Federal excise taxes provided for states or political subdivisions thereof.

The electric and telephone membership corporations involved are those established under chapter 117 of the General Statutes of the State of North Carolina. Among other things, the North Carolina statute: (1) declares that membership corporations formed under its provisions are public agencies with the same rights as other political subdivisions of that State; (2) requires that application for the formation of membership corporations be investigated and passed upon by the State Rural Electricification Authority; (3) requires that upon dissolution of membership corporations all assets remaining after the payment of debts shall pass to and become the property of the State; (4) grants to the property of membership corporations the same tax exemption granted to property owned by counties and municipalities of the State; (5) states that the power of eminent domain may be exercised by the State Rural Electrification Authority on behalf of the membership corporations; and (6) states that membership corporations may not be organized for pecuniary profit.

It is held that under the Internal Revenue Code of 1954, and subject to the appropriate regulations (made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47) electric and telephone membership corporations established under chapter 117 of the General Statutes of North Carolina come within the scope of the exemption from certain Federal excise taxes provided for states or political subdivisions thereof. Such corporations are entitled to exemption from the following listed excise taxes provided that the requirements of the applicable regulations are met:

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

Applicability of the exemption from retailers excise tax with respect to the sales of taxable articles, for the exclusive use of humane societies, which are instrumentalities of a political subdivision of a State. See Rev. Rul. 57-170, page 411.

Irrigation districts of California come within the scope of exemptions from certain Federal excise taxes in respect to state and political subdivisions and other governmental units. See Rev. Rul. 57-254, page 383.

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER A.—AUTOMOTIVE AND RELATED ITEMS

PART I.—MOTOR VEHICLES

SECTION 4061.—IMPOSITION OF TAX

(Also Section 4071.) Rev. Rul. 57-95

Race cars, which are designed and adapted *exclusively* for use on off-highway race tracks, and parts and accessories (except tires and tubes) used in the manufacture thereof, are not subject to the manufacturers excise tax imposed by either section 4061(a) or 4061(b) of the Internal Revenue Code of 1954. Separate sales of replacement parts for such vehicles are also exempt from the tax if the parts are usable only in nontaxable racing cars. Tires and inner tubes used on the race cars are subject to the manufacturers excise tax imposed by section 4071 whether sold for use in the manufacture of the cars or for replacement purposes.

Advice has been requested concerning the applicability of the manufacturers excise tax to the sales of racing cars, as such, parts and accessories used in the manufacture of these vehicles, and replacement parts for these cars.

The racing cars are designed and adapted exclusively for use on off-highway race tracks. They are never driven on public highways. These race cars are usually manufactured complete without the engine or transmission, as the engine and transmission are of a special make and are usually installed by the buyer of the chassis and body. However, when the buyer requests the manufacturer to furnish these parts, the engine and transmission are included with the race car.

Section 4061(a) of the Internal Revenue Code of 1954 imposes a manufacturers excise tax on automobiles. Section 4061(b) of the Code specifies that, in addition to the motor vehicles enumerated in section 4061(a), parts and accessories therefor (other than tires and tubes and certain other exceptions not here in question) shall also be subject to a manufacturers excise tax. Section 4220 of the Code, as amended by Public Law 367, 84th Congress, 69 Stat. 689, C. B. 1955-2, 768, effective September 1, 1955, provides that a manufacturer may purchase automobile parts and accessories tax-free under exemption certificates for use in the manufacture or production of taxable or nontaxable articles.

A manufacturers excise tax is imposed by section 4071(a) (1) of the Code on tires of the type used on highway vehicles. Section 4071(a) (2) of the Code imposes a manufacturers excise tax on "other" tires, and section 4071(a) (3) of the Code imposes a similar tax on inner tubes for tires.

Since the race cars in question are designed and adapted *exclusively* for use on off-highway race tracks and are never driven on public highways, it is held that such cars are therefore not subject to the tax imposed by section 4061(a) of the Code, regardless of whether sold with or without engines and transmissions. It is further held that engines, transmissions, parts and accessories (except tires and tubes), which are used by the buyer of the body and chassis to complete the race car, are not subject to the manufacturers excise tax on parts and accessories under section 4061(b) of the Code.

Separate sales of replacement parts are also exempt from the manufacturers excise tax on parts and accessories if the parts are usable only in nontaxable race cars or engines. However, separate sales of replacement parts for racing cars or engines are subject to the tax if the parts are also usable in vehicles or engines which operate on public highways.

If the tires used in the manufacture of race cars or for replacement purposes are not of the type used on highway vehicles, the tax imposed by section 4071(a) (2) of the Code will be applicable rather than the tax under section 4071(a) (1) of the Code. Inner tubes are subject to the manufacturers excise tax under section 4071(a) (3) of the Code whether used in the manufacture of the race cars or for replacement purposes.

Rev. Rul. 57–231

Heating pads which are primarily designed to operate from a cigarette lighter or similar outlet in an automobile electrical system constitute automobile parts or accessories and are, therefore, 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 to the sale of heating pads which are designed to operate from a cigarette lighter or similar outlet in an automobile electrical system. The heating pads are equipped with nine-foot cords and are available for use with either a six-volt or 12-volt electrical system. The pads are sold to provide comfort or relief of pain while traveling in automobiles or other motor vehicles.

Section 4061(b) of the Internal Revenue Code of 1954 specifies that, in addition to the motor vehicle articles enumerated in section 4061(a), parts or accessories therefor shall also be subject to a manufacturers excise tax. Section 316.55 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "parts or accessories" for an automobile truck or other automobile chassis or body, as including any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

Accordingly, it is held that heating pads which are primarily designed to operate from a cigarette lighter or similar outlet in an auto-

mobile electrical system constitute automobile parts or accessories within the meaning of section 4061(b) of the Code and are, therefore, subject to the manufacturers excise tax imposed by that section.

Because the position of the Internal Revenue Service as to the applicability of the tax to heating pads has not been consistent with that expressed above, and by virtue of the authority of section 7805(b) of the Code, this Revenue Ruling will be applied only to sales made on and after July 1, 1957.

Rev. Rul. 57–232

Utility lights which are primarily designed to operate from a cigarette lighter or similar outlet in an automobile electrical system constitute automobile parts or accessories and are, therefore, 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 to the sale of utility lights which are designed to operate from a cigarette lighter or similar outlet in an automobile electrical system.

Light "A" is equipped with a spring clasp, both clear and "danger red" lenses, and is limited to use on a six-volt electrical system. Light "B" has a swivel hook, a "danger red" plastic shade, and is available for both six-volt and 12-volt electrical systems. Each light is equipped with a 12-foot cord with a plug end designed for insertion into the cigarette lighter or similar outlet.

Section 4061(b) of the Internal Revenue Code of 1954 specifies that, in addition to the motor vehicle articles enumerated in section 4061(a), parts or accessories therefor shall also be subject to a manufacturers excise tax. Section 316.55 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "parts or accessories" for an automobile truck or other automobile chassis or body, as including any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

Accordingly, it is held that the utility lights referred to above are considered automobile parts or accessories within the meaning of section 4061(b) of the Code and are, therefore, subject to the manufacturers excise tax imposed by that section.

Because the position of the Internal Revenue Service as to the applicability of the tax to this type of utility lights has not been consistent with that expressed above, and by virtue of the authority of section 7805(b) of the Code, this Revenue Ruling will be applied only to sales made on and after July 1, 1957.

Rev. Rul 57–237

Whether the manufacturers excise tax on motor vehicles applies to vehicles assembled in Puerto Rico from parts imported from a foreign country depends upon whether they are sold within the geographical United States.

Advice has been requested whether the manufacturers excise tax on motor vehicles applies to sales of automobiles manufactured, or

assembled, in Puerto Rico from parts imported from Europe, where sales are made (1) in the Commonwealth of Puerto Rico, (2) in adjacent islands not connected with the United States, (3) in possessions of the United States, and (4) within the States of the United States.

Section 4061 of the Internal Revenue Code of 1954 imposes a tax upon automobile chassis and bodies and certain other motor vehicle articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer.

Section 7701 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 manufacturers excise tax imposed by section 4061 of the Code is limited to sales made in the United States in its geographical sense. Therefore, under the circumstances described above, no manufacturers excise tax applies to the sales made (1) in the Commonwealth of Puerto Rico, (2) in adjacent islands not connected with the United States, and (3) in possessions of the United States. However, where a sale is made within the geographical United States, whoever makes the initial sale therein is liable for the tax. Where the manufacturer ships the automobile into the United States before selling it, he is liable for tax on his sale therein. If the manufacturer sells the automobile in Puerto Rico, or elsewhere outside the geographical United States, to a dealer or distributor who subsequently imports the automobile into the United States, the dealer or distributor is the importer who is liable when he resells it.

PART II.—TIRES AND TUBES

SECTION 4071.—IMPOSITION OF TAX

(Also Sections 4224, 6416.) Rev. Rul. 57–15

> The manufacturers excise tax does not apply to the sale of tread rubber to a state for its exclusive use. However, the tax applies to the sale of such rubber to a retreader, for use in the retreading of worn tires subsequently sold to a state, or for use in performing a retreading service for a state.

Advice has been requested whether the manufacturers excise tax applies to a manufacturer's sales of tread rubber for the following purposes:

(1) For use by a state in retreading its own tires for highway vehicles.
(2) For use by a retreader in retreading worn tires for highway vehicles, where such tires are subsequently sold to a state.
(3) For use by a retreader in retreading tires for highway vehicles, where the tires are owned by a state.

Section 4071(a) of the Internal Revenue Code of 1954, as amended by the Highway Revenue Act of 1956, 70 Stat. 387, C. B. 1956–2, 1150, imposes a tax on tread rubber sold by the manufacturer, producer,

or importer. Section 4072(b) defines the term "tread rubber" to mean any material which is commonly or commercially known as tread rubber or camelback, or which is a substitute for such material and is of a type used in recapping or retreading tires. Pursuant to section 4073(c), the tax does not apply to tread rubber sold by the manufacturer to any person for use by such person otherwise than in the recapping or retreading of tires of the type used on highway vehicles.

Under the provisions of section 4224 of the Code, no manufacturers excise tax is imposed upon the sale of any article for the exclusive use of a State, territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. Pursuant to the provisions of section 6416(b)(2)(A), a manufacturer may obtain refund or credit, without interest, of tax paid on the sales of articles which are resold by any person for the exclusive use of a state or other exempt governmental organization.

Under the provisions of section 4224 of the Code, it is held that no tax attaches where, as in the situation in (1) above, tread rubber is sold by the manufacturer direct to a state for use by the state in retreading its own tires. Furthermore, in accordance with the provisions of 6416(b)(2)(A), a manufacturer who has paid tax on the sale of tread rubber which is resold to a state for its exclusive use may obtain a refund or credit of the tax paid.

It is further held that the sale by a retreader to a state of tires which have been retreaded does not constitute a resale to the state of the tread rubber as such but, rather, constitutes a sale to the state of the tires in the processing of which tread rubber was used. Likewise, the use by a retreader of tread rubber in the retreading of tires which are owned by a state does not constitute a resale to the state of the tread rubber, but a use by the retreader of such rubber in the performance of a retreading service. Accordingly, a manufacturer may not sell tread rubber tax-free to a retreader for the purposes set forth in (2) and (3) above, nor may he obtain a refund or credit of the tax paid on tread rubber which is subsequently resold to a retreader for such use.

Rev. Rul. 57-218

Pursuant to the provisions of section 4071(a) of the Internal Revenue Code of 1954, the sale of tires, if wholly or in part of rubber, by the manufacturer, importer, or producer, is subject to the manufacturers excise tax on tires at the rate of eight cents a pound on tires of the type used on highway vehicles and at five cents a pound on other tires. *Held*, the determination of which rate of tax applies depends upon the "type" of tires and not upon the actual use for which the tires are sold. Therefore, tax at the rate of eight cents a pound will apply to all sales by the manufacturer of tires "of the type used on highway vehicles," even though some of those tires may be sold for use on nonhighway vehicles.

Applicability of tax to tires of the type used exclusively on off-highway race cars. See Rev. Rul. 57-95, page 365.

SECTION 4072.—DEFINITIONS

Rev. Rul. 57-219

The manufacturers excise tax applies to the sale of tread rubber produced from scraps, ends, and defective pieces of tread rubber on which tax previously has been paid.

Advice has been requested whether the manufacturers excise tax on tread rubber applies to the sale of tread rubber produced from scraps, ends, and defective pieces of tread rubber on which tax previously has been paid.

Numerous companies purchase salvage rubber materials which they reprocess into tread rubber, or "camelback." This may be accomplished by various processes of remilling or rerolling. In some cases, the rubber materials only are heated, mixed, and rolled into flat pieces of tread rubber. In other cases, there are added such other ingredients as oils, clay, sulphur, etc. Sometimes the mixture is run through an extruder to produce the dimension of camelback needed. The resulting product is sold for use in a recapping operation.

Section 4071 of the Internal Revenue Code of 1954, as amended by the Highway Revenue Act of 1956, Public Law 627, 70 Stat. 387, C. B. 1956–2, 1150, imposes a tax on tread rubber sold by the manufacturer, producer, or importer thereof. Section 4072 of the Code defines the term "tread rubber" to mean any material which is commonly or commercially known as tread rubber or "camelback," or which is a substitute for such material and is of the type used in recapping or retreading tires.

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.

Accordingly, it is held that the manufacturers excise tax on tread rubber applies to the sale of tread rubber produced by reprocessing salvage rubber materials. There is no provision of law which would exempt from the tax such a sale merely because the scrap materials used in the manufacturing operation are salvaged from tread rubber, on the sale of which excise tax had previously been paid.

PART III.—PETROLEUM PRODUCTS

SUBPART A.—GASOLINE

SECTION 4082.—DEFINITIONS

Rev. Rul. 57-250

A parent corporation is not a producer of gasoline by reason of refining operations performed by its wholly-owned subsidiary. Accordingly, the exemption in the case of sales of gasoline to a producer provided by section 4083 of the Internal Revenue Code of 1954 does not apply to gasoline sold to the corporation by any producer or importer.

Advice has been requested whether, for purposes of purchasing gasoline tax-free, a parent corporation is a producer of gasoline by reason of refining operations performed by its wholly-owned subsidiary.

A corporation buys and sells, but does not refine, compound, blend, or produce, gasoline. It purchases the gasoline tax paid and does not sell exclusively to producers of gasoline. However, its wholly-owned subsidiary which purchases and refines crude oil into gasoline is registered and bonded as a producer.

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 of the Code states that the term "producer" includes a refiner, compounder or blender, and a dealer selling gasoline exclusively to producers of gasoline, as well as a producer. Any person to whom gasoline is sold tax-free under this subpart shall be considered the producer of such gasoline. Section 4083 of the Code provides that the tax imposed by section 4081 of the Code shall not apply in the case of sales of gasoline to a producer of gasoline.

Section 314.30(a) of Regulations 44, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that a "producer" includes a refiner; compounder, or blender, and a dealer selling gasoline exclusively to producers of gasoline, as well as an actual producer. The term "producer" also includes any person (not included in the preceding sentence) to whom gasoline is sold tax free for any purpose but such person is considered a "producer" only with respect to gasoline purchased tax free. The mere blending or mixing by any person of gasoline to adapt it for seasonal use or to meet the requirements of particular vendees, or blending which is not a substantial part of the blender's regular year-round business, does not constitute him a producer.

The fact that the subsidiary in the instant case, which is wholly-owned and controlled by the parent, is a registered and bonded producer does not make the parent a producer in its own right. Accordingly, it is held that, since the parent corporation does not actually produce gasoline or lubricating oil or sell gasoline exclusively to producers of gasoline, it is not a producer of gasoline within the meaning of section 4082 of the Code. Therefore, the exemption in the case of sales to a producer provided by section 4083 of the Code does not apply to gasoline sold to the parent corporation by any producer or importer. Furthermore, the tax on gasoline imposed by section 4081 of the Code does not apply when it is resold by the parent corporation.

SUBPART B.—LUBRICATING OIL

SECTION 4091.—IMPOSITION OF TAX

Rev. Rul. 57-204

Lubricating oil manufactured from a mixture of virgin crude oil and used oil is subject to the manufacturers excise tax imposed by section 4091 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacurers excise tax to lubricating oil manufactured from a mixture of virgin crude oil and used oil.

Used oil is mixed with virgin crude oil and the commingled product is then subjected to the same processing and treating as that given to virgin crude oil.

Section 4091 of the Internal Revenue Code of 1954 imposes a manufacturers excise tax on the sale of lubricating oils.

Section 314.40(c) of Regulations 44, as amended by Treasury Decision 6197, C. B. 1956–2, 803, and made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, defines a manufacturer as (1) any person who produces lubricating oil by any process of manufacturing, refining, or compounding, or any manipulation involving substantially more than a mere mixing of taxable oils and (2) any person who produces lubricating oil by mixing taxable oils with any other substances.

Section 314.40(d) of the regulations states that the term "manufacturer" does not include (1) a person who merely blends or mixes two or more taxable lubricating oils, (2) a persons who merely cleans, renovates, or refines used or waste lubricating oil, or (3) a person who merely blends or mixes one or more taxable lubricating oils with used or waste lubricating oil which has been cleaned, renovated, or refined.

In the instant case, the used or waste oil, when mixed with virgin crude oil, to be refined, loses its identity, as such, in the process. Furthermore, the resulting end product is lubricating oil refined from such mixture rather than a mere blend or mixture of taxable lubricating oil with used or waste lubricating oil which has been cleaned, renovated or refined, as described in section 314.40(d)(3) of Regulations 44. It is not the process used but the fact that the used or waste oil loses its identity, as such, before the refining process which determines the application of the tax under the circumstances. Accordingly, the manufacturers excise tax imposed by section 4091 of the Code is applicable to the manufacturer's sale or use of lubricating oil produced from a mixture of virgin crude and used or waste oil.

Rev. Rul. 57–251

Applicability of the manufacturers excise tax on lubricating oil, imposed by section 4091 of the Internal Revenue Code of 1954, to the sale of oil by the manufacturer for use in flushing crankcases of motors.

Advice has been requested whether the manufacturers excise tax on lubricating oil applies to the sale of oil by the manufacturer for use in flushing crankcases of motors after the old oil has been drained. After the flushing operation, the flushing oil is drained and replaced by regular lubricating oil.

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 person 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 person 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 a nonlubricating purpose 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 a nonlubricating use, 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.

Flushing oil is a type of oil which is suitable for use as a lubricant and therefore is considered to be lubricating oil within the meaning of the law and regulations. The determination of whether oil used in flushing crankcases of motors constitutes the use of the oil for a lubricating or a nonlubricating purpose is dependent upon the manner in which such operations are performed.

It is held that all sales of lubricating oil for use in flushing the crankcases of automobiles, trucks, tractors, etc., are subject to the manufacturers excise tax if during any part of the flushing process the motor is running or any parts requiring lubrication are in motion. However, where the flushing oil is used to flush the crankcases of automobiles, trucks, tractors, etc., and the motors are entirely motionless during the flushing operation, the oil used in such operations is not considered to perform a lubricating function. Therefore, the tax does not attach to the sale of the oil by the manufacturer thereof direct to the person for such use, provided the sale is supported by the required certificate of nonlubricating use.

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.

PART II.—ELECTRIC, GAS AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

Rev. Rul. 57-194

Gas hot plates which may have incidental use for laundry or cooking purposes, but are sold primarily for use by the commercial cafe trade are not considered gas cooking appliances of the household type. Therefore, sales of such articles are not subject to the 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 certain types of gas hot plates.

The gas hot plates in question were at one time primarily used for laundry purposes and occasionally for cooking purposes. However, since the advent of the automatic washer, their use for laundry purposes has been negligible. They are now advertised and held out for use by the commercial cafe trade and are not, according to normal standards, considered cooking appliances of the type ordinarily used in homes.

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Section 4121(a) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of electric, gas, or oil appliances of the household type used for cooking, warming, or keeping warm food or beverages for consumption on the premises.

Accordingly, it is held that gas hot plates which may have incidental use for laundry or cooking purposes but are sold primarily for use by the commercial cafe trade, are not considered gas cooking appliances of the household type. Therefore, sales of such articles are not subject to the tax imposed by section 4121 of the Code.

PART III.—ELECTRIC LIGHT BULBS

SECTION 4131.—IMPOSITION OF TAX

(Also Section 4218.) Rev. Rul. 57-96

The manufacturers excise tax on electric lights bulbs imposed by section 4131 of the Internal Revenue Code of 1954 does not apply to sales by the importer of complete miniature bulb light sets.

Advice has been requested whether the manufacturers excise tax on electric light bulbs applies to sales by the importer of miniature bulb light sets, such as Christmas tree lighting outfits.

In the instant case, a company is engaged in the business of importing miniature bulb light sets from Japan. These sets consist of insulated wire, a plug, and miniature light bulbs surrounded by little plastic cups. They are imported in decorated boxes and resold in the same boxes.

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. Section 4218 of the Code provides, insofar as it is applicable to imported electric light bulbs, that if any person imports an article and uses it (otherwise than in the manufacture of a taxable article), he shall be liable for manufacturers excise tax in the same manner as if such article was sold by him.

If electric light *bulbs* are imported and sold as loose bulbs, the tax imposed by section 4131 of the Code applies to the importer's sale of the bulbs. If the importer uses the imported bulbs in the manufacture of complete light sets, the tax imposed by section 4218 of the Code applies to his use of them. However, the Internal Revenue Service does not regard the importation of complete light sets as the importation of electric light bulbs, as such, within the meaning of section 4131 of the Code.

Accordingly, it is held that the manufacturers excise tax does not apply to the importer's sales of miniature bulb light sets under the circumstances in the instant case.

Sales of electric light bulbs by a manufacturer to a municipal electric light plant that furnishes such bulbs, either with or without charge, to its customers. See Rev. Rul. 57-181, page 383.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT

PART I.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS

SECTION 4141.—IMPOSITION OF TAX

Rev. Rul. 57–266

Records primarily designed to be played on coin-operated phonographs are subject to the manufacturers excise tax on phonograph records imposed by section 4141 of the Internal Revenue Code of 1954.

Advice has been requested whether the manufacturers excise tax on phonograph records applies to records primarily designed to be played on coin-operated phonographs.

Section 4141 of the Internal Revenue Code of 1954 imposes a tax on phonograph records when sold by the manufacturer, producer or importer. Section 316.62 of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the term "phonograph records" means all disks, cylinders, or other articles, regardless of the material from which they are made, and upon which are recorded or may be recorded human speech or other sounds for reproduction by means of a phonograph or combination radio and phonograph.

It is held that the manufacturers excise tax on phonograph records applies to all sales of records to be used on coin-operated phonographs, regardless of any special process or materials employed in producing such records.

SECTION 4142.—DEFINITION OF RADIO AND TELEVISION COMPONENT

Rev. Rul. 57–252

An ultra high frequency converter for a television receiving set is not an article of the type named as a "radio and television component" in section 4142 of the Internal Revenue Code of 1954. Accordingly, separate sales thereof by the manufacturer are not subject to the manufacturers excise tax on "radio and television components" imposed by section 4141 of the Code. However, if a set manufacturer sells the converter on or in connection with a television receiving set, the manufacturers excise tax on "television receiving sets" applies to the total sales price of the complete set.

The Internal Revenue Service has been asked whether the manuturers excise tax applies to sales of an ultra high frequency (UHF) converter. The converter consists of an antenna, power supply, oscillator, mixer, amplifier and switching arrangement. It is designed to convert a conventional television receiving set to enable it to receive signals in the ultra high frequency range.

Section 4141 of the Internal Revenue Code of 1954 imposes a tax upon 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 phono-

graph records (including in each case parts or accessories therefor sold on or in connection with the sale thereof). Except in the case of radio and television components and phonograph records, the tax imposed by this section applies only to articles of the entertainment type. 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.

Since the ultra high frequency converter is not an article of the type named as "radio and television components" in section 4142 of the Code, it is held that the manufacturers excise tax on "radio and television components" imposed by section 4141 of the Code is not applicable to separate sales of this article. However, since the ultra high frequency converter is a part or accessory for a television receiving set, if a set manufacturer sells the converter on or in connection with a taxable television receiving set, the manufacturers excise tax on television receiving sets applies to the total sales price of the complete set.

PART II.—MUSICAL INSTRUMENTS

SECTION 4151.—IMPOSITION OF TAX

Rev. Rul. 57–111

The manufacturers excise tax on musical instruments, imposed by section 4151 of the Internal Revenue Code of 1954, applies to the component elements of a musical instrument essential to its operation, when sold on or in connection with the instrument.

Advice has been requested whether the manufacturers excise tax on musical instruments is applicable to mouthpieces, reeds, ligatures, mouth piece caps, neck cords, mutes, and lyres for holding music, when sold by the manufacturer on or in connection with saxophones and other wind instruments.

Section 4151 of the Internal Revenue Code of 1954 provides that a tax shall be imposed upon the sale of musical instruments by the manufacturer, producer, or importer. No tax is imposed by this section upon parts or accessories sold on or in connection with the sale of musical instruments.

It is held that the term "musical instruments" as used in the statute includes all component elements of musical instruments essential to their operation. For example, in the case of a saxophone, one mouthpiece, one reed, and one ligature are essential to the operation of the instrument. Therefore, the tax applies to the complete instrument including such components when they are sold on or in connection with the instrument. On the other hand, the tax does not apply to the sale by the manufacturer of any extra or spare mouthpieces, reeds, or ligatures, whether sold separately or in connection with the sale of a complete musical instrument.

It is further held that mouthpiece caps, neck cords, mutes, and lyres for holding music are accessories for musical instruments rather

than component elements essential to their operation and, therefore, are not subject to tax whether sold separately or on or in connection with the sale of musical instruments.

The Internal Revenue Service has previously held that the sale of a mouthpiece, reed, or ligature, with a musical instrument was not subject to tax. That position has received publicity in the industry involved and has been relied upon as a basis for not paying the tax on such components. Therefore, under the authority of section 7805(b) of the Code, this ruling, to the extent that it holds taxable the sale of components under the circumstances stated, will not be applied to sales made prior to May 1, 1957.

Rev. Rul. 57–147

The sale of a carrying case for a musical instrument is not subject to the manufacturers excise tax, whether sold separately or with an instrument.

Advice has been requested whether the manufacturers excise tax on musical instruments is applicable to the sale of a carrying case for a musical instrument.

Section 4151 of the Internal Revenue Code of 1954 provides that a tax shall be imposed upon the sale of musical instruments by the manufacturer, producer, or importer.

Section 4216(a) of the Code provides that the price for which an article is sold shall include any charge for coverings and containers of whatever nature and any charge incident to placing the article in condition packed ready for shipment.

Section 4151 of the Code does not impose the tax upon parts or accessories sold in connection with the sale of musical instruments. Cases specially designed and adapted for carrying musical instruments are not considered coverings or containers within the meaning of section 4216(a) of the Code. The sale of carrying cases for musical instruments are, therefore, not subject to the manufacturers excise tax, whether sold separately or with an instrument.

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART II.—PHOTOGRAPHIC EQUIPMENT

SECTION 4173.—EXEMPTIONS

Rev. Rul. 57–65

A camera weighing more than four pounds including the batteries, but excluding the lens and film, comes within the exemption provided by section 4173 of the Internal Revenue Code of 1954. Accordingly, it is not subject to the manufacturers excise tax imposed by section 4171 of the Code.

Advice has been requested whether a certain camera is exempt, under section 4173 of the Internal Revenue Code of 1954, from the manufacturers excise tax imposed by section 4171 of the Code.

The camera has an electronic flash built into a hood which is a permanent part of the camera. The electronic system consists of a circuit powered by four batteries. The flash tube, which is not removable from the camera, operates automatically each time a picture is taken. The batteries, upon which the camera's operation is dependent, are removable solely for the purpose of replacement. The weight of the camera including the batteries, but excluding the lens and the film, is in excess of four pounds. The camera weighs three pounds and eight ounces without the batteries.

Section 4171 of the Code imposes a tax on cameras and camera lenses when sold by the manufacturer, producer, or importer. Section 4173 of the Code provides an exemption from the tax for cameras weighing more than four pounds exclusive of lens and accessories.

Since the batteries are essential to the operation of the camera in the instant case, they are considered to be integral parts of, rather than accessories for, the camera. Therefore, it is held that this camera, which weighs in excess of four pounds, including the batteries but excluding the lens and film, falls within the scope of the exemption provided by section 4173 of the Code. Accordingly, it is not subject to the tax imposed by section 4171 of the Code.

SUBCHAPTER E.—OTHER ITEMS

PART I.—BUSINESS MACHINES

SECTION 4191.—IMPOSITION OF TAX

Rev. Rul. 57–4

The tax imposed by section 4191 of the Internal Revenue Code of 1954 on the sale by the manufacturer, producer, or importer of business machines applies to the sale of pencil sharpeners designed to be fastened to a desk, table, etc., but does not apply to the sale of pocket size pencil sharpeners, or to the sale of pencil pointers which sharpen the lead only.

Advice has been requested concerning the applicability of the manufacturers excise tax on business machines to the sale by the manufacturer, producer, or importer of several types of pencil sharpeners and to pencil pointers.

These articles are described as follows:

(a) A pencil sharpener designed especially for draftsmen. This sharpener removes the wood from the pencil and may be adjusted to produce a blunt, medium, or hairline or needle point. It is constructed so that it may be fastened to a desk, table, etc.

(b) The ordinary pencil sharpener designed primarily for office, school, or home. This sharpener also removes the wood from the pencil, but it produces only one size of point. It likewise is constructed so that it may be fastened to a desk, table, etc.

(c) A pocket size pencil sharpener. This sharpener is approximately one inch long and contains a cutting blade against which the pencil is manually rotated to remove the wood and produce a point on the lead.

(d) A pencil pointer designed solely to point the lead in drafting pencils. It is used for both the mechanical pencils with loose lead and the wood drafting pencils used by draftsmen. However, it does not cut the wood of the wood pencils but operates solely on the exposed pencil lead, and will produce anything from a blunt to a hairline or needle point.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax on the sale by the manufacturer, producer, or importer, of certain business machines, including pencil sharpeners. A pencil sharpener of the type taxable under section 4191 of the Code is considered to be one designed not only to sharpen the lead of pencils but also to cut or trim the wood of wood pencils.

It is held that the pencil sharpeners of the type described in (a) and (b) above come within the category of pencil sharpeners contemplated by section 4191 of the Code, and the sale thereof by the manufacturer, producer, or importer, is subject to the tax imposed by that section. However, even though the pocket size pencil sharpener described in (c) above cuts or trims the wood of wood pencils, it is not considered to be a pencil sharpener of the type contemplated by the Code, and therefore, the sale by the manufacturer of such a pencil sharpener is not taxable.

It is further held that since the pencil pointer described in (d) above does not cut or trim the wood of wood pencils, it is not a pencil sharpener within the meaning of section 4191 of the Code and is not subject to the tax imposed by that section.

Rev. Rul. 57–81

A stand with a flat top upon which a taxable business machine, nontaxable machine, or other articles may be placed is considered primarily susceptible of general use and the charge for such stand, sold with a taxable business machine, is not subject to the manufacturers excise tax.

Advice has been requested whether the manufacturers excise applies to sales of a stand sold with a business machine.

The stand has tubular steel legs, rubber casters, a flat top on which a dictating or transcribing machine may be placed, and shelves for accessories. The stand does not contribute in any manner to the operation of the machines, and it could be used as a stand for other purposes. It is sold as an optional or separate piece of equipment.

Section 4191 of the Internal Revenue Code of 1954 imposes a tax on sales by the manufacturer of the business machines enumerated in such section, including parts and accessories sold on or in connection therewith. Dictating and transcribing machines are included in that enumeration.

It is held that such a stand, upon which a taxable or nontaxable machine or other articles may be placed, is considered primarily susceptible of general use and not a part or accessory for the machine. Accordingly, the stand referred to above is not subject to the manufacturers excise tax, whether sold separately or in connection with a taxable machine.

Rev. Rul. 57–220

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 dictographs, dictating machines, and transcribing machines (including in each case parts and accessories of such articles sold on or in connection therewith, or with the sale thereof). Generally, tape and wire recorders are not subject to the manufacturers excise tax. However, if a tape or wire recorder is designed, constructed, and held out and sold by the manufacturer to be used for dictating and transcribing as well as for general purpose recording, it is considered to be a dictating or transcribing machine.

Rev. Rul. 57–238

An "automatic eyeleter," designed to be permanently secured to a bench or table and which punches a hole in paper or cardboard and inserts and sets an eyelet, is not a portable paper fastening machine within the purview of section 4191 of the Internal Revenue Code of 1954 and, accordingly, is not subject to the manufacturers excise tax imposed on business machines.

Advice has been requested whether the manufacturers excise tax on business machines applies to sales of "automatic eyeleters."

The "automatic eyeleter" is a manually operated machine weighing approximately three pounds. It is designed to be permanently secured to a shop bench or table through two holes tapped in its base. It does not perform its function efficiently and satisfactorily without being fastened to a desk, bench, or table. A downward stroke of its handle punches a hole in paper or cardboard, inserts and sets an eyelet, and advances another eyelet into position for the next such operation. It is used principally by sign shops to provide eyelets for hanging signs and by printing plants to bind small jobs. It is also used in motion picture studios for eyeleting films and in some instances by law and accounting firms for fastening briefs and other documents.

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 portable paper fastening machines.

The fact that a paper fastening machine has holes drilled in the base does not necessarily remove it from the category of a portable paper fastening machine. The determining factor is whether it is suitable for performing its function in an efficient manner without being fastened to a desk, bench, or table.

In the instant case, the automatic eyeleter is not suitable for performing its function in an efficient and satisfactory manner without being fastened to a desk, bench, or table. Accordingly, it is held that it is not a portable paper fastening machine within the meaning of section 4191 of the Code. Therefore, no liability is incurred for the manufacturers excise tax on sales of these machines by the manufacturer, producer, or importer.

PART II.—PENS AND MECHANICAL PENCILS AND LIGHTERS

SECTION 4201.—IMPOSITION OF TAX

Exemption for cigarette lighters taxable as jewelry. See Rev. Rul. 57–64, page 358.

SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4216.—DEFINITION OF PRICE

Rev. Rul. 57–253

Section 4216 of the Internal Revenue Code of 1954, relating to the manufacturers excise tax, provides that in determining the price for which an article is sold certain charges, including installation charges, shall be excluded from the price only if the amount thereof is established to the safisfaction of the Secretary of the Treasury or his delegate. *Held*, where a manufacturer, producer, or importer of an article subject to the manufacturers excise tax makes an installation charge in connection with the sale of such article, it is not required that such charge be billed separately in order for it to be excluded from the tax base. However, the propriety of any installation charge which is not billed separately must be satisfactorily established by adequate records.

SECTION 4218.—USE BY MANUFACTURER OR IMPORTER CONSIDERED SALE

Use of imported miniature light bulbs in the manufacture of complete light sets. See Rev. Rul. 57–96, page 374.

SECTION 4220.—EXEMPTION FOR SALES OR RESALES TO MANUFACTURERS

(Also Section 6416.) Rev. Rul. 57–221

No credit or refund is allowable with respect to manufacturers excise tax imposed on sales of electric light bulbs where the bulbs are sold by the manufacturer thereof to a person who incorporates them into nontaxable subassemblies which are in turn sold to a manufacturer for installation on taxable freezers.

Advice has been requested whether credit or refund of manufacturers excise tax is allowable with respect to electric light bulbs sold by the manufacturer thereof to a person who incorporates them into nontaxable subassemblies which, in turn, are sold to a manufacturer of taxable electric freezers for installation thereon.

Under the provisions of section 4220(1) of the Internal Revenue Code of 1954, electric light bulbs may be sold tax free (A) for use by the vendee as components in the manufacture of any article taxable under Chapter 32, or (B) for resale by the vendee for such use by

his vendee if the bulbs are in due course so resold. Section 6416(b)(3)(A) of the Code authorizes a credit or refund of tax paid on electric light bulbs purchased and used by a manufacturer as components in the manufacture of an article with respect to which tax under Chapter 32 has been paid, or which has been sold tax free under section 4220 or 4224.

Where the manufacturer of nontaxable subassemblies includes with such subassemblies the number of bulbs required as component parts, the bulbs are considered to have been used by him in producing his particular end product. Electric light bulbs may not be sold by the manufacturer thereof tax free under section 4220(1) of the Code to a vendee for such purpose, because the end product manufactured by the vendee is not a taxable article. Consequently, the tax is properly payable with respect to the sales of the bulbs so included in these nontaxable subassemblies.

It is held that a manufacturer of a taxable freezer who purchases these nontaxable subassemblies, including bulbs, is not entitled to a credit or refund under section 6416(b)(3)(A) of the Code for the tax paid by the bulb manufacturer. This is so because the bulbs are not purchased as such by the freezer manufacturer, since they lost their separate identity when used by the subassembly manufacturer in producing the subassemblies.

Rev. Rul. 57-281

Although incandescent lamps and neon tubes may be purchased free of manufacturers excise tax for use in the manufacture of other taxable articles under section 4220 of the Internal Revenue Code of 1954, such lamps and tubes may not be purchased tax-free for use in the manufacture of nontaxable articles such as radio receivers of the nonentertainment type.

Advice has been requested whether incandescent lamps and neon tubes may be purchased free of manufacturers excise tax for use as components in the manufacture of radio receivers of the nonentertainment type.

Section 4131 of the Internal Revenue Code of 1954 imposes a tax on the sale of electric light bulbs and tubes by the manufacturer.

Section 4220(1)(A) of the Code provides that no tax under chapter 32 shall be imposed with respect to the sale of any article (other than an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, 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 enumerated in this chapter. Section 4220(2)(A) provides that no tax under this chapter shall be imposed with respect to the sale of an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, 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 any article.

The exemption contained in section 4220(2) of the Code applies only to the articles named therein. Although incandescent lamps and neon tubes may be purchased free of excise tax for use in the

manufacture of other taxable articles, it is held that such lamps may not be purchased tax-free for use in the manufacture of nontaxable articles such as radio receivers of the nonentertainment type.

SECTION 4223.—EXEMPTION OF ARTICLES MANUFACTURED OR PRODUCED BY INDIANS

Taxability of articles sold by Indians at retail. See Rev. Rul. 57–248, page 18.

SECTION 4224.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Section 4131.) Rev. Rul. 57–181

Sales of electric light bulbs by a manufacturer to a municipality where such bulbs are furnished, either with or without charge, to customers of a municipal electric light plant are not exempt from the manufacturers excise tax.

Advice has been requested concerning the applicability of the manufacturers excise tax to sales of electric light bulbs to a municipality that operates an electric light plant and sells electric current to the public. In connection with supplying this electric service, the municipality keeps its customers supplied with electric light bulbs for no additional charge.

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. Under Section 4224 of the Code, no manufacturers excise tax attaches 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.

Accordingly, the manufacturers excise tax does not apply to the sale of electric light bulbs for the exclusive use of a municipality. However, it is held that where the municipality furnishes the electric light bulbs to nongovernmental purchasers of electric service, either with or without additional charge, the "exclusive use" test of the statute has not been met. Therefore, the tax imposed by section 4131 attaches to sales of electric light bulbs by the manufacturer to a municipality for such purposes.

(Also Sections 4055, 4292.) Rev. Rul. 57–254

Irrigation districts formed pursuant to the laws of the State of California come within the scope of the exemptions provided by sections 4055 and 4224 of the Internal Revenue Code of 1954, which relate to sales of articles, otherwise subject to the retailers or manufacturers excise taxes, for the exclusive use of a State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. They also come within the scope of the exemption provided by section 4292 of the Code which relates to taxes on communication and transportation services and facilities furnished to such governmental units.

Advice has been requested whether irrigation districts in the State of California come within the scope of the exemptions from certain

Federal excise taxes provided for states and political subdivisions thereof.

Sections 4055 and 4224 of the Internal Revenue Code of 1954 provide that the retailers and manufacturers taxes will not apply with respect 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 any political subdivision of the foregoing, or the District of Columbia. That section also provides that the tax shall not be imposed upon amounts paid for the transportation of property to or from such governmental units.

Irrigation districts in the State of California are formed pursuant to Division 11 of the Water Code of California (Deering's California Codes). They are specifically declared to be state agencies formed and existing for governmental purposes. The statutes provide in detail for the formation and administration of irrigation districts, which are managed and operated by boards of directors.

Irrigation districts are under the general supervision of the Department of Public Works, the powers and duties of which are exercised through the State Engineer. They are under the more specific supervision of the county boards of supervisors, who are charged with the duty of conducting the hearings and elections that result in the formation of the district and seeing that the duties and functions of the officers and board of directors of the districts are carried out.

The irrigation districts are required by statute (except where all funds required are raised otherwise than by assessment) to levy assessments on the land within the districts for the purpose of paying their expenses and discharging their obligations. If the district board or any of its officers neglects or refuses to levy assessments or carry out any of the duties required by statute, the county board of supervisors may remove such official or perform the required duties in his stead in the same manner and with the same effect as if they were done by the duly constituted official.

Any money belonging to a district may be deposited in accordance with the general laws governing the deposit of public money. Any amount in excess of $25,000 in the construction fund of an irrigation district may be deposited in the county treasury and withdrawn from time to time.

The districts possess the right of eminent domain to acquire water and property deemed necessary to carry out the purposes for which the districts are formed.

It is held that irrigation districts formed pursuant to Division 11 of the Water Code of California come within the scope of the exemptions provided by (1) section 4055 of the Internal Revenue Code of 1954, relating to the retailers excise taxes, (2) section 4224 of the Code, relating to the manufacturers excise taxes, and (3) section 4292 of the Code, relating to the tax on communications and transportation services and facilities. The exemptions pertain to sales made or services rendered to any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Accordingly, where taxable articles are sold to irrigation districts of the State of California for their exclusive use or where communication and transportation services and facilities are furnished to such irrigation districts, the exemptions will apply, provided the requirements of the law and applicable regulations with respect to the particular exemption are met.

Circumstances under which the sale of tread rubber may, or may not, be exempt from manufacturers excise tax as a sale to a state. See Rev. Rul. 57–15, page 368.

Applicability of the exemption from manufacturers excise tax with respect to the sales of taxable articles, for the exclusive use of humane societies, which are instrumentalities of a political subdivision of a State. See Rev. Rul. 57–170, page 411.

Applicability of the exemption from tax where taxable articles are sold to an electric or telephone membership corporation established under the General Statutes of North Carolina.
See Rev. Rul. 57–193, page 364.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART I.—ADMISSIONS

SECTION 4231.—IMPOSITION OF TAX

Rev. Rul. 57–44

An amount paid by a theatre patron for participation in a "Dish Club Plan" is not subject to the tax on admissions imposed by section 4231(1) of the Internal Revenue Code of 1954, provided that no part of the proceeds from the sale of dish coupons inures to the benefit of the theatre operator.

The Internal Revenue Service has been asked whether amounts paid by patrons for participation in a "Dish Club Plan," in connection with a payment for admission, is subject to the tax on admissions.

In order to increase business, a theatre entered into an agreement with a promotion company which will operate the "Dish Club Plan" and receive the entire proceeds from the sale of the dish coupons. Female patrons will be given an opportunity to become "members" at the beginning of each designated period. Such patrons will be given booklets entitling them to procure a dish on a specified evening each week. Under the plan, a patron, upon presenting her booklet to the box office attendant, may purchase a special reduced rate admission ticket (for an amount 25 cents less than the regular charge to others on the same occasion) and a dish coupon for 25 cents. The patron is

then admitted to the theatre and will be given a dish upon surrendering the dish coupon to a representative of the promotion company and presenting her booklet to be punched to show that she has received the dish for that particular evening.

Section 4231(1) of the Internal Revenue Code of 1954 imposes a tax upon amounts paid for admission, if more than 90 cents on and after September 1, 1956, and 50 cents prior thereto, unless otherwise exempt under section 4233 of the Code.

Since all the proceeds from the sale of the dish coupons are received by the promotion company, it is held that the sale of the dish coupon is a separate transaction and is not a charge for admission to the theatre. Accordingly, it is held that the amount paid by a theatre patron for participation in the "Dish Club Plan" is not subject to the tax on admissions imposed by section 4231(1) of the Code. See Rev. Rul. 55–50, C. B. 1955–1, 506 and Rev. Rul. 56–38, C. B., 1956–1, 512.

Rev. Rul. 57–156

At certain ski resorts, there are no charges made for admission to the general area and therefore any persons not wishing to ski or ride the ski-tow may enter as spectators free of charge. However, a charge is made to those persons who use the ski slopes or the tow facilities. *Held*, the amounts paid for the use of the ski slopes or tow facilities under such circumstances are not subject to the admissions tax imposed by section 4231 of the Internal Revenue Code of 1954.

Rev. Rul. 57–182

For purposes of the cabaret tax, imposed by section 4231(6) of the Internal Revenue Code of 1954, a "disc jockey" program broadcast from a restaurant, cocktail lounge, or similar establishment constitutes a "public performance for profit" if the conception of such program is directed toward the entertainment of the patrons of the establishment, as well as the radio audience.

Advice has been requested whether liability for the cabaret tax is incurred in connection with a "disc jockey" program broadcast from a restaurant, cocktail lounge, or similar establishment.

Section 4231(6) of the Internal Revenue Code of 1954 imposes a tax on all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. Section 4232(b) of the Code provides that the term "roof garden, cabaret, or other similar place," shall include any room in any hotel, restaurant, hall, or other public place where music and dancing privileges or any other entertainment, except instrumental or mechanical music alone, are afforded the patrons in connection with the serving or selling of food, refreshment, or merchandise.

Many factors may enter into the determination of whether a "disc jockey" program emanating from a restaurant, cocktail lounge, or similar establishment constitutes "a public performance for profit." In general, however, it is held that if the conception and execution of the program are directed toward the entertainment of the patrons

of the place where such program is conducted as well as the radio audience, such a program does constitute "a public performance for profit." Accordingly, the cabaret tax applies to all amounts paid for admission, refreshment, service, or merchandise, by or for any patron or guest who is entitled to be present during any portion of such a program.

Rev. Rul. 57–263

Amounts received as payments for food, refreshment, or merchandise dispensed by means of vending machines in an establishment which qualifies as a cabaret under section 4231 of the Internal Revenue Code of 1954 are subject to the tax imposed by that section. Amounts received for photographic or checking services are also taxable. The person receiving such payments is liable for the return and payment of the tax, whether he is the owner of the cabaret or a concessionaire.

Advice has been requested whether amounts paid for food, refreshment, or merchandise dispensed by means of vending machines in an establishment which qualifies as a cabaret are subject to cabaret tax; if so, it has been requested that a determination be made as to the person liable for the return and payment of the tax in the situations described below.

1. A cabaret owner or operator rents certain vending machines which he places in his cabaret for the dispensing of food, refreshment and cigarettes to patrons. The cabaret owner or operator has control over the machines, pays the operating expenses, maintains them, and receives all the proceeds therefrom. Under the rental agreement, the owner of the machines receives either a flat rate each month or an amount equal to a percentage of the gross receipts from the machines.

2. A cabaret owner or operator grants to another person rights to concessions in the cabaret. The concessions include the operation of food, refreshment and cigarette vending machines, the photographing of customers, and the maintenance of checking facilities. Under the terms of the agreement between the parties, the concessionaire receives the proceeds from the concessions, pays the operating expenses, provides necessary maintenance and service, and has control over the vending machines and the photographic and checking facilities. The concessionaire pays the cabaret owner a flat rate for the concessions rights or an amount equal to a percentage of the gross receipts derived from the concessions.

Under the provisions of section 4231(6) of the Code, a tax is imposed 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. That section also provides that the tax shall be returned and paid by the person receiving such payments.

The statute imposes the tax upon all amounts paid for admission, refreshment, service, or merchandise, at a cabaret, and there is no qualification with respect to how the serving or selling of food, refreshment, or merchandise must be accomplished. The law also provides that the person *receiving* such payments at a cabaret is liable for the tax thereon, and there is no provision that liability shall be limited to

the owner or operator of the cabaret. Nor is there any statutory requirement that, where a concessionaire receives such payments, the concession must constitute a cabaret in and of itself for the payments to be subject to tax. The determination of who receives the payments must be based upon the facts of each particular case.

It is held that amounts paid for food, refreshment, or merchandise at a cabaret are subject to tax even though such items are dispensed by means of vending machines. It is further held that, under the circumstances described in (1) above, the cabaret owner or operator who rents and operates the vending machines is the person receiving the payments for the food, refreshment, or merchandise within the meaning of section 4231(6) of the Code, and he is liable for the return and payment of the tax on the total receipts from the machines. Under such circumstances, the owner of the machines is not liable for tax on amounts paid to him by the cabaret owner or operator for the rental of the machines, regardless of the basis upon which the rental payments are made.

On the other hand, it is held, that under the circumstances described in (2) above, the concessionaire is the person receiving the payments for the food, refreshment or merchandise, and he is liable for the return and payment of the tax on the total receipts from the machines. A photographic or checking concession is considered to provide a "service" within the meaning of the statute and fixed amounts paid by patrons of the cabaret for such service are subject to the cabaret tax. Under these circumstances, the cabaret owner or operator is not liable for tax on amounts paid to him for the concessions rights regardless of the basis upon which payments are made.

Rev. Rul. 57–282

Section 4231(6) of the Internal Revenue Code of 1954 imposes a tax on 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. *Held*, a skating rink which is operated as a place for skating by the general public is not a type of establishment contemplated by section 4231(6) of the Code and amounts paid for admission, refreshment, service, or merchandise at such a rink are not subject to the cabaret tax. However, where an amount paid for admission to a skating rink is in excess of 90 cents, the full amount paid is subject to the admissions tax imposed by section 4231(1) of the Code. See M. T. 29, C. B. 1948–2, 166.

SECTION 4233.—EXEMPTIONS

Rev. Rul. 57–230

Under the provisions of section 4233(a)(1)(A)(iii) of the Internal Revenue Code of 1954, any admissions, all the proceeds of which inure exclusively to a corporation or any community chest, fund, or foundation organized and operated exclusively for charitable purposes and exempt from income tax under section 501(c)(3) of the

Code, are exempt from admissions tax, if such corporation or organization is supported to any degree by contributions from a governmental source, or is primarily supported by contributions from the general public. *Held*, where a parent organization of a charitable group is made up of numerous local organizations such as branches, chapters, posts, units, etc., which are separate legal entities, the exemption for each unit, etc., so far as the support requirements are concerned, will be determined by the source of the support of that unit and will not be determined by the source of the support of the parent organization.

Rev. Rul. 57–283

Revenue Ruling 136, C. B. 1953–2, 333, holds that, in determining whether a privately-operated nonprofit hospital is primarily supported by contributions from the general public so as to qualify for the admissions tax exemption provided by section 4233(a)(1)(A)(iii) of the Internal Revenue Code of 1954, the revenue received from pay patients is considered as earned income rather than as contributions from the general public. *Held*, the term "revenue received from pay patients" as used in this connection means the gross amount received from the patients, without reduction for any expense incurred in caring for those patients.

Revenue Ruling 136, C. B. 1953–2, 333, is amplified.

PART II.—CLUB DUES

SECTION 4241.—IMPOSITION OF TAX

Rev. Rul. 57–239

Where there is more than one class of active resident annual members in a social, athletic, or sporting club, the club dues tax which should be collected from a life member of such a club is equivalent to the tax upon the amount paid for dues or membership fees by a member of the class of active resident annual members in which the life member qualifies.

Advice has been requested concerning which class of members of a social, athletic, or sporting club are considered to be the "active resident annual" members for the purpose of determining the amount of club dues tax to be paid by a life member.

A golf club has two classes of membership, namely, *regular* and *senior*. Members of both classes have full club rights and privileges. A person is eligible for *senior* membership if he is more than 60 years of age and has been a *regular* member for more than 25 years. The annual dues for *regular* members are $600, while the annual dues for *senior* members are $300. The club also has *life* members. The *life* members do not pay annual dues. Some of these *life* members are more than 60 years of age and have been *regular* members more than 25 years.

Section 4241(a)(1) of the Internal Revenue Code of 1954 imposes a tax upon any amount paid as dues or membership fees to any social, athletic or sporting club or organization, if the dues or fees

of an active resident annual member are in excess of $10 per year. Under the provisions of section 4241(a)(3) of the Code, a tax equivalent to the tax upon the amount paid by active resident annual members for dues or membership fees, other than assessments, is imposed in the case of life memberships. In such a case, the tax shall be paid annually at the time for payment of dues by active resident annual members.

Section 101.22 of Regulations 43, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines an "active resident annual member" as one who is not a life member but who enjoys full club privileges as distinguished from the privileges enjoyed by a person holding a nonresident membership, an associate membership, or other partial or restricted membership. Since in the instant case both the *regular* members and the *senior* members of the club have the right to enjoy full club privileges, the members of both classes are considered to be "active resident annual members."

It is held that where there is more than one class of active resident annual members of a club, the club dues tax of a life member is equivalent to the tax upon the amount paid for dues or membership fees by active resident annual members of the class in which such life member qualifies. Thus, in the case described above, a life member who is less than 60 years of age or who has not been a *regular* member for 25 years is liable for club dues tax equivalent to the tax paid by *regular* members of the club, whereas a life member who is 60 years of age or more and who has been a *regular* member for 25 years is liable for club dues tax equivalent to the tax paid by *senior* members.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4251.—IMPOSITION OF TAX

(Also Section 4252.) Rev. Rul. 57–205

Mobile radio telephone service of the "private use" type, when utilized by a common carrier in the conduct of its business as such, is exempt from the communications tax by section 4253(f) of the Internal Revenue Code of 1954. However, where the subscribers share a common exchange, dispatching or relay service, such service does not constitute a "private use" system and is, therefore, subject to the communications tax on "local telephone service" imposed by section 4251 of the Code.

The Internal Revenue Service has been asked, for purposes of the exemption afforded common carriers by section 4253(f) of the Internal Revenue Code of 1954, whether mobile radio telephone service furnished to subscribers by radio and telephone companies is "local telephone service" or "talking circuit special service."

A communications company leases to its subscribers, including common carriers, certain mobile radio transmitting and receiving units which are installed in the lessees' vehicles and by means of which two-way radio communication is carried on between the drivers of such vehicles and the terminal dispatchers. These mobile radio telephone services fit into two main categories described in the examples below.

Example 1. The subscriber has exclusive use of all lines, channels, land station installations, mobile units, and terminal equipment.

Example 2. The subscribers share a common exchange, dispatching or relay service.

Section 4251 of the Code imposes a tax on amounts paid for communications facilities and services, including among others, local telephone service and leased wire, teletypewriter or talking circuit special service. Section 4252(a) of the Code defines "local telephone service" as meaning any telephone service not taxable as long distance telephone service; leased wire, teletypewriter or talking circuit special service; or wire and equipment service. Section 4252(d) of the Code, which defines the term "leased wire, teletypewriter or talking circuit special service," provides that the tax imposed on such service shall apply whether or not the wires or services are within a local exchange area. Section 130.38 of Regulations 42, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, provides that, in general, "leased wire, teletypewriter or talking circuit special service" relates to private line service where channels, equipment, and other facilities are furnished to enable users to communicate between specified locations continuously or for specified periods. Section 4253(f) of the Code provides, in part, that no tax shall be imposed on the amount paid for so much of the leased wire, teletypewriter or talking circuit special service as is utilized by a common carrier in the conduct of its business as such.

In example 1, the subscriber has exclusive use of all lines, channels, land station installations, mobile units, and terminal equipment. Accordingly, it is held that a service of this type, generally referred to as a "private use" system, constitutes "leased wire, teletypewriter or talking circuit special service" as contemplated by section 4252(d) of the Code. Therefore, when a mobile radio telephone service of this type is utilized by a common carrier in the conduct of its business as such, the amount paid for the service is exempt from the communications tax by section 4253(f) of the Code. See Rev. Rul. 57–137, page 393 of this Bulletin.

In example 2, the subscribers share a common exchange, dispatching or relay service. Accordingly, it is held that a service of this type does not constitute "leased wire, teletypewriter or talking circuit special service" as defined in section 130.38 of the regulations, but does constitute "local telephone service" as contemplated by section 4252(a) of the Code. Therefore, the exemption provided by section 4253(f) of the Code does not apply to a service of this type.

(Also Section 4252.) Rev. Rul. 57–206

The excise tax on communications facilities and services applies to amounts paid for leased radio channel service.

Advice has been requested whether the excise tax on communications facilities and services applies to amounts paid for leased radio channel service.

A communications company leases to its subscribers a radio channel service which provides two-way radio-telegraphic communications between lessor-owned radio terminals at different points or between

lessor-owned radio terminals and radio terminals owned and operated by the subscribers. The service is furnished under a minimum-period contract which provides for continuous use of the channel or for use during specified daily periods only. The channel is for the exclusive and private use of the subscriber. The service is used by subscribers in conjunction with teleprinter equipment, such equipment and connecting tie lines between the equipment and the lessor-owned radio terminals being supplied by either the subscribers or the lessor. However, subscribers must supply, at their own expense, electric power to operate the printer equipment.

Section 4251 of the Internal Revenue Code of 1954 imposes a tax on amounts paid for communications facilities and services, including local telephone service; long distance telephone service; telegraph service; leased wire, teletypewriter, or talking circuit special service; and wire and equipment service. Section 4252(d) of the Code, which defines the term "leased wire, teletypewriter, or talking circuit special service," provides that the tax imposed on such service shall apply whether or not the wires or services are within a local exchange area.

Section 130.38 of Regulations 42, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides 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, radio for which tolls are charged by the carrier. The communications may be telephonic, in Morse or similar code, or may be reproduced at the terminating end in the form of a typewritten page or tape, or picture or facsimile. This section of the regulations also cites, as examples of such services, "channels and equipment for teletypewriter or teleprinter service" and "channels and equipment for teletypewriter or teleprinter exchange service." It is significant that this section of the regulations uses the term "channels" in reference to services and facilities subject to the tax on communications. "Channels" may relate either to a wire line or to a "radio path."

Accordingly, it is held that leased radio channel service incorporates the essential features of, and falls within the scope of, "leased wire, teletypewriter or talking circuit special service" as contemplated by section 4252(d) of the Code. Therefore, any amounts paid by subscribers for leased radio channel service, including amounts paid for tie-lines and rental of teleprinter equipment, are subject to the excise tax on communications imposed by section 4251 of the Code.

SECTION 4252.—DEFINITIONS

Classification of mobile radiotelephone service furnished to common carriers. See Rev. Rul. 57–205, page 390.

Applicability of the tax on communications to amounts paid for leased radio channel service. See Rev. Rul. 57–206, page 391.

SECTION 4253.—EXEMPTIONS

Rev. Rul. 57–137

For purposes of exemption from the communications tax, an arrangement of telephone facilities and equipment that is used exclusively for internal communications, as in the case of the installations connecting taxicab companies' dispatching centers with cab stand call boxes, is classified as leased wire service even though connections with local telephone exchange facilities are possible by means of existing facilities.

The Internal Revenue Service has been asked to reconsider its position relating to the application of the communications taxes in respect of typical switchboard and internal telephone systems utilized by taxicab companies, in view of the decisions in the cases of *Yellow Cab Company of Cleveland* v. *Carey* (141 F. Supp. 379) and *Yellow Cab Company of Alameda County* v. *United States* (144 F. Supp. 158).

The telephone facilities utilized by the different cab companies are not in all respects alike, but they may be described as being generally similar. Switchboards and switching equipment, to which trunk lines from local telephone exchanges and tie lines from other private branch exchanges may be connected, are installed at the cab companies' dispatching centers. Lines from the switchboards are also connected to telephone instruments (call box phones) located at cab stands, hotels, hospitals, etc., generally within the subscriber's local service area. Operators at the dispatching centers may receive incoming calls for cab service through these call box lines or through the local telephone exchange facilities. The operator then may ring a call box at a cab stand near the locality where the cab service is desired and relay the request for service, orally, to the cab driver who answers. At other times newly arrived drivers signal or call the dispatching center from cab stand call boxes to report their availability. Although in some cases it is possible to interconnect these call box lines with the local telephone exchange facilities, since both local exchange trunks and the call box lines may lead into the dispatching center switchboard, usually this is done only in cases of emergency.

Section 4251 of the Internal Revenue Code of 1954 imposes a tax on amounts paid for certain communication services, including "local telephone service" and "leased wire, teletypewriter, or talking circuit special service." Section 4253(f) of the Code exempts from the tax amounts paid for leased wire, teletypewriter, or talking circuit special service utilized by a common carrier in the conduct of its business as such. This exemption does not extend to amounts paid for local telephone service.

A taxicab company is considered to be a common carrier for purposes of the above exemption. The applicability of the exemption to amounts paid for telephone facilities and services utilized by a taxicab company in the conduct of its business depends, then, upon whether the service is classified as "local telephone service" or as "leased wire, teletypewriter, or talking circuit special service."

It has been the position of the Service that where it is possible to connect telephone instruments to the local exchange service through switching equipment on the customer's premises, the instruments and switching equipment constituted for communications tax purposes, a private branch exchange system and therefore, was subject to the

tax on local telephone service. In the case of lines connecting such instruments to the private branch exchange system, the local telephone service tax applied where such lines terminated within the customer's local service area. However, where such lines extended beyond the boundary of the customer's local service area, the leased wire tax described in section 4252(d) of the Code applied. Common carriers could thus be granted exemption from tax, under section 4253(f) of the Code, only on charges for the lines classified as leased wire service, since the exemption does not apply to local telephone service.

Pursuant to the position stated above, the Service has consistently held that where the call box telephones and lines are located in the same local exchange areas as the dispatching centers and connection with local telephone service is available, the tax on local telephone service applies to the charges for the call box telephones and lines. Where such connection was not possible, the Service has held the lines to constitute leased wire service. This position was based upon the possible use of the installation.

However, in the cases cited above, the district courts found that that part of the systems connecting the cab companies' dispatching centers with the call boxes comprises service of the kind described under section 4252(d) of the Code. In reaching this conclusion, cognizance was taken of the fact that although the call boxes could be connected with outside telephones through the telephone company's local exchange facilities, this was done only in emergency situations, such as urgent police calls. Thus, the decisions of the courts are based upon the actual use of the facility in question, as opposed to their possible use.

Accordingly, it is now held that where in actual practice an arrangement of telephone facilities and equipment is used exclusively for internal communications, as in the case of the installations connecting the cab companies' dispatching centers with the call boxes, such an arrangement is of the kind contemplated by section 4252(d) of the Code, even though connection with a local telephone exchange system is possible by means of existing equipment and even though there is an occasional use of the facilities for emergency calls, such as fire or police calls. Therefore, the exemption under section 4253(f) of the Code will apply to amounts paid for such services if they are utilized by a common carrier, such as a taxicab company, in the conduct of its business as such.

Rev. Rul. 57-255

The exemption from the tax on communication facilities and services afforded common carriers by section 4253(f) of the Internal Revenue Code of 1954 does not apply to amounts paid for teletypewriter services or facilities where such amounts are billed to and paid by a company which performs services for steamship companies, but is not itself a common carrier.

Advice has been requested whether the exemption from communications tax afforded common carriers by section 4253(f) of the Internal Revenue Code of 1954 applies to amounts paid for teletypewriter services or facilities under the circumstances described below.

M corporation is engaged in the business of performing services for steamship companies. These services include the booking of

cargo and passengers, entering and clearance of vessels, inward and outward pilotage and towage, arranging for dockage space, loading and unloading of cargo, purchasing supplies for vessels, arranging for repairs, and other miscellaneous services. In the performance of these services, *M* corporation utilizes a teletypewriter service furnished by a local telephone company. Such service is subscribed to by *M* corporation in its own name. Each message transmitted over the teletypewriter concerns the business of one of the steamship companies and, when *M* corporation receives its bill for the service, the charge for each message is billed, in turn, by *M* corporation to the particular steamship company for whom the message was transmitted.

Section 4251 of the Code imposes a tax on amounts paid for certain communication services or facilities, including teletypewriter service.

Section 4253(f) of the Code provides that no tax shall be imposed on the amount paid for so much of leased wire, teletypewriter or talking circuit special service, or wire and equipment service, as is utilized in the conduct, by a common carrier or a telephone or telegraph company or a radio broadcasting station or network, of its business as such.

The steamship companies for whom *M* corporation performs services are common carriers and, within their own right, would be entitled to the benefits of the exemption afforded by section 4253 (f) of the Code. However, *M* corporation is not a common carrier. The teletypewriter service is furnished by the telephone company to *M* corporation, and *M* corporation uses the service primarily in furtherance of its own business purposes. The fact that the steamship companies reimburse *M* corporation for the specific charges for the service is immaterial.

Accordingly, it is held that, since *M* corporation is not a common carrier, it is not entitled to the exemption provided by section 4253 (f) of the Code. Therefore, amounts paid by *M* corporation for teletypewriter services or facilities are subject to the tax imposed by section 4251 of the Code.

SUBCHAPTER C.—TRANSPORTATION

PART I.—PERSONS

SECTION 4261.—IMPOSITION OF TAX

26 CFR 42.4261–6: Payments made outside the United States; evidence of nontaxability. Rev. Rul. 57–24

Under certain circumstances, the tax on the transportation of persons imposed by section 4261 of the Internal Revenue Code of 1954 does not apply to payments made outside the United States by members of the Armed Forces of the United States or their dependents for transportation between two or more points within the United States, which is a continuation of a journey to or from a point outside the United States.

Advice has been requested whether the tax on the transportation of persons applies to payments made outside the United States by members of the Armed Forces of the United States or their dependents for commercial transportation between two or more points within the United States, which is a continuation of a journey to or from a point outside the United States, where the connecting transportation to or from the point outside the United States is furnished by a vessel or aircraft operated by the Armed Forces of the United States. The question arises because of the fact that the members of the Armed Forces or their dependents, at the time of purchasing transportation for the United States portion of the journey, do not have evidence, such as a ticket or order, that such transportation is for use in conjunction with connecting transportation to or from a point outside the United States.

Section 4261(b) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid without the United States for taxable transportation of persons by rail, motor vehicle, water, or air but only if such transportation begins and ends in the United States.

Under the provisions of section 42.4261–6 of the Facilities and Services Excise Tax Regulations, the tax on the transportation of persons does not apply to a payment made outside the United States for transportation which begins or ends outside the United States. A payment made outside the United States for transportation between two or more points within the United States, which is part of a transportation from or to a point outside the United States, is considered to be a payment for transportation which begins or ends outside the United States where it is definitely established, at the time of making payment for the United States portion, that such portion is purchased for use in making the journey from or to a point outside the United States.

It is held that transportation between two or more points within the United States furnished to members of the Armed Forces or their dependents, which is part of a transportation to or from a point outside the United States, is transportation which begins or ends outside the United States, where the connecting transportation is furnished by a vessel or aircraft of the Armed Forces and the serviceman is not serving under orders as a member of the crew of the ship or aircraft during the trip in question. Accordingly, under these circumstances, the tax on the transportation of persons does not apply to payments made outside the United States by members of the Armed Forces or their dependents for transportation within the United States, provided (1) that it is definitely determined by the agency or carrier, at the time of the receipt of payments for tickets for such transportation, that the tickets are strictly for use in conjunction with connecting transportation to or from points outside the United States and such connecting transportation is to be furnished by a vessel or aircraft of the Armed Forces, and (2) that the ticket or exchange orders issued for such transportation and related travel orders, or United States of America Transportation Requests, Standard Form No. 1169, are appropriately cross-referenced or inscribed, thereby establishing the continuity of the journey between a point outside the United States and a point within the United States.

26 CFR 42.4261–3: Payments made within the United States. Rev. Rul. 57–195

A payment was made in Canada for round-trip air transportation from Montreal, Canada, to New York City. Under the provisions of section 4261 (b) of the Internal Revenue Code of 1954, this payment is excluded from the tax on the transportation of persons. Because of bad weather, the airline found it necessary to cancel the return flight from New York City to Montreal, and the passenger was given a refund on the return portion of his round-trip air transportation. The passenger then purchased, in the United States, rail transportation from New York City to Montreal. *Held*, the tax on the transportation of persons imposed by section 4261 (a) of the Code applies to the amount paid within the United States for the rail transportation from New York City to Montreal. The facts that the passenger of the airline had originally purchased tax-exempt, round-trip, air transportation in Canada and his purchase of rail transportation was necessitated by circumstances beyond his control does not exempt him from paying the tax on the payment made to the rail carrier in the United States. Compare Revenue Ruling 55–534, C. B. 1955–2, 665, in which it was held that the tax on the transportation of persons does not apply to settlements between carriers, even though the payments made to the initial carrier by or for the passengers may have been exempt from the tax.

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26 CFR 42.4261–6: Payments made outside the United States; evidence of nontaxability. Rev. Rul. 57–240

Under certain conditions the tax on transportation of persons does not apply to a payment made outside the United States for transportation between two or more points within the United States which is part of transportation from or to a point outside the United States, where the exchange order for the United States portion is not drawn upon the carrier which issues the tickets.

Advice has been requested as to the evidence required to establish the nontaxable character of a payment made outside the United States for the transportation of a person between two or more points within the United States which is part of transportation from or to a point outside the United States where the exchange order for the United States portion is not drawn upon the carrier which issues the tickets.

A travel agency located in the United States handles the procurement of transportation for travelers coming into the United States who purchased their transportation from travel agencies located abroad. The payments in question are those which cover transportation between two or more points in the United States which is part of transportation that begins or ends outside the United States. In the instant case, the traveler whose journey includes travel in the United States pays the foreign travel agency for the entire trip. That agency then draws an exchange order on the local agency for procurement of the transportation called for in the order. After procurement of the tickets for such transportation, the local agency forwards them to the foreign agency to be delivered to the pur-

chaser. The exchange orders are retained by the local agency as part of its records.

The tax on transportation of persons imposed by section 4261 (b) of the Internal Revenue Code of 1954, as amended by Public Law 796, 84th Congress, 70 Stat. 644, C. B. 1956–2, 1180, effective October 1, 1956, does not apply to a payment made outside the United States for transportation which begins or ends outside the United States. Section 42.4261–6 of the Facilities and Services Excise Tax Regulations provides that a payment made outside the United States for transportation between two or more points within the United States which is part of transportation from or to a point outside the United States is considered to be a payment for transportation which begins or ends outside the United States, where it is definitely established at the time of making payment for the United States portion that such portion is purchased for use in making the journey from or to a point outside the United States. The nontaxable character of such a payment must be established under the rules set forth in that section of the regulations.

Section 42.4261–6 (c) (3) of the regulations provides that where an order for the United States portion is issued outside the United States, it shall be inscribed to show (i) the origin and destination of the connecting transportation, (ii) the identity of the carrier furnishing the connecting transportation, and (iii) the serial number of the ticket or order covering such connecting transportation.

Section 42.4261–6 (d) of the regulations provides that, where the ticket for the United States portion is issued in the United States pursuant to an order which was purchased and properly inscribed outside the United States under the rules set forth in section 42.4261–6 (c) (3) (above), liability for payment or collection of tax will not be incurred upon the issuance of the ticket, provided the agency or carrier issuing such ticket stamps or inscribes thereon an appropriate legend, for example, "Tax not paid—furnished on order," or "Exempt—order."

The provisions of the regulations contemplate that the exchange order will be drawn upon the carrier which actually issues the ticket for the transportation called for in the exchange order and that such agency or carrier will therefore have in its records a copy of the exchange order as evidence of the nontaxable character of the payment made by the passenger for such ticket.

However, it is held that where an exchange order is not drawn upon the carrier which issues the ticket for such transportation, in order to establish the non-application of the tax, the carrier must be furnished a copy of the exchange order purchased and properly inscribed outside the United States, or, if that is not possible, a statement containing the following: (1) a certification that the ticket is being procured for use by the passenger in conjunction with connecting transportation from or to a point outside the United States, (2) the name and address of the agency which issued the exchange order, (3) the serial number of the order and the date of issuance, (4) the name and address of the passenger, (5) the origin and destination of the connecting transportation, (6) the identity of the carrier furnishing the connecting transportation, and (7) the serial number of the ticket covering such connecting transportation. The carrier should retain the copy of the exchange order or the statement in its records

as evidence that the ticket issued by it was purchased for use in conjunction with connecting transportation from or to a point outside the United States. The carrier also must stamp or inscribe the ticket in the manner hereinbefore described.

PART II.—PROPERTY

SECTION 4271.—IMPOSITION OF TAX

Rev. Rul. 57–57

Applicability of the tax on the transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954, to charges made by a carrier, pursuant to an average demurrage agreement, for demurrage on cars of coal and other commodities when average demurrage as computed under Revenue Ruling 56–16 exceeds the actual demurrage charges.

Revenue Ruling 56–16, C. B. 1956–1, 524, modified.

The Internal Revenue Service has been requested to reconsider Revenue Ruling 56–16, C. B. 1956–1, 524, which relates to the applicability of the tax on the transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954, to charges made by a carrier, pursuant to an average demurrage agreement, for demurrage on cars of coal and other commodities.

Under the average demurrage agreement, the customer is debited for the time cars are held for loading and unloading beyond a certain period and credited for the time cars are released by him within a certain period, demurrage charges being assessed at the end of each month for any outstanding debits. If the credits equal or exceed the debits, no charge is made for the detention of the cars, and no payment is made to shippers or receivers because of such excess credits. The excess credits for any one month are not considered in computing the average detention for another month.

Amounts paid as demurrage charges in connection with the transportation of coal are not taxable, since the tax is measured by the quantity of coal transported and not by the amount paid for the transportation or accessorial services in connection therewith. Where an average demurrage agreement covers debits and credits in connection with the transportation of both coal and other commodities, it is necessary to eliminate from the tax base any demurrage charges attributable to the transportation of coal. For this reason, it was stated in Revenue Ruling 56–16 that, under such circumstances, the carrier should eliminate from its demurrage account with the customer all items, both debits and credits, applicable to cars of coal and should compute the three percent transportation tax on any remaining debit balance which results from taxable transportation movements.

It has been pointed out, however, that in some instances the debit balance thus obtained will be more than the actual demurrage charges. This is due to the fact that any excess *credits* attributable to cars of coal over debits attributable to cars of coal would reduce the charges for demurrage separately attributable to the transportation of other commodities.

Therefore, it is held that the carrier, for the purpose of computing the transportation tax on demurrage charges incurred by a customer pursuant to an average demurrage agreement, should eliminate from its demurrage account with the customer all items, both debits and credits, applicable to cars of coal and compute the three percent tax on the charges for any remaining debit balance which results from taxable transportation movements, unless the amount of such charges exceeds the amount of demurrage charges actually billed the customer, in which case the tax should be computed on the amount of the actual demurrage charges.

Revenue Ruling 56–16 is modified accordingly.

Rev. Rul. 57–169

The tax on the transportation of property imposed by section 4271(a) of the Internal Revenue Code of 1954 applies to the amount paid for the transportation of containers to a transit point in the United States where they are used in packaging or barreling commodities in the process of exportation, when such containers are not shipped to the transit point pursuant to an export order.

Advice has been requested whether, under the circumstances described below, the tax on the transportation of property imposed by section 4271(a) of the Internal Revenue Code of 1954 applies to the amount paid for the transportation of containers to a point in the United States where they are used for packaging or barreling commodities which are in the course of exportation.

In the instant case, empty steel drums are shipped from an inland manufacturing plant to an ocean port where they are used to barrel in transit liquid commodities which are in the course of exportation. The liquid commodities are being transported pursuant to an export order and, after being transferred to the steel drums, are delivered to an ocean carrier for transportation to a foreign destination. The steel drums, however, are not shipped to the port pursuant to an export order.

In accordance with Subpart E of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, the tax on the transportation of property does not apply to amounts paid for transportation of property in the course of exportation to a foreign destination, or shipment to a possession of the United States. Property will be considered to be in the course of exportation from the time of delivery to a carrier for transportation by continuous movement to a point beyond the boundaries of the United States. The export character of a shipment shall be evidenced by a contract, order, proposal of purchase, or other written evidence of intention to export, antedating the delivery of the shipment to the carrier.

The test of the export character of a shipment is the continuity of movement from the point of origin in the United States to its foreign destination. Regarding continuity of movement, section 143.31 of the regulations provides that in case a break occurs in the movement of property shipped for export, which is not in accommodation to the means of transportation, and the property comes to rest in transit prior to exportation, that part of the amount paid for the transportaion which pertains to the movement from the point of origin to the point where the break occurs is taxable.

Property is not considered to be in the course of exportation when it is being assembled for shipment, or is being moved to a place to be shipped, if a foreign destination is undetermined and the property has not been actually and definitely started to some foreign destination pursuant to an export order. See Rev. Rul. 56–219, C. B. 1956–1, 691.

Accordingly, it is held that where containers are shipped to a transit point in the United States where they are used for packaging or barreling commodities in the process of exportation, and such containers are not shipped to the transit point pursuant to an export order, they are not considered to be in the course of exportation from the point of origin to the transit point. Under such circumstances, the movement of the container from the point of origin to the transit point is domestic in character and subject to the tax on transportation of property from one point in the United States to another.

However, in the case of commodities shipped pursuant to an export order and stopped in transit for packaging or barreling, such stoppage does not constitute a "break" in the continuity of the export movement of the commodities. See Rev. Rul. 55–338, C. B. 1955–1, 543.

Rev. Rul. 57–183

The tax on the transportation of property applies to amounts paid to a carrier for furnishing a helper to assist the driver of a truck in unloading regardless of whether such charge is billed separately.

Advice has been requested whether the amount paid to a carrier for furnishing a helper to assist the driver of a truck in unloading is subject to the tax on the transportation of property.

In the instant case, when a shipment is made where only one man is necessary to perform the unloading at the consignee's receiving dock, the work is done by the driver of the truck. The amount paid to the carrier for the transportation of the shipment includes this unloading service. However, when the consignee requests a helper in order to expedite the unloading, the carrier makes an additional charge for the services of the helper.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Under the provisions of section 143.1(d) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, the term "transportation," as used in the statute and regulations, in general, includes accessorial services furnished in connection with a transportation movement, such as loading, unloading, and similar services and facilities.

It is held that where the carrier furnishes a helper to assist the driver of a truck in loading or unloading a shipment transported by it, the additional charge billed by the carrier for the services of the helper is considered to be a charge for accessorial services. It is immaterial whether this charge is billed as a separate item or is included in the total charge for the transportation service. Accordingly, the total amount paid, including the payment for the services of the helper, is subject to the tax on the transportation of property,

even though the regular transportation charge is paid by the shipper, and the additional charge for the services of the helper is paid by the consignee.

Rev. Rul. 57-222

A payment made in the United States by a United States firm to a Canadian trucker while he is in the United States, as well as a payment mailed from this country to the trucker at his Canadian address, for transportation which begins in Canada and ends in the United States, constitutes a "payment within the United States" for purposes of the tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954. The tax is applicable to the pro rata part of such payment that represents transportation within the United States.

The Internal Revenue Service has been asked whether, under the provisions of Revenue Ruling 56-686, C. B. 1956-2, 880, either of the payments mentioned below constitutes a "payment outside the United States" for purposes of the tax on the transportation of property.

A United States firm hired a Canadian citizen to transport logs owned by the firm from Canada to its plant in the United States. The carrier is usually paid for the hauling while he is at the firm's plant in the United States. However, the firm sometimes pays for the hauling by mailing a check from the United States to the trucker's Canadian address.

Section 4271 of the Internal Revenue Code of 1954 imposes a tax on the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. 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.

Revenue Ruling 56-686 holds that a check drawn on a Canadian bank, covering prepaid freight charges for transportation which began in Canada and ended in the United States, and forwarded from the shipper's Canadian office to the carrier's office in the United States constituted a "payment outside the United States," and the tax was not applicable to such payment. That ruling holds further that a check picked up at the shipper's Canadian office, covering prepaid freight charges for transportation which began in Canada and ended in the United States, constituted a "payment outside the United States," and the tax was not applicable to such payment.

The applicability of the tax on the transportation of property is not determined by the location of the place where the payment for the transportation is received by the carrier, or by the address of the person to whom the payment is made. Instead, the applicability of the tax is determined by the location of the place where the acts necessary on the part of the shipper to effect payment occur. Rev. Rul. 56-686, *supra*.

The facts in the instant case are distinguishable from those in Revenue Ruling 56-686. In that ruling, the shipper maintained an office in Canada, dealt through a Canadian bank, and prepared and mailed all of its checks from the Canadian office. In the instant

case, all of the acts necessary on the part of the payor to effect payment would occur in the United States. Accordingly, it is held that a payment made by the United States firm to the Canadian trucker while he is at the United States plant, as well as the payment mailed from the United States plant to the trucker at his Canadian address, would constitute a "payment within the United States." Since the transportation involved is from a point without the United States to a point within the United States, the tax would apply to the pro rata part of such payment that represents transportation within the United States.

Rev. Rul. 57–223

The exemption from the tax on transportation of property provided by section 4292 of the Internal Revenue Code of 1954 does not apply to amounts paid by a fabrication company to a carrier for the transportation of steel bars and other materials to its plant where they are fabricated into steel bridge railings ordered for and to be delivered to a state or political subdivision of a state.

Advice has been requested whether, under the circumstances described below, amounts paid for the transportation of steel bars and other materials to a fabrication plant, where they are processed into steel bridge railings to be delivered to a state or political subdivision of a state, including an agency or instrumentality thereof, are exempt from the tax on transportation of property.

A contractor, who was engaged by a state highway department to construct a bridge, ordered the fabricated steel bridge railings required for the project from a structural steel fabrication company. Upon receipt of the order, the fabrication company purchased from a steel mill the steel bars and other materials necessary to produce the specific railings covered by the order. The fabrication company paid a trucking company for the transportation of the steel bars and other materials from the steel mill to its plant. After the steel bars and other materials were processed into bridge railings, the bridge railings were transported from the fabrication plant to the bridge project site consigned to the state highway department, in care of the contractor, pursuant to appropriate instructions issued by the state highway department authorizing such procedure. The fabrication company paid a trucking company for such transportation.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax 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 4292 of the Code provides that this tax shall not apply to any payment received for transportation services or facilities furnished to the government of a state, territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. That section also provides that the tax shall not be imposed upon amounts paid for the transportation of property to or from such a governmental unit.

Section 143.24 of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that an amount paid directly to a carrier by a state, or political subdivision thereof,

for the transportation of property is exempt from the tax. That section further provides that an amount paid for the transportation of property to or from the government of a state, territory of the United States, or political subdivision thereof, or the District of Columbia, is exempt from the tax. Where the shipping papers show the consignor or consignee to be a state, territory, or political subdivision thereof, or the District of Columbia, or an agency or instrumentality of any of the foregoing, such papers may be accepted by the carrier as proof of the exempt character of the shipment.

In the instant case, the amount paid for the transportation of the bridge railings from the fabrication plant to the bridge project site is exempt from the tax as being an amount paid for transportation of property to a state. See Rev. Rul. 55–162, C. B. 1955–1, 541. However, the purchase order for the state project was for finished bridge railings rather than raw materials, and fabrication was the step which produced such finished product. Accordingly, the transportation of the steel bars and other raw materials from a point of origin to the fabrication plant constitutes transportation of property to the fabrication company and not to the state. The fact that the movement of the finished product from the fabrication plant to the state is exempt from the tax does not affect the applicability of the tax to amounts paid for the movement of the raw materials from a point of origin to the plant where they are processed into the finished product. Nor does the fact that the transportation charges may be reflected in the purchase price of the finished product paid by the state, in itself, exempt the payment of the transportation charges from the tax.

It is held that, since the transportation of the steel bars and other materials from the steel mill to the fabrication plant is not transportation of property to a state or political subdivision of a state within the meaning of section 4292 of the Code, the amount paid by the fabrication plant to the carrier for such transportation is not exempt from the tax on transportation of property, even though the finished bridge railings were for delivery to a state.

Rev. Rul. 57–265

A carrier which has erroneously overcollected transportation of property tax from a consignee with respect to a shipment may not refund such tax to the shipper thereof even though the shipper presents with his claim to the carrier the original receipt showing payment of the tax.

Advice has been requested whether, under the circumstances described below, a carrier may repay to a shipper transportation of property tax erroneously collected from a consignee.

A consignee located in the United States purchased a carload of lumber from a shipper located in Canada. The lumber was sold on a "laid-down basis" and was shipped by rail to the consignee, who paid the freight charges and the transportation tax to the carrier. The carrier collected tax, not only on the portion of the freight charges allocable to the transportation of the lumber in the United States, but also on the portion of the freight charges allocable to the transportation in Canada. After payment of the freight charges and the tax,

the consignee, in settling his account with the shipper, forwarded the paid freight bill to the shipper. The paid freight bill was subsequently presented to the carrier by the shipper with a request for refund of the tax collected on the freight charges allocable to the Canadian transportation. The shipper contends that, under the circumstances, the consignee was merely acting as his agent in paying the freight charges and that the amount claimed as a refund should be repaid to him by the carrier.

Section 4271(c) of the Internal Revenue Code of 1954 provides that, 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. Section 4271(d) of the Code provides that the tax shall be paid by the person making the payment subject to tax.

Under the provisions of section 143.61 of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, a collecting agency, which has erroneously or illegally overcollected and overpaid any tax due, may claim a refund of the amount so overcollected and overpaid, but only if it is established that the tax so overcollected and overpaid has been returned *to the person from whom collected*, or that the collecting agency has obtained the written consent of such person to the granting of the refund.

It is recognized that, under certain circumstances, the person who actually pays the transportation charges may be acting in the capacity of an agent. However, a carrier, for purposes of the tax, has no obligation to determine the capacity in which the payor is acting. The carrier is required to collect the tax from the person who makes the taxable transportation payment to it even though such person is acting as an agent in making the payment. See Rev. Rul. 55–281, C. B. 1955–1, 538.

It is held that a carrier is authorized to make a refund of transportation of property tax erroneously or illegally overcollected and overpaid, only to the person from whom the carrier collected the tax, irrespective of the capacity in which such person was acting in making payment of the transportation charges and the tax. Therefore, in the instant case, the carrier may refund the erroneously collected tax only to the consignee who paid the transportation charges and tax to the carrier in the first instance. Any problem of reimbursement between the shipper and consignee is a matter to be settled between such parties.

Rev. Rul. 57–267

The tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 applies to the amount paid for the transportation of packaged dairy products from an interior point into a seaport warehouse, to be held there in anticipation of future export sales.

Advice has been requested whether, under the circumstances described below, the transportation of processed dairy products from an interior point into a seaport warehouse, from which they are shipped to a foreign country, is a part of the export movement of the products and, therefore not subject to the tax on the transportation

of property imposed by section 4271 of the Internal Revenue Code of 1954.

The products are completely processed and packaged for export prior to shipment from the interior point to the warehouse. There is no contract, order, proposal of purchase, or other written evidence of intention to export antedating delivery of these products to the carrier at the point of origin and, therefore, the shipping papers do not show a consignee or destination outside the United States. The products are shipped to the warehouse in order that a ready supply may be maintained at the seaport to fill export orders subsequently received. Only export orders are filled from the warehouse.

Section 143.35 of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that property intended expressly for export may be shipped from an interior point into a pool or similar arrangement, such as a grain elevator, oil storage tank, coal yard, etc., and, in continuation of the export movement, an equivalent amount of property of the same grade and kind, only, may be shipped therefrom to a place outside the United States.

In certain industries, such as the grain, oil and coal industries, shipments of property for export consist of fungible commodities which are shipped in bulk and which, in the course of their exportation, must pass through facilities at a port where generally all shipments of property of the same grade and kind are commingled so that the individual shipments lose their identity, and the property is accounted for solely on the basis of weight, grade, and kind. Examples of such facilities are (1) grain elevators used to transfer grain from cars to vessels, but not the assembling of grain for the purpose of filling orders acquired after the grain has arrived at the elevator, (2) oil tanks which are used to conduct oil or gasoline from tank cars to vessels, and (3) coal pools at tidewater and lake ports where each transshipper is assigned certain classifications or consignments (identified by name or by number and based upon a specific type and grade of coal) into which carloads of coal are shipped from the mines and from which the transshippers order a given number of cars or tons of coal reshipped without regard to the identity of the particular cars. Facilities of this nature constitute "pools or similar arrangements" within the meaning of section 143.35 of Regulations 113.

In the case of a shipment of property into a pool, a like quantity and grade of which is to be shipped from the pool for export, the export character of the shipment is determined by the following facts: (a) that the property in question was shipped from an interior point for the express purpose of entering the pool for export, pursuant to a contract, order, proposal of purchase, or other written evidence of intention to export the property to a place beyond the boundaries of the United States; (b) that the property did not come to rest at the pool for a business purpose, such as grading, cleaning, mixing, or manufacture; and (c) that the property shipped from the pool for export in continuation of the movement described under (a) is an equivalent tonnage of the same grade and kind as that shipped into the pool for export.

In the instant case, it is held, that shipment of the package dairy products from an interior point to the warehouse at the port does not constitute shipment into a pool or similar arrangement within the meaning of section 143.35 of the regulations and, therefore, the provisions of that section do not apply. It is further held, that since these products were not shipped pursuant to actual export orders but merely in anticipation of future export sales, they were not in the course of exportation at the time that they were transported to the warehouse. See Rev. Rul. 56–219, C. B. 1956–1, 691. Accordingly, the amount paid for the transportation of the packaged dairy products from the point of origin to the warehouse is subject to the tax on transportation of property.

Rev. Rul. 57–284

The tax on the transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954, applies to an amount paid by an exporter for the transportation, to a port of exportation, of cotton purchased from the Commodity Credit Corporation under a cotton export program where, prior to such transportation, the exporter did not have a contract or order from a foreign buyer for export of the cotton.

Advice has been requested whether the tax on the transportation of property applies to an amount paid by an exporter for the transportation of cotton from an interior point in the United States to a port of exportation, under the circumstances described below.

The cotton was sold by the Commodity Credit Corporation under a contract with the exporter which provided that he export, or cause to be exported, before a particular date, the identical cotton purchased. As an assurance to the Commodity Credit Corporation that this condition would be complied with, the purchaser was required to supply a performance bond, or an irrevocable bank letter of credit, guaranteeing payment to the Commodity Credit Corporation of a specified amount per bale in the event satisfactory evidence of exportation of the cotton was not furnished. At the time of sale, the cotton was stored at various locations throughout the United States, and it was then transported to a port of exportation. However, at the time the cotton was shipped from the interior point in the United States to the port of exportation, the exporter did not have a contract or order from a foreign buyer for export of the cotton.

Section 4271 of the Internal Revenue Code of 1954 imposes a tax upon the amount paid for the transportation of property except coal, by rail, motor vehicle, water or air from one point in the United States to another. In accordance with subpart E of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, the tax does not apply to an amount paid for the transportation of property in the course of exportation to a foreign destination, or shipment to a possession of the United States. Exportation does not begin until (a) a definite intention to export property is formed and (b) the property is actually put into motion for a foreign destination, or is delivered to a carrier for such transportation. Property is not considered to be in the course of exportation when it is being assembled for shipment, or is being moved to a place to be shipped, if a foreign

destination is undetermined and the property has not been actually and definitely started for some foreign destination. Reshipment for export of a domestic shipment does not change the domestic shipment to foreign commerce.

Section 143.30 of the regulations provides that property will be considered to be in the course of exportation from the time of delivery to a carrier in the United States for transportation by continuous movement to a point beyond the boundaries of the United States. The export character of a shipment shall be evidenced by a contract, order, proposal of purchase, or other written evidence of the intention to export, antedating the delivery of the shipment to the carrier.

In view of the foregoing, in order for a shipment of cotton from an interior point in the United States to a port to be considered as being in the course of exportation and exempt from tax, it must be shown that prior to commencement of the movement the shipper had in his possession (a) a contract, order, proposal of purchase, or similar document, from a foreign buyer calling for delivery of the cotton beyond the boundaries of the United States or (b), if the shipper is not the actual exporter, written evidence that the exporter had such a contract, order, etc.

It is held that the contract between the Commodity Credit Corporation and the exporter does not constitute an export contract or order within the meaning of the regulations. Accordingly, since the exporter did not have a contract or order from a foreign buyer prior to transportation of the cotton to the port of exportation, the cotton, when delivered to the carrier at the interior point, had not actually and definitely started for some foreign destination and was not in the course of exportation. Therefore, the movement of the cotton from the interior point to the port of export is domestic in character and the amount paid for such transportation is subject to tax on the transportation of property.

Rev. Rul. 57–285

Where a shipper declares the value of a shipment in excess of the value specified in a carrier's tariff, the tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 applies to the additional amount paid because of the excess value declaration.

Advice has been requested whether the tax on the transportation of property applies to amounts paid to a carrier under the circumstances described below.

The tariffs of certain carriers provide that a shipment of property shall be deemed to have a declared value of a specified amount unless a higher value is declared at the time of receipt of the shipment from the shipper. Where the shipper declares a value in excess of the value specified in the tariff, the carrier makes a charge at a stated rate for each $100 or fraction thereof by which the declared actual value exceeds the value specified in the tariff. The charge for this excess value is in addition to and is billed separately from the transportation charge made by the carrier based on its established tariff rate of a certain amount per pound. In some tariffs, the excess value charge is classified as a transportation charge, while in other tariffs it is not so classified.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another.

It is held that where the shipper declares a value in excess of the value specified in the tariff as the value a shipment shall be deemed to have, the additional amount paid to the carrier, based upon the excess value of the shipment, constitutes a part of the amount paid for the transportation of such shipment. Accordingly, the tax on the transportation of property applies to the total amount paid, regardless of whether the charge for the excess value is classified by the applicable tariff as a transportation charge or is billed as a separate item.

Whether the term "transportation" includes services of icing and salting furnished by a carrier in connection with a transportation movement. See Rev. Rul. 57-36, page 551.

Taxability of an amount paid to a carrier for the transportation of property while the property is within the custody of a court. See Rev. Rul. 57-208, page 411.

PART III.—OIL BY PIPELINE

SECTION 4281.—IMPOSITION OF TAX

(Also Section 461.) Rev. Rul. 57-148

> The date of the payment to a carrier by its customer for transportation of oil by pipeline, and not the date the transportation service is furnished, determines when the tax imposed by section 4281 of the Internal Revenue Code of 1954 on such transportation is due and payable by the carrier, even though the carrier may be on the accrual basis for Federal income tax purposes.

Advice has been requested whether a carrier, who is on the accrual basis for Federal income tax purposes, becomes liable for the excise tax on the transportation of oil by pipeline at the time when the transportation service is furnished by the carrier or when the payment for the transportation is received by the carrier from its customer. The charge for the service is entered on the carrier's books as an item of accrued income at the time the service is rendered and the customer is billed. However, payment for the service often is not received until a subsequent quarter, which in some cases may be in a subsequent year.

Section 4281 of the Internal Revenue Code of 1954 imposes upon all transportation of crude petroleum and liquid products thereof by pipeline a tax equivalent to four and one-half percent of the amount paid for such transportation. The tax imposed by this section is to be paid by the person furnishing such transportation.

It is held that where a charge is made by a carrier for the transportation of oil by pipeline, the carrier's liability for the excise tax

does not arise until the payment for the transportation is received by the carrier from its customer. Accordingly, the tax should be reported on the excise tax return for the quarter during which the payment is received.

Since the carrier's liability for the excise tax does not arise until it receives payment for the transportation, it follows that the tax may be accrued as an expense deduction for Federal income tax purposes only at that time and not at the time of furnishing the transportation or billing the customer.

SUBCHAPTER D.—SAFE DEPOSIT BOXES

SECTION 4287.—DEFINITION OF A SAFE DEPOSIT BOX

Rev. Rul. 57-207

The tax imposed by section 4286 of the Internal Revenue Code of 1954 on the use of safe deposit boxes of not more than 40 cubic feet capacity applies to the rental of several adjacent safe deposit boxes, no one of which exceeds 40 cubic feet, but with an aggregate capacity of more than 40 cubic feet.

Advice has been requested whether the excise tax on safe deposit boxes applies to rentals of several adjacent safe deposit boxes, no one of which exceeds 40 cubic feet, but whose combined capacity is greater than 40 cubic feet.

A company leased four adjacent safe deposit boxes of an aggregate capacity of 72 cubic feet, no one of which exceeds 40 cubic feet. A wire grill fence enclosure of approximately 200 cubic feet, to which the lessee company has sole access, was constructed around these four safe deposit boxes.

Section 4286 of the Internal Revenue Code of 1954 imposes a tax on the amount collected for use of any safe deposit box. Such tax shall be paid by the person paying for the use of the safe deposit box. Section 4287 of the Code defines a safe deposit box, for purposes of section 4286, as any valut, safe, box, or other receptacle, of not more than 40 cubic feet capacity, used for safekeeping or storage of jewelry, plate, money, specie, bullion, stocks, bonds, securities, valuable papers of any kind, or other valuable personal property.

Where a lessee is assigned a number of adjacent safe deposit boxes, safes, receptacles, etc., of not more than 40 cubic feet capacity each, within a vault, enclosure, compartment, etc., for the storage and safekeeping of valuables, it is construed that this is the lease of the several safe deposit boxes, receptacles, etc., individually, even though the lessee has sole access to the vault, enclosure, compartment, etc., where located. Therefore, it is held that the amount paid for the lease of the adjacent safe deposit boxes described above is subject to the tax imposed by section 4286 of the Code, even though the area enclosed by the wire grill exceeds 40 cubic feet.

SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4292.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Sections 4055, 4224.) Rev. Rul. 57-170

Subsidiary branches of a State humane society, which society was created as a body corporate under the authority of State law, are empowered to act in the furtherance of certain governmental functions. They are vested with special police powers in the enforcement of the law concerning the prevention of cruelty to children and animals. Certain public funds are appropriated to the use of these societies in performing their statutory functions. Salaries of certain agents of the societies who are designated as public law enforcement officers are paid in part by counties or municipalities. *Held*, such humane societies are instrumentalities of political subdivisions of a State within the meaning of sections 4055, 4224, and 4292 of the Internal Revenue Code of 1954. Accordingly, the retailers and manufacturers excise taxes imposed under chapters 31 and 32, respectively, of the Code, do not apply to sales made to such societies. Also, the taxes imposed by sections 4251, 4261, and 4271 of the Code do not apply to payments for communication and transportation services or facilities furnished to the societies or to payments for the transportation of property to or from such societies.

(Also Section 4271.) Rev. Rul. 57-208

The amount paid to a carrier for the transportation of property while the property is within the custody of a state, county, or municipal court is exempt from the tax on the transportation of property.

Advice has been requested concerning the applicability of the tax on the transportation of property to an amount paid to a carrier for the transportation of property while the property is within the custody of a state, county, or municipal court.

In connection with his official duties in enforcing the orders and decrees of various courts, a law enforcement officer of a municipal government engages trucking companies to transport property belonging to persons named as defendants in processes issuing from the courts. The officer does not pay for such transportation from governmental funds but arranges to pay the carrier after collecting the amount from the plaintiff who obtained the court order. In some instances, he arranges to have the plaintiff make the payment directly to the carrier.

Section 4271(a) of the Internal Revenue Code of 1954 imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4292 of the Code provides that the tax shall not apply to amounts paid for the transportation of property to or from the government of a State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia.

Under the circumstances described above, the issuance of the court order has the effect of bringing the property within the custody of the court. Therefore, it is held that any necessary transportation of such property while it is within the custody of a state, county, or municipal court constitutes transportation to or from the government of a state, etc., within the meaning of section 4292 of the Code. Accordingly, the tax on the transportation of property will not apply to the amount paid to a carrier for such transportation, provided the shipping papers clearly show that the property is consigned to or by the state or political subdivision thereof.

Rev. Rul. 57–268

Exemption from the tax on transportation of property applies to amounts paid for the transportation of construction materials consigned to a State, in care of a contractor, only if the contractor submits evidence to the supplier that he has been authorized to consign such materials to the State, in his care, identifying the specific contract or specific project with respect to which the State issued the authorization.

Rev. Rul. 55–162, C. B. 1955–1, 541, amplified.

Advice has been requested concerning the nature of the evidence the contractor must furnish to the supplier to take advantage of the exemption from payment of the tax on transportation of property as set forth in Revenue Ruling 55–162, C. B. 1955–1, 541. Further advice has been requested whether a letter issued by a State constitutes authority for the contractor to claim exemption from payment of the tax on transportation of property, where the letter is not issued in connection with a specific contract, or in relation to a particular project.

A State highway department issued a letter to an association of road building contractors, authorizing any member to arrange for all construction materials which are to be incorporated into a State project to be consigned to the State, in care of himself. However, the authorization as set forth in the letter was not issued in connection with a specific contract, or in relation to a particular State project.

Section 4292 of the Internal Revenue Code of 1954 provides, in part, that the tax on the transportation of property shall not be imposed upon amounts paid for the transportation of property to or from the Government of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. In Revenue Ruling 55–162, it was held that the exemption provided by section 4292 of the Code applies to amounts paid for the transportation of construction materials to be incorporated into a State project, where such materials are consigned to a State or political subdivision, in care of a contractor. However, it was further held that before a contractor may take advantage of this exemption and have construction materials consigned to a State or political subidivision, in care of himself, it will be necessary for the particular State or political subidivision to issue appropriate instructions authorizing such procedure.

It is held that the contractor who has been authorized by a State or political subdivision to take advantage of the exemption from payment of the tax on the transportation of property may do so by submitting to the supplier a statement certifying that he has been authorized to claim the exemption, identifying the contract or other document in

which such authorization was given, and instructing the supplier to make the shipment involved free of tax. Such statement should accompany the contract or order given by the contractor to the supplier. It is not necessary that this statement be notarized or that it be signed, or countersigned by an official of the State or political subdivision.

It is further held that where the invitation to bid for the construction of a State project, the contract for such project, or related document issued to the contractor by an official of the State or political subdivision, contains a provision authorizing the contractor to have the construction materials to be incorporated in that particular project consigned to the State or political subdivision, in care of the contractor, such provision constitutes "appropriate instructions" within the meaning of Revenue Ruling 55–162. However, since the letter to the association of road building contractors, described above, was no issued in connection with a specific contract, or in relation to a particular State project, it does not constitute "appropriate instructions" within the meaning of Revenue Ruling 55–162.

Rev. Rul. 55–162, amplified.

Applicability of the exemption from tax where services or facilities (communications, transportation of persons, or transportation of property) are furnished to an electric or telephone membership corporation established under the General Statutes of North Carolina. See Rev. Rul. 57–193, page 364.

Irrigation districts of California come within the scope of exemptions from certain Federal excise taxes in respect to state and political subdivisions and other governmental units. See Rev. Rul. 57–254, page 383.

CHAPTER 34.—DOCUMENTARY STAMP TAXES

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

(Also Section 4331.) Rev. Rul. 57–209

The transfer of capital stock or certificates of indebtedness from the names of a husband and wife as joint tenants to the names of the husband and wife as tenants in common is subject to the documentary stamp tax imposed under sections 4321 and 4331 of the Internal Revenue Code of 1954.

Advise has been requested whether the documentary stamp tax is incurred by reason of the transfer of capital stock held by a husband and wife as joint tenants, with right of survivorship, to the husband and wife as tenants in common.

Section 4321 of the Internal Revenue Code of 1954 provides that there shall be imposed 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 at the rates specified therein. Similarly, section 4331 of the Code imposes a tax on each sale or transfer of any certificates of indebtedness, issued by a corporation, at a specified rate.

Section 4351 defines the term "sale or transfer" as follows:

> For the purpose of this subchapter, the term "sale or transfer" means any sale, agreement to sell, memorandum of sale or delivery, or transfer of legal title, whether or not shown by the books of the corporation or other organization (or by any assignment in blank, or by any delivery, or by any payer or agreement or memorandum or other evidence of transfer or sale); and whether or not the holder acquires a beneficial interest in the instruments.

A husband and wife owned shares of stock as joint tenants with right of survivorship. The stock was transferred from the husband and wife as joint tenants to themselves as tenants in common. The transfer of stock in the manner indicated involves a change in the legal capacity in which the stock is held since the interests of the husband and wife after the transfer are not the same as before the transfer was made. The legal incidents of these forms of ownership, *i. e.*, joint tenants with right of survivorship and tenants in common, are not the same and the parties hold in a different legal capacity. Therefore, the transfer of stock held by a husband and wife as joint tenants to such persons as tenants in common is a transfer of legal title to the stock within the intent of the law and is subject to the transfer tax imposed under section 4321 of the Code. A similar transfer of certificates of indebtedness would be subject to the transfer tax imposed under section 4331 of the Code.

PART II.—SALES OR TRANSFERS OF CERTIFICATES OF INDEBTEDNESS

SECTION 4331.—IMPOSITION OF TAX

Rev. Rul. 57-5

The documentary stamp tax imposed by section 4331 of the Internal Revenue Code of 1954 on the sale or transfer of a certificate of indebtedness issued by a corporation is computed on the basis of the face value of the instrument. Payments made on account of principal noted on the instrument may be deducted from the original face value in determining the basis for computing the tax at the time of such transfer. It is not necessary that the payments on principal be actually endorsed on the instrument. It is sufficient if the instrument incorporates by reference the particular books or papers on which such payments have been recorded.

For the application of the transfer tax in the case of the transfer of certificates of indebtedness from a husband and wife as joint tenants to themselves as tenants in common, see Rev. Rul. 57-209, page 413.

SUBCHAPTER C.—CONVEYANCES

SECTION 4361.—IMPOSITION OF TAX

Rev. Rul. 57–72

Where real property is conveyed in condemnation proceedings to the United States or any agency or instrumentality thereof, the instrument of conveyance is subject to the documentary stamp tax imposed by section 4361 of the Internal Revenue Code of 1954 and is payable by the private party to the transaction.

Advice has been requested whether a private owner of real property is liable for the documentary stamp tax where the United States or any agency or instrumentality thereof acquires the property in condemnation proceedings.

Section 4361 of the Internal Revenue Code of 1954 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 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.

The documentary stamp tax imposed on deeds, when title to real estate is conveyed, is a tax on the transaction and is applicable to conveyances resulting from condemnation actions, as well as to voluntary conveyances. There is no distinction under the stamp tax law or regulations between voluntary and involuntary conveyances, and the tax applies equally to both. The term "sold" as defined by section 113.81(b) of Regulations 71, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, means a transfer of title for a valuable consideration which may involve money or anything of value. Section 113.83(d) of such regulations cites as an example of conveyances subject to the tax, "Deeds given by masters in chancery, sheriffs, clerks of court, etc., for realty sold under foreclosure or execution."

In view of the foregoing, the United States or any agency or instrumentality thereof is not liable for the documentary stamp tax imposed by section 4361 of the Code with respect to a conveyance of real property acquired by it in a condemnation proceeding. However, this exemption 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. Accordingly, it is held that the documentary stamp tax is payable by the grantor or condemnee, the nonexempt party to a transaction, when real property is conveyed in condemnation proceedings

to the United States or any agency or instrumentality thereof. See Mimeograph 4497, C. B. XV–2, 354 (1936), which holds that in the case of a sale under foreclosure, where the purchaser is an exempt Federal agency, if the mortgagor does not voluntarily affix the stamps, the sheriff or other person making the sale should affix the required stamps on behalf of the mortgagor and include the cost thereof as a necessary expense of the sale.

SUBCHAPTER D.—POLICIES ISSUED BY FOREIGN INSURERS

SECTION 4371.—IMPOSITION OF TAX

Rev. Rul. 57–256

Where the "insured" is a domestic corporation or domestic partnership, or an individual resident of the United States, the documentary stamp tax, imposed by section 4371(1) of the Internal Revenue Code of 1954, applies with respect to a foreign insurance policy covering property shipped from a foreign country to the United States if the coverage continues beyond the place of unloading at the port of entry.

Advice has been requested with respect to the applicability of documentary stamp tax to a foreign insurance policy covering property shipped from a foreign country to the United States.

In the case of *Amtorg Trading Corporation* v. *United States*, 103 Fed. (2d) 339, the court had before it the question of whether a foreign insurance policy covering a cargo shipped to the United States was subject to the documentary stamp tax. The policy of insurance provided that the insurer's liability should cease upon discharge of the cargo at the port of destination. The court held that the policy was not taxable because the cargo was only within the United States during the brief time of passage through the three mile limit and the place of its discharge which was only a trifling portion of the voyage.

It is the position of the Internal Revenue Service that a policy of insurance covering property shipped from a foreign country to a port in the United States is not taxable where the coverage within the United States constitutes only a trifling portion of the total coverage. To this extent, the principle enunciated in the Amtorg case has been followed. However, such principle relates only to the passage through the three mile limit of the territorial waters of the United States to the point of unloading at the port of entry in the United States.

Accordingly, it is held that the documentary stamp tax does not apply to a foreign insurance policy covering property shipped from a foreign country to the United States if the coverage terminates at the point of unloading in the port of entry. *Amtorg Trading Corporation* v. *United States*, *supra*. However, if the insured is a domestic corporation or domestic partnership, or an individual resident of the United States, such a policy that covers the property beyond the point of unloading is subject to the tax. See S. T. 898, C. B. 1940–1, 255. For instance, a foreign insurance policy covering the movement of property, after unloading, to a warehouse within the boundaries of the port of entry is taxable.

Rev. Rul. 57-257

Applicability of the documentary stamp tax to policies of insurance issued to foreign and domestic insured by foreign insurers in connection with risks that are wholly or partly in the United States.

Advice has been requested relative to the applicability of the documentary stamp tax to insurance policies issued to foreign and domestic insured by foreign insurers in connection with risks that are wholly or partly in the United States.

A policy of insurance covering property shipped from a foreign country to a port in the United States, which terminates upon unloading, is not taxable because the coverage within the United States constitutes only a trifling portion of the total coverage. See Revenue Ruling 57-256, page 416, this Bulletin, as to what constitutes a trifling portion of the total coverage.

Section 113.01(a) of Regulations 71, which regulations are made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954-2, 47, provides that the tax is imposed upon each insurance policy if issued—

(A) by a nonresident alien individual, a foreign partnership, or a foreign corporation, as insurer, and the policy or other instrument is not signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States within which the insurer is authorized to do business;

(B) to or for, or in the name of, a domestic corporation, domestic partnership, or an individual resident of the United States, against or with respect to hazards, risks, losses, or liabilities wholly or partly within the United States; or

(C) to or for, or in the name of, a foreign corporation, foreign partnership, or nonresident individual, engaged in a trade or business within the United States with respect to hazards, risks, or liabilities wholly within the United States.

Section 7701(a)(9) of the Internal Revenue Code of 1954 defines the term "United States" to include only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

The application of the provisions of the regulations may be demonstrated by the following examples:

1. Policies of foreign insurance covering shipments to or from the United States and moving from or to Puerto Rico, the Hawaiian Islands and/or the Virgin Islands, where the insured is a foreign corporation, foreign partnership, or nonresident individual, are not taxable for the reason that the hazards, risks, etc., insured against are not wholly in the United States.

2. Policies of foreign insurance covering shipments from the United States to Puerto Rico or the Virgin Islands, when the insured is domestic, that is, a domestic corporation, a domestic partnership, or an individual resident of the United States, are not taxable unless the insurance becomes effective prior to the time the property is actually shipped, in which case the insured risk would be partly within the United States.

3. Policies of foreign insurance covering shipments to the United States from Puerto Rico or the Virgin Islands, where the insured is domestic, are not taxable unless the insurance continues in effect beyond the point or time of unloading at the United States port of entry, in which case the insured risk would be partly in the United States.

4. Policies of foreign insurance covering shipments from the United States to the Hawaiian Islands (or Alaska), where the insured is domestic, are not taxable unless the insurance becomes effective prior to the time the property is actually shipped or continues in effect after the property is unloaded at the Hawaiian (or Alaskan) port of destination, in either of which events the coverage would be partly in the United States.

5. Policies of foreign insurance covering shipments to the United States from the Hawaiian Islands (or Alaska), where the insured is domestic, are not taxable unless the insurance becomes effective prior to the time the property is actually shipped or continues in effect after the property is unloaded at the United States port of destination, in either of which events, as in example 4, the coverage would be partly in the United States.

CHAPTER 35.—TAXES ON WAGERING

SUBCHAPTER A.—TAX ON WAGERS

SECTION 4401.—IMPOSITION OF TAX

(Also Sections 4411, 4421.) Rev. Rul. 57-258

A game, called "Five Card Draw," consisting of a small card with thirteen pull tabs, whereby a player for a sum of money pulls five tabs, each revealing a playing card symbol, with certain combinations winning prizes, is subject to the wagering taxes imposed by sections 4401 and 4411 of the Internal Revenue Code of 1954.

Advice has been requested whether the operation of a game known as "Five Card Draw" is subject to wagering taxes.

The "Five Card Draw" game consists of a small card approximately 2½ x 4¼ inches with thirteen pull tabs, each tab concealing a symbol of a playing card, ranging from ace, deuce, trey, etc., through king. A player, for 25 cents, purchases a card and pulls five tabs revealing five card symbols. Various winning combinations entitle the player to prizes of from 50 cents to $20. Each card is consecutively numbered and usable for the pulling of five tabs only.

Section 4401 of the Internal Revenue Code of 1954 imposes an excise tax on wagers as defined in section 4421 of the Code.

Section 4411 of the Code imposes an occupational tax to be paid by each person who is liable for tax under section 4401 of the Code, or who is engaged in receiving wagers for or on behalf of any person so liable.

Section 4421(1) of the Code defines the term "wager" to mean (1) any wager with respect to a sports event or a contest placed with a person engaged in the business of accepting such wagers, (2) any wager placed in a wagering pool with respect to a sports event or a contest, if such pool is conducted for profit, and (3) any wager placed in a lottery conducted for profit. Section 4421(2) provides that the term "lottery" includes the numbers game, policy, and similar types of wagering but does not include any game of a type in which usually

the wagers are placed, winners determined, and the distribution of prizes or other property is made in the presence of all persons placing wagers in such game.

The report of the Senate Committee on Finance on the Revenue Act of 1951, under which the present wagering taxes were introduced, specifically mentions the following games which are to be excluded from the definition of "lottery": Card games such as draw poker, stud poker, and blackjack; roulette games; dice games such as craps, bingo, and keno; and the gambling wheels frequently encountered at country fairs and charity bazaars. On the other hand, this report specifically mentions punchboards as an example of a game which normally would come within the definition of "lottery." See Senate Report No. 781, Eighty-second Congress, First Session, C. B. 1951–2, 458 at 540.

The game "Five Card Draw" described above is essentially nothing more than a type of punchboard. The foregoing legislative history of the definition of the term "lottery," as used in section 4421(2) of the Code, indicates that such a game falls within the meaning of the term "lottery."

Accordingly, it is held, that the wagering taxes imposed by sections 4401 and 4411 of the Code are applicable to the operation of the game called "Five Card Draw." The operator is liable for the ten percent wagering excise tax imposed by section 4401 and the $50 per year occupational tax imposed by section 4411, and each person who receives wagers in the game for or in behalf of the operator is liable for the $50 occupational tax.

SUBCHAPTER B.—OCCUPATIONAL TAX

SECTION 4411.—IMPOSITION OF TAX

The operation of a game called "Five Card Draw." See Rev. Rul. 57–258, page 418.

SUBCHAPTER C.—MISCELLANEOUS PROVISIONS

SECTION 4421.—DEFINITIONS

Rev. Rul. 57–241

The operation of a non-coin-operated gaming device does not constitute a "drawing" for purposes of the exclusion from the taxes on wagering provided by section 4421(2)(B) of the Internal Code of 1954. This type operation is not excluded from the taxes on wagering by section 4221(2)(A) of the Code.

Advice has been requested whether the operation of a non-coin-operated gaming device constitutes a "drawing" for purposes of the exclusion from the taxes on wagering provided by section 4421 (2) (B) of the Internal Revenue Code of 1954. If not, further advice has been requested whether the operation of this device is excluded from the taxes on wagering by section 4421(2)(A) of the Code.

An organization which has been granted an exemption from income tax under section 501 of the Code operates so-called "joker" machines. These machines are non-coin-operated gaming devices The player purchases the desired number of tickets from an attendant, and each ticket entitles him to one play. If a certain winning combination appears on the board of the machine the attendant pays the player accordingly. The proceeds from the operation are used to defray club expenses and to carry out its charitable aims. No part of the proceeds inures to the benefit of any private stockholder or individual.

Section 4401 of the Code imposes an excise tax on wagers. Section 4411 of the Code provides that an occupational tax shall be paid by each person who is liable for the excise tax under section 4401 or who is engaged in receiving wagers for or on behalf of any person so liable.

The term "wager" as used in the foregoing provisions of the statute, is defined in section 4421 of the Code as including (A) any wager with respect to a sports event or a contest placed with a person engaged in the business of accepting such wagers, (B) any wager placed in a wagering pool with respect to a sports event or a contest, if such pool is conducted for profit, and (C) any wager placed in a lottery conducted for profit.

Section 4421(2) of the Code provides that the term "lottery" includes the numbers game, policy, and similar types of wagering. However, section 4421(2)(A) of the Code excludes from the term "lottery" any game of the type in which usually (1) the wagers are placed, (2) the winners are determined, and (3) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such games. The report of the Senate Committee on Finance, Senate Report No. 781, Eighty-second Congress, First Session, C. B. 1951–2, 458, at 540, mentions specifically as coming within the exclusion from the term "lottery" card games such as draw poker, stud poker, and blackjack, roulette games, dice games such as craps, bingo games, and the gambling wheels frequently operated at county fairs and charity bazaars.

Section 4421(2)(B) of the Code states that the term "lottery" does not include any drawing conducted by an organization exempt from income tax under sections 501 and 521 of the Code if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual.

The term "drawing" as used in section 4421(2)(B) of the Code is defined in M. T. 44, C. B. 1952-2, 251, as a physical drawing of a ticket or equivalent thereof, such as the use of a wheel or a similar device, whereby a winner is conclusively determined by a number, etc., without reference to any other event the happening of which is beyond the control of the operator. The operation of a non-coin-operated gaming device is not considered to come within the meaning of this definition and, therefore the exclusion provided by section 4421(2)(B) of the Code is not applicable.

The inherent feature of the games to which the exclusion provided by section 4421(2)(A) of the Code applies is that of "group play," that is, where the wagers are placed, the winners are determined, and the prizes are awarded almost uniformly in the presence of all bet-

tors. Since this feature is not present in the operation of the non-coin-operated gaming device in the instant case, which is a continual operation rather than a series of games, the exclusion provided by section 4421(2)(A) of the Code is not applicable. Accordingly, it is held that the operation of the gaming device described above constitutes a "lottery" within the meaning of section 4421(2) of the Code, and all operators of such devices, including organizations which are exempt from income tax under sections 501 and 521 of the Code, are liable for the excise tax and the occupational tax imposed by sections 4401 and 4411 of the Code, respectively. All persons who accept wagers on the device for or on behalf of the operator are likewise liable for the occupational tax.

The operation of a game called "Five Card Draw." See Rev. Rul. 57–258, page 418.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

SUBCHAPTER B.—OCCUPATIONAL TAX ON COIN-OPERATED DEVICES

SECTION 4461.—IMPOSITION OF TAX

Rev. Rul. 57–184

A coin-operated gaming device which has multiple coin drop chutes and payoff cups, but has only one handle which activates a single mechanism, is considered to be a single unit for purposes of the occupational tax imposed by section 4461 of the Internal Revenue Code of 1954.

Advice has been requested whether certain coin-operated gaming devices are considered to be single units for purposes of the occupational tax imposed by section 4461 of the Internal Revenue Code of 1954.

One coin-operated gaming device has three separate coin drop chutes, three separate payout cups, but has only one handle which activates a single mechanism and a single reel, One, two, or three coin chutes may be played at one time and, if a winning combination is attained, payout is made in each cup which corresponds to a coin chute in which a coin was inserted.

Another coin-operated gaming device has seven coin drop chutes, and each chute may be played for a specific number or position. This device has only one payout cup and only one number or position wins with each play. It has one handle which activates a single mechanism and a single reel.

Section 4461 of the Code imposes a tax of $250 to be paid by every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated gaming device, and $250 per year for each additional device so maintained or the use of which is so permitted.

It is held that, since each of these devices has only one mechanism and is operated as a single unit, each machine is considered to be a

single unit for purposes of the occupational tax imposed by section 4461 of the Code. Therefore, only one $250 special tax stamp is required with respect to the maintenance for use of each such device. Compare with Revenue Ruling 56–139, C. B. 1956–1, 533, which holds that a coin-operated gaming device that operates as two distinct units except for a common handle is taxable as two coin-operated gaming devices, notwithstanding the fact that it is activated by a single handle.

SUBCHAPTER C.—OCCUPATIONAL TAX ON BOWLING ALLEYS, BILLIARD AND POOL TABLES

SECTION 4471.—IMPOSITION OF TAX

Rev. Rul. 57–66

The special tax, imposed by section 4471 of the Internal Revenue Code of 1954, is not applicable to bowling alleys, billiard and pool tables maintained by a state-operated educational institution where such facilities are available only to students and other persons directly connected with the institution and their guests.

Advice has been requested concerning the application of the special tax, imposed by section 4471 of the Internal Revenue Code of 1954, to the operation of bowling alleys, billiard and pool tables by a state-operated educational institution.

In the instant case, the alleys and tables are operated by the student union of a state university. The union is an auxiliary activity of the university and is operated as a department of the university to provide social and recreational facilities for the students. The services rendered by the union are financed from an allocation of student activity fees collected by the university. Nominal charges are made for the use of certain facilities including the alleys and tables and for instructional aid. The facilities are operated exclusively for the use of the students.

Section 4471 of the Code imposes a special tax to be paid by every person who operates a bowling alley, billiard room, or pool room at the rate of $20 a year for each bowling alley, billiard table, or pool table.

The Internal Revenue Service has concluded that the special tax is not applicable to bowling alleys, billiard or pool tables, operated by an auxiliary activity of a state-operated university where the facilities are available only to students and other persons directly connected with the university and their guests, irrespective of whether a charge is made for their use. On the other hand, in the case of a similar activity, where the facilities are open to the general public and are conducted in the manner of a private business, the tax will be imposed.

Under the circumstances described, since the student union is an auxiliary activity of the state-operated university, the operation by it of bowling alleys, billiard and pool tables for the exclusive use of the students of the university is not subject to the special tax imposed by section 4471 of the Code.

Rev. Rul. 57-157

Pool tables measuring 45 inches or more in overall length are subject to the special tax imposed by section 4471 of the Internal Revenue Code of 1954.

Advice has been requested whether miniature pool tables are subject to the occupational tax on bowling alleys, billiard and pool tables imposed by section 4471 of the Internal Revenue Code of 1954.

There are many miniature tables on the market which resemble pool tables but which are designed primarily for use by children. These tables, because of their small size and general design, are not adaptable for use in playing the regular game of pool and are considered to be more in the category of toys. Other tables, though smaller in dimensions than regular pool tables, are constructed in proportion to regular tables and are of sufficient size so that they are used both by adults and children in playing the standard game of pool. Some of these are provided by hotels for the use of their guests, while others are used in the recreational programs of various institutions.

Section 4471 of the Code imposes a special tax to be paid by every person who operates a bowling alley, billiard table, or pool table. That provision of the statute contains no definition of the term "pool table." However, section 4161 of the Code imposes a manufacturers excise tax on billiard and pool tables measuring 45 inches overall or more in length. While this latter provision of the statute has no direct relationship to the occupational tax, the size limitation contained therein seems to provide a reasonable basis for distinguishing between those tables used in playing the standard game of pool and those tables which should be considered to be more in the nature of children's toys.

It is held, therefore, that the occupational tax imposed by section 4471 is applicable to any miniature pool table that measures 45 inches or more in overall length.

SUBCHAPTER D.—TAX ON USE OF CERTAIN VEHICLES

SECTION 4481.—IMPOSITION OF TAX

26 CFR 41.4481-1: Imposition of tax. Rev. Rul. 57-259

A single-unit truck, which was put into taxable use on July 1, was subsequently altered so that it could pull a trailer. Likewise, a truck-tractor, which also was put into taxable use on July 1, was subsequently converted to a single unit. In either instance, the alteration changes the classification of the vehicle for purposes of the highway motor vehicle use tax. *Held*, in accordance with the provisions of section 4481 of the Internal Revenue Code of 1954, tax due for any tax year on the use of a highway motor vehicle is computed on the basis of the taxable gross weight of the vehicle at the time of its first taxable use in that year, and any alteration in the vehicle subsequent to such first taxable use will not affect the tax for that year, even though the alteration changed its classification under the schedule of taxable gross weights set forth in the regulations. However, liability

for the subsequent tax year will be based on the taxable gross weight assigned to the category of the schedule of taxable gross weights in which the vehicle falls at the the time of its first taxable use in that year.

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26 CFR 41.4481–3: Registration. Rev. Rul. 57–224

Foreign trucking firms will not incur liability for the Federal highway motor vehicle use tax on the use of vehicles within the United States unless such vehicle are, or are required to be, registered under the laws of any State in which they are operated.

The Internal Revenue Service has been asked (1) whether certain Canadian owned vehicles which operate within the United States are subject to the highway motor vehicle use tax and (2) whether the purchase of a special permit or identification tag for the purpose of paying a State highway use tax or a truck-mile tax constitutes "registration" as contemplated by section 41.4481–3(a) of the Highway Motor Vehicle Use Tax Regulations.

Under the laws of certain States which border on the Dominion of Canada, the Canadian owners of motor vehicles may, within specified limitations, operate their vehicles within those States without paying the usual registration or license fee. However, in those States which levy a highway use tax or a truck-mile tax, these Canadian owners are required to obtain, in connection with the payment of such a tax, special permits or identification plates for all trucks operated within the State.

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax on the use of certain highway motor vehicles. Section 4481(b) of the Code provides that the tax shall be paid 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 the vehicle is, or is required to be, registered. Section 4482(c)(1) of the Code defines the term "State" to mean a State, a Territory of the United States, and the District of Columbia.

Section 41.4481–3(a) of the regulations state that—

* * * the term "registered" when used with reference to a highway motor vehicle means—

(1) Registered under the law of any State or Territory of the United States or the District of Columbia, or,

(2) Required to be registered under the law of any State or Territory of the United States in which such highway motor vehicle is operated or situated * * *.

Any highway motor vehicle which is operated under a dealer's tag, license, or permit is considered to be registered in the name of such dealer. A highway motor vehicle is not considered to be registered solely by reason of the fact that there has been issued a special permit for operation of the vehicle at particular times and under specified conditions.

It is held that liability for the highway motor vehicle use tax is not incurred by foreign trucking firms on the use of vehicles within the United States unless such vehicles are, or are required to be, registered under the laws of any State in which they are operated. It is further held that compliance with a State law requiring the purchase of a special permit or identification tag for purposes of a State highway use tax law does not constitute "registration" for purposes of the Federal highway motor vehicle use tax.

SECTION 4482.—DEFINITIONS

26 CFR 41.4482(b)–1: Definition of taxable gross weight. Rev. Rul. 57–225

A truck-tractor that has been converted for use as a wrecker is classified as a single unit truck for purposes of the highway motor vehicle use tax.

For purposes of the highway motor vehicle use tax, advice has been requested relative to the classification, of a converted truck-tractor previously used for pulling semitrailers, now retired from over-the-road service and used as a wrecker for towing disabled vehicles. It has been converted for use as a wrecker by removing the fifth wheel and attaching a crane.

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax on the use of any highway motor vehicle which has a taxable gross weight of more than 26,000 pounds. Section 4482(b) of the Code provides that taxable gross weight shall be determined under regulations prescribed by the Secretary of the Treasury or his delegate, and defines the term as the sum of (1) the actual unloaded weight of the highway motor vehicle fully equipped for service, and the semitrailers and trailers (fully equipped for service) customarily used in connection with highway motor vehicles of the same type, and (2) the weight of the maximum load customarily carried on highway motor vehicles of the same type and on the semitrailers and trailers customarily used in connection therewith.

Section 41.4482(b)–1(c) of the Highway Motor Vehicle Use Tax Regulations sets forth a schedule of taxable gross weights prescribed under the authority provided in section 4482(b) of the Code, which schedule is based on the sum of the weights referred to in the statutory definition of the term "taxable gross weight." It lists three classes of vehicles, namely, single units, combinations, and buses.

It is held that where a truck-tractor has been converted in the manner described above, it is properly classified as a single unit truck for purposes of the highway motor vehicle use tax.

Rev. Rul. 57–226

Section 4481(a) of the Internal Revenue Code of 1954 imposes a tax on the use of certain highway motor vehicles which have a taxable gross weight of more than 26,000 pounds. Section 4482(b) of the Code provides that "taxable gross weight" shall be determined under regulations prescribed by the Secretary of the Treasury or his delegate, and that such regulations may include formulas or other methods for determining the taxable gross weight of vehicles by class, specifications, or otherwise. Section 41.4482(b)–1(c) of the Highway Motor Vehicle Use Tax Regulations sets forth a schedule of taxable gross weights for different classes of vehicles, based on the number of axles and the actual unloaded weight of the power unit fully equipped for service. *Held*, the term "axle," as it is used in the schedule of taxable gross weights, is not restricted to the driving axles of a vehicle. Rather, the term includes all axles that are, in fact, parts of the vehicle.

SECTION 4483.—EXEMPTIONS

26 CFR 41.4483: Statutory Provision; exemptions. Rev. Rul. 57-269

The exemption from the highway motor vehicle use tax authorized by the Secretary of the Treasury, C. B. 1956–2, 1369, as to the use of vehicles by the United States, depends on whether the vehicles are actually operated by the United States.

The Internal Revenue Service has been asked to clarify the exemption granted by the Secretary of the Treasury, C. B. 1956–2, 1369, under the provisions of section 4483(b) of the Internal Revenue Code of 1954 with respect to the use of certain highway motor vehicles in the situations described below.

Situation (1). A company leases trucks outright to the United States Government. The trucks, which are used for hauling mail, are driven and maintained by Post Office Department employees.

Situation (2). A company hauls mail in its own trucks under United States contracts. The trucks are driven and maintained by employees of the company. There are no Federal Government employees involved in the operation of the trucks at any time.

Situation (3). A company operates mobile postal units under United States mail contracts. The postal units are built on truck chassis according to Post Office Department specifications. They are owned by the company and are driven in over-the-road operations by employees of the company. A United States Government postal clerk sorts in transit and otherwise handles the mail that is being transported.

Situation (4). A nongovernmental corporation is operated under a business franchise in the State in which it is located. Its sole financial support is derived from the performance of research and development contracts. Most of its projects are for the United States Government and are undertaken on a standard Government cost-plus-fixed-fee type of contract. In connection with one of its projects, the company uses a specially-equipped truck that is owned by the Federal Government.

Section 4481(a) of the Code imposes a tax on the use of certain highway motor vehicles. Section 4481(b) of the Code provides that the tax shall be paid by the person in whose name the highway motor vehicle is, or is required to be, registered, or, in case the highway motor vehicle is owned by the United States, by the agency or instrumentality of the United States operating such vehicle.

Section 4483(b) of the Code provides that the Secretary of the Treasury may authorize exemption from the tax imposed by section 4481 as to the use by the United States of any particular highway motor vehicle, or class of highway motor vehicles, if he determines that the imposition of such tax with respect to such use will cause substantial burden or expense which can be avoided by granting tax exemption and that full benefit of such exemption, if granted, will accrue to the United States. Pursuant to this provision, the Secretary has authorized exemption from the tax as to the use by the United States on or after July 1, 1956, of any highway motor vehicle on the public highways in the United States, whether or not such highway motor vehicle is owned by the United States. See C. B. 1956–2, 1369.

Section 41.4482(c)-1(c) of the Highway Motor Vehicle Use Tax Regulations defines the term "use" to mean the use of a highway motor vehicle on the public highways in the United States, that is, operation of the motor vehicle, by means of its own motor, on any roadway in the United States which is not a private roadway.

Therefore, it is held that, for purposes of the exemption from the highway motor vehicle use tax, the term "use by the United States" as used in the authorization of the Secretary, means the operation by the United States or any agency or instrumentality thereof on the public highways in the United States of any highway motor vehicle, whether or not such highway motor vehicle is owned by the United States or any agency or instrumentality thereof. Accordingly, the exemption would apply in situation 1, where the trucks are actually operated by the United States Government. Since in situations 2, 3, and 4 the trucks are operated by the companies, rather than by the Federal Government, the exemption granted under the provisions of section 4483(b) of the Code will not apply.

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26 CFR 41.4483–1: State and local governmental exemption. Rev. Rul. 57–270

Section 4481 of the Internal Revenue Code of 1954 imposes an excise tax on the use of certain highway motor vehicles. However, section 4483 of the Code exempts from this tax the use of any highway motor vehicle by any State or any political subdivision of a State. Section 41.4483–1 of the Highway Motor Vehicle Use Tax Regulations provides, in part, that the term "use by any State or any political subdivision thereof" means the operation by any State or any political subdivision thereof. *Held*, since volunteer fire departments are quasi-governmental organizations that perform functions ordinarily carried on by governmental units, this exemption applies to the operation of vehicles by volunteer fire departments. See Revenue Ruling 55–545, C. B. 1955–2, 458, regarding the exemption from manufacturers excise tax provided by section 4224 of the Code.

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 5703.—LIABILITY FOR TAX AND METHOD OF PAYMENT

26 CFR 270.194: Stamps for affixture in foreign countries. Rev. Rul. 57–196

(Also Section 275.183.)

United States internal revenue tobacco products tax stamps may now be forwarded to Israel for affixture to tobacco products manufactured in Israel for exportation to the United States. Accord-

ingly, Revenue Ruling 55-680, C. B. 1955-2, 475, which contains a list of the foreign countries to which the internal revenue tobacco tax stamps may be shipped, is hereby amended to include Israel.

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26 CFR 275.183: Stamps for affixture in foreign countries.

The list of foreign countries to which tobacco stamps may be sent for affixture therein is supplemented. See Rev. Rul. 57-196, page 427.

SECTION 5705.—REFUND OR ALLOWANCE OF TAX

26 CFR 270.164: Claim for refund of tax. (Also Section 270.197.) Rev. Rul. 57-16

Claims may be filed for the refund of tax paid under the return system to cover cigars returned to the manufacturer or importer (withdrawn from the market) in partially filled packages as well as in full packages.

The date of taxpayment of cigars taxpaid under the return system need not be shown on the face of Form 843, Claim, where the various dates of taxpayment appear on the schedule required to accompany the claim.

Advice has been requested whether claims may be filed for the refund of tax paid on cigars withdrawn from the market by the manufacturer in partially filled packages, where the tax thereon had been paid under the return system. Advice has also been requested with respect to the method of showing the date of taxpayment.

Section 270.164 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers) provides, in part, that the tax paid by return on cigars which are withdrawn from the market by the manufacturer, or are lost (otherwise than by theft) or destroyed by fire, casualty, or act of God, while in the possession or ownership of the manufacturer, may be refunded. Similar provision is made in section 270.197 of the regulations with respect to the refund of tax paid on imported cigars under the return system.

It is held that the above provisions are applicable to cigars withdrawn by the manufacturer or importer from the market in partially filled packages as well as in full packages.

Sections 270.164 and 270.197 of the regulations also provide that the manufacturer or importer must prepare a schedule, in letter form, of the cigars covered by the claim for refund, where such tax had been paid under the return system. Such schedule, prepared by the manufacturer, should show (1) the class of the product, (2) the factory from which the product was removed (permit number), (3) the number of full packages and the number of partially filled packages, indicated separately, (4) the separate quantity of cigars of each class in full and partially filled packages, (5) the date of taxpayment, (6) the rate of tax, and (7) the amount of tax for each item.

It will not be necessary to show the dates of taxpayment on the face of Form 843, Claim, where the various dates of taxpayment appear on the schedule, under the heading "Date of Taxpayment."

Schedules by importers will be prepared in the same manner except that item (2), above, will be omitted.

The following schedule is published as a guide to illustrate the information which a manufacturer should furnish:

SPECIMEN

SCHEDULE FOR REFUND OF TAX PAID BY RETURN ON CIGARS WITHDRAWN FROM THE MARKET

(Claimant) (Number and Street, City, Zone, State)

Assembled at: _____

Class of product	Factory from which product was removed		No. of full or partially filled packages (Indicate separately)	Quantity of cigars	Date of tax payment	Rate of tax	Amount of tax
	Permit No.	State					
C	C–1042	Pa.	500 full	25, 000	10/12/56	$4	$100. 00
D	"		250 partial	10, 262	10/ 2/56	7	71. 83
			750	35, 262			$171. 83

(Also Sections 270.165, 275.154.) Rev. Rul. 57–121
(Also Part II, Section 2198.)

A corporation, which acquires all of the capital stock of the manufacturing company which was thereafter dissolved, is considered the "manufacturer" within the intent of section 5705(a) of the Internal Revenue Code of 1954 (section 2198 of the 1939 Code), and, as such, is entitled to file a claim for refund of the tax paid on tobacco products by the former company where such tobacco products are subsequently withdrawn from the market after acquisition by the successor corporation.

Advice has been requested whether a corporation, which purchased all of the capital stock of a manufacturing company, after which the manufacturing company was dissolved, is entitled to file a claim for refund of the value of stamps affixed to tobacco products withdrawn from the market where the stamps were purchased and affixed to the tobacco products removed from its factory by the manufacturing company prior to its sale.

Stamps were purchased by *X* company and affixed to cigarettes produced in and removed from its factory. Subsequent thereto, all of the capital stock of *X* company was transferred to *Y* company and *X* company was formally dissolved, at which time the assets of *X* company were distributed to *Y* company. The cigarettes were withdrawn from the market by *Y* company after dissolution of *X* company, and *Y* company filed a claim for refund of the value of the stamps attached to such cigarettes.

Section 5705(a) of the Internal Revenue Code of 1954 provides in part that a refund of any tax imposed by chapter 52 thereof shall be made to the manufacturer on proof satisfactory to the Secretary

of the Treasury, or his delegate, that the claimant manufacturer has paid the tax on articles withdrawn by him from the market. Similarly, section 2198 of the Internal Revenue Code of 1939 provides for the redemption of internal revenue stamps affixed to packages of tobacco products withdrawn from the market by the manufacturer.

Section 270.164 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers), provides in part for the refund to the manufacturer of tax paid by return on cigars withdrawn from the market by the manufacturer. Section 270.165(b) thereof provides in part for the refund to the manufacturer of the value of stamps attached to packages of cigars or cigarettes withdrawn from the market by the manufacturer. A similar provision with respect to the refund to the manufacturer of the value of stamps attached to packages of manufactured tobacco withdrawn from the market by such manufacturer is contained in section 275.154(b) of the Regulations relating to Manufactured Tobacco (Manufacturers, Importers, and Dealers).

It is held that the phrase "that the claimant manufacturer * * * has paid the tax on articles withdrawn by him from the market," contained in section 5705(a) of the 1954 Code, covers not only the corporate entity which manufactured the product but also a corporation into which the manufacturing coporation was merged, a new corporation resulting from the consolidation of another corporation with the manufacturing corporation, and a corporation which acquires all of the corporate stock of the manufacturing corporation which is thereafter dissolved, as well as the transfer by operation of law of the control of the manufacturing corporation, such as through bankruptcy, the appointment of a receiver, or by other court order.

Accordingly, a corporation which acquires all of the capital stock of the manufacturing company, which was thereafter formally dissolved, should be considered the "manufacturer" within the intent of section 5705(a) of the 1954 Code and section 2198 of the 1939 Code, since that corporation is the successor to the manufacturing company and, therefore, is entitled to file a claim for refund of tax paid on the tobacco products subsequently withdrawn from the market. On the other hand, if a concern merely purchases the assets of a manufacturing corporation which continues in existence, then the purchasing concern is not entitled to file a claim for refund of the value of stamps purchased and affixed to tobacco products produced and removed by the manufacturing corporation prior to the sale of its assets.

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26 CFR 270.165: Claim for redemption, or refund of the value, of stamps.

For the filing of claims by a corporation, as successor to the manufacturer of cigars or cigarettes taxpaid by stamp, see Rev. Rul. 57–121, page 429.

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26 CFR 270.197: Claim for refund of tax.

For the extent of refund of tax paid under the return system and method of preparing the schedule, see Rev. Rul. 57–16, page 428.

26 CFR 275.154: Claim for redemption, or refund of the value, of stamps.

For the filing of claims by a corporation, as successor to the manufacturer of taxpaid tobacco products, see Rev. Rul. 57–121, page 429.

SUBCHAPTER C.—OPERATIONS BY MANUFACTURERS OF ARTICLES

SECTION 5721.—INVENTORIES

For the method of reporting tobacco materials on inventories of manufacturers of tobacco products, see Rev. Proc. 57–11, page 739.

SECTION 5722.—REPORTS

For the method of showing tobacco materials on monthly reports of manufacturers of tobacco products, see Rev. Proc. 57–11, page 739.

SECTION 5723.—PACKAGES, LABELS, NOTICES, AND STAMPS

26 CFR 270.193: Affixture of stamps. (Also Section 275.182.) Rev. Rul. 57–97

Section 270.193 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers) provides that, except in the case of cigars taxpaid by return, the importer shall, before removal subject to tax, securely affix to each package of cigars or cigarettes one or more stamps of such proper class and denominations as will fully taxpay the contents of the package. Similar provisions with respect to manufactured tobacco is made in section 275.182 of the Regulations relating to Manufactured tobacco (Manufacturers, Importers, and Dealers). *Held*, since the Internal Revenue Code of 1954, and the pertinent regulations, do not prescribe or restrict the quantities of imported tobacco products which may be put up in packages for domestic sale or consumption, such products may be put up in packages of any size so long as sufficient tax stamps are affixed to the packages to fully taxpay the contents and the denominations of such stamps accurately indicate the quantity of tobacco products contained in each package. For a similar ruling with respect to domestic tobacco products, see Revenue Ruling 56–113, C. B. 1956–1, 546.

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26 CFR 275.182: Affixture of stamps.

For the quantity of imported tobacco products which may be placed in a package, see Rev. Rul. 57–97, above.

SUBCHAPTER E.—RECORDS OF MANUFACTURERS OF ARTICLES AND DEALERS IN TOBACCO MATERIALS

SECTION 5741.—RECORDS TO BE MAINTAINED

26 CFR 270.142: Record.

For instructions on records to be kept by manufacturers of cigars and cigarettes, see Rev. Proc. 57–8, page 732.

26 CFR 275.132: Record.

For instructions on records to be kept by manufacturers of tobacco, see Rev. Proc. 57–7, page 730.

CHAPTER 53.—MACHINE GUNS AND CERTAIN OTHER FIREARMS

SUBCHAPTER B.—GENERAL PROVISIONS

SECTION 5848.—DEFINITIONS

26 CFR 179.20: Firearm. Rev. Rul. 57–6

A rifled bore pistol or revolver of the conventional type is not a firearm as defined in section 5848 of the Internal Revenue Code of 1954, but a smooth bore "pistol or revolver" is a firearm as so defined.

Revenue Ruling 54–159, C. B. 1954–1, 251, revoked.

Revenue Ruling 54–159, C. B. 1954–1, 251, holds that the removal of the rifling from the barrel of .38 and .45 caliber revolvers and the use of standard revolver cartridge casings, hand loaded with shot, do not remove such weapons from the classification of revolvers.

The Internal Revenue Service has reconsidered, for classification purposes under the National Firearms Act (chapter 53 of the Internal Revenue Code of 1954), the status of a pistol or revolver, designed or redesigned to fire through a smooth bore, *primarily* fixed ammunition consisting of the case, primer, propellent charge, and "shot," rather than fire, through a rifled bore, fixed ammunition consisting of the case, primer, propellent charge, and a "bullet." As a result of comprehensive ballistics and practical comparative tests, the weapons have been classified as follows:

A rifled bore pistol or revolver of the conventional type meets the basic requirements of a "small projectile weapon" as defined in sections 179.35 and 179.37 of the Regulations relating to Machine Guns and Certain Other Firearms, even if loaded with "shot cartridges" for the reason that it is designed to function most proficiently from a ballistics standpoint when discharging a "bullet." Accordingly, a rifled bore pistol or revolver of the conventional type is not a firearm as defined in section 5848 of the Code.

On the other hand, a smooth bore pistol or revolver fails to meet the basic requirement of a "small projectile weapon" even when loaded

with "bullet cartridges" for the reason that the weapon is designed to function most proficiently from a ballistics standpoint when discharging "shot," equaling the potential of shotguns with comparable specifications. Therefore, a smooth bore handgun is not a "pistol or revolver" as defined in the regulatory definitions referred to above and is not entitled to exception from the provisions of chapter 53 of the Code. Accordingly, it is held that such a weapon is a firearm as defined in section 5848(1) and (5) of the Code and as such is subject to the provisions of the National Firearms Act (chapter 53 of the Code).

Revenue Ruling 54–159, C. B. 1954–1, 251, is hereby revoked. However, under the authority of section 7805(b) of the Code, this ruling will be applied without retroactive effect.

(Also Part II, Federal Firearms Act, Section 1; Section 315.27.) Rev. Rul. 57–227

Only those firearms covered by section 5848 of the Internal Revenue Code of 1954 which have been deactivated in the manner prescribed in Revenue Ruling 55–590, C. B. 1955–2, 483, under the supervision of an investigator of the Alcohol and Tobacco Tax Division, may be considered in the category of a "DEWAT." Notwithstanding its operating condition, any firearm covered by such section which has not been deactivated in the prescribed manner under the supervision of such officer comes within the purview of Chapter 53 of the Code inasmuch as the exemption afforded "unserviceable" firearms is conditional and applicable only in respect to the transfer tax imposed under section 5811(a) of the Code.

The Internal Revenue Service emphasizes the distinction between an "unserviceable" firearm and a "DEWAT" as defined in Revenue Ruling 55–590, C. B. 1955–2, 483, for purposes of Chapter 53 of the Internal Revenue Code of 1954, and announces that such distinction will be enforced in order to avoid abuses of the ruling in respect of DEWATS.

The minimum requirements for the process of transforming a firearm into a DEWAT were established with the assistance of recognized ordnance experts, and the Internal Revenue Service has consistently held that the deactivation must be witnessed by the investigator who certifies as to the condition of the DEWAT. To insure that the minimum requirements would be met, investigators of the Alcohol and Tobacco Tax Division were instructed to make the necessary arrangements to have firearms deactivated by experienced welders under their supervision. Such deactivation has ordinarily been accomplished at no expense to the individual owners of the firearms. This procedure was adopted, and has been continued, (1) since experience has shown that improper welding increases the possibility of reactivating a DEWAT and, (2) to eliminate any possibility of substitute brazing, soldering, or other process to simulate steel welding in "deactivating" firearms.

It is the position of the Internal Revenue Service that only such firearms covered by section 5848 of the Internal Revenue Code of 1954 which have been deactivated in the prescribed manner under the supervision of Alcohol and Tobacco Tax investigators may be considered in the category of DEWATS. Any firearms which have *not* been deactivated in the prescribed manner under the supervision of

such officers come within the purview of Chapter 53 of the Internal Revenue Code of 1954 notwithstanding their operating condition, inasmuch as the exemption afforded "unserviceable" firearms is conditional and applicable *only* in respect to the transfer tax imposed under section 5811(a) of the Code.

A "DEWAT" and an "unserviceable" firearm under Chapter 53 of the Code are both firearms under the Federal Firearms Act, 15 U. S. C. 901–909, and, accordingly, are subject to the applicable provisions of the Federal Firearms Act and the regulations issued pursuant thereto since "any part or parts" of a weapon is a "firearm" as defined therein.

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26 CFR 179.31: Muffler or silencer. Rev. Rul. 57-34
(Also Part II, Federal Firearms Act,
Section 1; Section 315.27.)

A barrel extension, having a diameter of four inches, an overall length of 16 inches, and no baffle plates, for a standard industrial gun produced by a domestic manufacturer, but which neither silences nor appreciably diminishes the explosive report of the gun, is not a "muffler or silencer" within the purview of the National Firearms Act or of the Federal Firearms Act.

Any similar device, designed for use with an industrial gun, should be submitted for classification purposes prior to general production thereof.

Advice has been requested whether a barrel extension designed to reduce the risk of injury to the hearing of operators of industrial guns is a muffler or silencer within the purview of the National Firearms Act (chapter 53 of the Internal Revenue Code) and the Federal Firearms Act, title 15, U. S. C., chapter 18.

The Internal Revenue Service has examined the brochures, plans, and specifications relating to a particular barrel extension, having a diameter of four inches, an overall length of 16 inches, and no baffle plates, designed for use with a standard industrial gun of a domestic manufacturer, and has witnessed demonstrations of the device. The stated purpose of the device is to reduce the risk of injury to the hearing of operators of industrial guns by projecting the report of discharge of the explosive away from such operator.

Section 5848 of the Internal Revenue Code of 1954 includes as a part of the definition of a firearm a "muffler or silencer for any firearm," whether or not such firearm is included within the definition of a firearm as contained therein. Pursuant thereto, section 179.31 of the Regulations relating to Machine Guns and Certain other Firearms defines a "muffler" or "silencer" as any device for silencing or diminishing the report of any portable weapon, such as a rifle, carbine, pistol, revolver, machine gun, submachine gun, shotgun, fowling piece, or other device from which a shot, bullet, or projectile may be discharged by an explosive. Similarly, section 1 of the Federal Firearms Act, 15 U. S. C. 901, includes in the definition of a firearm a "firearm muffler or firearm silencer."

The demonstrations of the device described above conclusively established that it neither silenced nor appreciably diminished the explosive report. Therefore, it is held that this barrel extension for industrial guns, conforming to the plans and specifications examined,

is not a "muffler or silencer" within the purview of the National Firearms Act, chapter 53 of the Internal Revenue Code of 1954, or within the purview of the Federal Firearms Act, title 15 U. S. C., chapter 18.

Any device of similar nature designed for attachment to an industrial gun, for the purpose of affecting the report of discharge in any way, should be submitted for testing so that a determination may be made in each case whether the particular device is a "muffler" or "silencer" under these statutes. Similarly, any person proposing to produce devices of this nature should contact the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D. C.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART II.—TAX RETURNS OR STATEMENTS

SUBPART A.—GENERAL REQUIREMENTS

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT OR LIST

Requirements for private printing and alternate method of filing Form 1042S. See Rev. Proc. 57–4, page 725.

PART III.—INFORMATION RETURNS

SUBPART A.—INFORMATION CONCERNING TRANSACTIONS WITH OTHER PERSONS

SECTION 6033.—RETURNS BY EXEMPT ORGANIZATIONS

26 CFR 1.6033–1: Returns by exempt organizations.

Procedure for filing Form 990–P by trustees of exempt employees' trusts which invest in insurance company contracts. See Rev. Proc. 57–15, page 745.

SUBPART B.—INFORMATION CONCERNING TRANSACTIONS WITH OTHER PERSONS

SECTION 6041.—INFORMATION AT SOURCE

Rev. Rul. 57–7

An agreement under which a corporation places coin-operated amusement or gaming devices on premises occupied by another, in consideration of a stipulated percentage of the gross receipts less specified expenses as remuneration for permitting the machines to occupy space on such premises, constitutes a lease of such space by the occupant as lessor to the corporation as lessee. If the re-

muneration paid by the corporation to the occupant of the premises (if other than a corporation) in any taxable year amounts to $600 or more the corporation is required, under section 6041 of the Internal Revenue Code of 1954, to file information returns on Forms 1096 and 1099 with respect to such remuneration.

Advice has been requested as to the nature, for Federal tax purposes, of the agreements hereinafter described, under which a corporation places coin-operated amusement and gaming devices on premises occupied by another.

M corporation owns slot machines, juke boxes, and pinball machines, as well as other amusement and gaming devices which are placed in various locations with the permission of the occupant of the premises. The parties agree that the occupant will receive a stipulated percentage of the receipts from the machines, after deduction of certain expenses, as remuneration for permitting the machines to occupy space in his establishment. Although the machines are owned by *M* corporation, the tax stamps are properly purchased by the occupant of the premises in his own name and he is reimbursed therefor by *M* corporation.

The machines can be opened only by a collector employed by *M* corporation who counts the money, usually in the presence of the occupant of the premises or one of his employees. The collector reimburses the occupant as to any payouts and then pays him the agreed percentage of the balance. Under the agreement between the parties, the occupant of the premises on which the machines are located is to make change for customers, if necessary, and to pay out any prizes or winnings. It is further understood by the parties that *M* is to pay the costs of repairing and installing the machines as well as all other expenses with respect thereto, and that *M* is to bear the losses from the operation of the machine, if any.

In view of the foregoing, these arrangements for Federal tax purposes constitute leases of space for the location of the machines entered into by *M* corporation, as lessee, with the occupants of the premises where the machines are placed, as lessors. If the remuneration paid by the corporation to the occupant of the premises (if other than a corporation) in any taxable year amounts to $600 or more, the corporation is required, under section 6041 of the Internal Revenue Code of 1954, to file information returns on Forms 1096 and 1099 with respect to such remuneration.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6103.—PUBLICITY OF RETURNS AND LISTS OF TAXPAYERS

26 CFR 301.6103(a)–101: Inspection of returns by committees of Congress other than those enumerated in Section 6103(d) of the Internal Revenue Code of 1954. (Also Part II, Section 55.) — E. O. 10699

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

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared-value excess-profits, capital-stock, estate, or gift tax return for the years 1945 to 1957, inclusive, shall, during the Eighty-fifth Congress, be open to inspection by the Senate Committee on Government Operations, or any duly authorized subcommittee thereof, in connection with its studies of the operation of Government activities at all levels with a view to determining the economy and efficiency of the Government, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1, 142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me on May 3, 1955.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
February 19, 1957.

(Filed by the Division of the Federal Register February 20, 1957, 10: 29 a. m., and published in the issue of the Federal Register for February 21, 1957, 22 F. R. 1059.)

(Also Part II, Section 55.) E. O. 10701

Inspection of income, excess-profits, declared-value excess-profits, capital-stock, estate, and gift tax returns by the Committee on Un-American Activities, House of Representatives.

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared-value excess-profits, capital-stock, estate, or gift tax return for any period to and including 1957, shall, during the Eighty-fifth Congress, be open to inspection by the Committee on Un-American Activities, House of Representatives, or any duly authorized sub-committee thereof, for the purpose of carrying on those investigations authorized by clause 17 of Rule XI of the Rules of the House of Representatives, agreed to January 3, 1957, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1, 142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me on May 3, 1955.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
March 12, 1957.

(Filed by the Division of the Federal Register March 12, 1957, 4: 14 p. m., and published in the issue of the Federal Register for March 13, 1957, 22 F. R. 1629.)

(Also Part II, Section 55.) E. O. 10703

Inspection of income, excess-profits, declared-value excess-profits, capital-stock, estate, and gift tax returns by the Select Committee of the Senate established by Senate Resolution 74, 85th Congress, to investigate improper activities in labor-management relations, and for other purposes.

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Seat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared-value excess-profits, capital-stock, estate, or gift tax return, for the years 1945 to 1957, inclusive, shall, during the Eighty-fifth Congress, be open to inspection by the Select Committee of the Senate Established by Senate Resolution 74 85th Congress, agreed to January 30, 1957, to investigate improper activities in labor-management relations, and for other purposes, or any duly authorized subcommittee thereof, for the purpose of carrying out the provisions of such resolution; such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1,142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me on May 3, 1955.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE
March 17, 1957.

(Filed by the Division of the Federal Register March 18, 1957, 3:03 p. m., and published in the issue of the Federal Register for March 20, 1957, 22 F. R. 1797.

(Also Part II, Section 55.) E. O. 10706

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

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared-value excess-profits, capital-stock, estate, or gift tax return, for the years 1945 to 1957, inclusive, shall, during the Eighty-fifth Congress, be open to inspection by the Senate Committee on the Judiciary, or any duly authorized subcommittee thereof, in connection with its investigation of the administration, operation, and enforcement of the Internal Security Act of 1950 and other internal security laws pursuant to Senate Resolution 57, 85th Congress, agreed to January 30, 1957, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1, 142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me on May 3, 1955.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE.
April 25, 1957.

(Filed by the Division of the Federal Register on April 29, 1957, 10:35 a. m., and published in the issue of the Federal Register for April 30, 1957, 22 F. R. 3027.)

(Also Part II, Section 55.) E. O. 10712

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

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared-value excess-profits, capital-stock, estate, or gift tax returns, for the years 1945 to 1957, inclusive, shall, during the Eighty-fifth Congress, be open to inspection by the Senate Committee on the Judiciary, or any duly authorized subcommittee thereof, in connection with its study and investigation of the antitrust and antimonopoly laws of the United States pursuant to Senate Resolution 57, 85th Congress, agreed to January 30, 1957, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1, 142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me on May 3, 1955.

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

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
May 17, 1957.

(Filed by the Division of the Federal Register on May 17, 1957, 4:51 p. m. and published in the issue of the Federal Register for May 21, 1957, 22 F. R. 3499.)

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6415.—CREDITS OR REFUNDS TO PERSONS WHO COLLECTED CERTAIN TAXES

Rev. Rul. 57–171

Section 6415(d) of the Internal Revenue Code of 1954 provides, in part, that any person making a refund of any payment on which the

tax on transportation of property has been collected may repay therewith the amount of tax collected on such payment. The established tariffs of a carrier provide that when a shipper or consignee delivers or picks up freight at the carrier's dock he is given an allowance. *Held*, such an allowance made by a carrier to a shipper or consignee for delivery or pick-up service constitutes a refund of part of the amount paid for the through transportation movement. Accordingly, where a carrier collects the full transportation charges and the tax that attaches thereto from a shipper or consignee and subsequently makes an allowance for delivery or pick-up service, the carrier is authorized to repay the tax applicable to such allowance. However, the tax may be repaid only to the person from whom such tax was collected.

SECTION 6416.—CERTAIN TAXES ON SALES AND SERVICES

Circumstances under which the sale of tread rubber may, or may not, be exempt from manufacturers excise tax as a sale to a state. See Rev. Rul. 57–15, page 368.

For determination as to whether credit or refund is allowable with respect to manufacturers tax imposed on sales of electric light bulbs which are incorporated into nontaxable subsassemblies which are sold for installation in taxable freezers, see Rev. Rul. 57–221, page 381.

SECTION 6420.—GASOLINE USED ON FARMS

(Also Section 6421.) Rev. Rul. 57–17

Relief from the Federal excise tax on gasoline provided by section 6420 of the Internal Revenue Code of 1954 is limited to gasoline used on a farm for farming purposes and does not extend to gasoline merely because it is used off the highway. Gasoline used in vehicles which are used for the purpose of maintaining a golf course is not gasoline used "on a farm for farming purposes" within the meaning of section 6420(c) of the Code. Accordingly, no payment may be made under section 6420 of the Code with respect to gasoline used in connection with the maintenance of a golf course. However, section 6421 of the Code provides, insofar as applicable to this situation, that the ultimate purchaser is entitled to a payment equal to one cent for each gallon of gasoline which is purchased on or after July 1, 1956, and which is used otherwise than as a fuel in a highway vehicle which (at the time of such use) is registered, or is required to be registered, for highway use under the laws of any State or foreign country.

SECTION 6421.—GASOLINE USED FOR CERTAIN NON-HIGHWAY PURPOSES OR BY LOCAL TRANSIT SYSTEMS

Refund of tax paid on gasoline used in connection with the maintenance of a golf course. See Rev. Rul. 57–17, page 440.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER A.—LIMITATIONS ON ASSESSMENT AND COLLECTION

SECTION 6501—LIMITATIONS ON ASSESSMENT AND COLLECTION

26 CFR 301.6501(c)—1: Exceptions to general period of limitations on assessment and collection.

The Internal Revenue Service explains its policy and issues a guide for taxpayers and practitioners regarding the circumstances under which the securing of a waiver or consent, fixing the period of limitation upon assessment of income and profits tax, is appropriate. See Rev. Proc. 57–6, page 729.

SUBCHAPTER D.—PERIODS OF LIMITATION IN JUDICIAL PROCEEDINGS

SECTION 6532.—PERIODS OF LIMITATION ON SUITS

26 CFR 301.6532–1: Periods of limitation on suits by taxpayers.

Form 2297 is prescribed for use by taxpayers to waive the requirement of registered mail notification of claim disallowance. See Rev. Proc. 57–12, page 740.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

Interest due on recomputation of tax where excessive losses for five consecutive years. See Rev. Rul. 57–179, page 112.

26 CFR 301.6601: Statutory provisions; interest on underpayment, nonpayment, or extensions of time for payment, of tax. (Also Sections 6602, 6611; 301.6602, 301.6611.) T. D. 6234[1]

[1] 22 F. R. 3559.

Regulations under chapter 67 of the Internal Revenue Code of 1954, relating to interest.

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 19, 1955, notice of proposed rulemaking regarding the regulations under chapter 67 of the Internal Revenue Code of 1954, relating to interest applicable to the taxes imposed by such Code, was published in the Federal Register (20 F. R. 6049). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the following regulations are hereby adopted:

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GENERAL RULES

Effective Date and Related Provisions

AUTHORITY: §§ 301.6601 to 301.6612, incl., and 301.7851, issued under sec. 7805 of the Internal Revenue Code of 1954, 68A Stat. 917; 26 U. S. C. 7805.

INTEREST

Interest on Underpayments

§ 301.6601 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 tav 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).

(c) LAST DATE PRESCRIBED FOR PAYMENT.—For purposes of this section, the last date prescribed for payment of the tax shall be determined under chapter 62 with the application of the following rules:

(1) EXTENSIONS OF TIME DISREGARDED.—The last date prescribed for payment shall be determined without regard to any extension of time for payment.

(2) INSTALLMENT PAYMENTS.—In the case of an election under section 6152(a) to pay the tax in installments—

(A) The date prescribed for payment of each installment of the tax shown on the return shall be determined under section 6152 (b), and

(B) The last date prescribed for payment of the first installment shall be deemed the last date prescribed for payment of any portion of the tax not shown on the return.

(3) JEOPARDY.—The last date prescribed for payment shall be determined without regard to any notice and demand for payment issued, by reason of jeopardy (as provided in chapter 70), prior to the last date otherwise prescribed for such payment.

(4) LAST DATE FOR PAYMENT NOT OTHERWISE PRESCRIBED.—In the case of taxes payable by stamp and in all other cases in which the last date for payment is not otherwise prescribed, the last date for payment shall be deemed to be the date the liability for tax arises (and in no event shall be later than the date notice and demand for the tax is made by the Secretary of his delegate).

(d) SUSPENSION OF INTEREST IN CERTAIN INCOME, ESTATE, AND GIFT TAX CASES.—In the case of a deficiency as defined in section 6211 (relating to income, estate, and gift taxes), if a waiver of restrictions under section 6213(d) on the assessment of such deficiency has been filed, and if notice and demand by the Secretary or his delegate for payment of such deficiency is not made within 30 days after the filing of such waiver, interest shall not be imposed on such deficiency for the period beginning immediately after such 30th day and ending with the date of notice and demand.

(e) INCOME TAX REDUCED BY CARRYBACK.—If the amount of any tax imposed by subtitle A is reduced by reason of a carryback of a net operating loss, such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the net operating loss arises.

(f) APPLICABLE RULES.—Except as otherwise provided in this title—

(1) INTEREST TREATED AS TAX.—Interest prescribed under this section on any tax shall be paid upon notice and demand, and shall be assessed, collected, and paid in the same manner as taxes. Any reference in this title (except subchapter B of chapter 63, relating to deficiency procedures) to any tax imposed by this title shall be deemed also to refer to interest imposed by this section on such tax.

(2) NO INTEREST ON INTEREST.—No interest under this section shall be imposed on the interest provided by this section.

(3) INTEREST ON PENALTIES, ADDITIONAL AMOUNTS, OR ADDITIONS TO THE TAX.—Interest shall be imposed under subsection (a) in respect of any assessable penalty, additional amount, or addition to the tax only if such assessable penalty, additional amount, or addition to the tax is not paid within 10 days from the date of notice and demand therefor, and in such case interest shall be imposed only for the period from the date of the notice and demand to the date of payment.

(4) PAYMENTS MADE WITHIN 10 DAYS AFTER NOTICE AND DEMAND.—If notice and demand is made for payment of any amount, and if such amount is paid within 10 days after the date of such notice and demand, interest under this section on the amount so paid shall not be imposed for the period after the date of such notice and demand.

(g) EXCEPTION AS TO ESTIMATED TAX.—This section shall not apply to any failure to pay estimated tax required by section 6153 (or section 59 of the Internal Revenue Code of 1939) or section 6154.

(h) NO INTEREST ON CERTAIN ADJUSTMENTS.—For provisions prohibiting interest on certain adjustments in tax, see section 6205 (a).

§ 301.6601–1 INTEREST ON UNDERPAYMENTS.—(a) *General rule.*—Interest at the rate of 6 percent per annum shall be paid on any unpaid amount of tax from the last date prescribed for payment of the tax (determined without regard to any extension of time for payment) to the date on which payment is received.

(b) *Exception to the general rule.*—In the case of an estate tax—

(1) If an extension of time has been granted, in accordance with section 6161(a)(2), for paying any portion of the tax shown on an estate tax return, or

(2) If the time for payment of the portion of the tax attributable to a reversionary or remainder interest is postponed in accordance with the provisions of section 6163(a),

such portion shall bear interest at the rate of 4 percent per annum from the expiration of 15 months after the date of the decedent's death to the date of the expiration of the period of the extension or postponement or to the date on which payment is received, whichever is earlier. If any part of such portion is paid before the date of the expiration of the period of the extension or postponement, such part shall bear interest only to the date on which payment is received. If, however, the full amount of the tax to which the extension or postponement applies is not paid on or before the date of the expiration of the period of the extension or postponement, the unpaid amount shall bear interest at the rate of 6 percent per annum from the date of the expiration of the period of the extension or postponement to the date on which payment is received.

(c) *Last date prescribed for payment.*—The term "last date prescribed for payment", as used in section 6601 and this section, means the last date prescribed for payment as determined under the provisions of chapter 62 and the following rules:

(1) In determining the last date prescribed for payment, any extension of time granted for payment of tax (including any postponement elected under section 6163(a)) shall be disregarded. The granting of an extension of time for the payment of tax does not relieve the taxpayer from liability for the payment of interest thereon during the period of the extension. Thus, except as provided in paragraph (b) of this section, interest at the rate of 6 percent per annum is payable on any unpaid portion of the tax for the period during which such portion remains unpaid by reason of an extension of time for the payment thereof.

(2) (i) If a tax or portion thereof is payable in installments in accordance with an election made under section 6152(a), the last date prescribed for payment of any installment of such tax or portion thereof shall be determined under the provisions of section 6152(b), and interest shall run on any unpaid installment from such last date to the date on which payment is received. However, in the event installment privileges are terminated by the district director for failure to pay an installment when due as provided by section 6152(d) and the time for the payment of any remaining installment is accelerated by the issuance of a notice and demand therefor, interest shall run on such unpaid installment from the date of the notice and demand to the date on which payment is received. But see section 6601(f)(4).

(ii) If the tax shown on a return is payable in installments, interest will run on any tax not shown on the return from the last date prescribed for payment of the first installment. If a deficiency is prorated to any unpaid installments, in accordance with section 6152(c), interest shall run on such prorated amounts from the date prescribed for the payment of the first installment to the date on which payment is received.

(3) If, by reason of jeopardy, a notice and demand for payment of any tax is issued before the last date otherwise prescribed for payment, such last date shall nevertheless be used for the purpose of the interest computation, and no interest shall be imposed for the period commencing with the date of the issuance of the notice and demand and ending on such last date. If the tax is not paid on or before such last date, interest will automatically accrue from such last date to the date on which payment is received.

(4) In the case of taxes payable by stamp and in all other cases where the last date for payment of the tax is not otherwise prescribed, such last date for the purpose of the interest computation shall be deemed to be the date on which the liability for the tax arose. However, such last date shall in no event be later than the date of issuance by the district director of a notice and demand for the tax.

(d) *Suspension of interest; waiver of restrictions on assessment.*— In the case of a deficiency determined by a district director (or an assistant regional commissioner, appellate) with respect to any income, estate, or gift tax, if the taxpayer files with such internal revenue officer an agreement waiving the restrictions on assessment of such deficiency, and if notice and demand for payment of such deficiency is not made by the district director within 30 days after the filing of such waiver, no interest shall be imposed on the deficiency for the period beginning immediately after such 30th day and ending on the date notice and demand is made by the district director. In the case of an agreement with respect to a portion of the deficiency, the rules as set forth in this paragraph are applicable only to that portion of the deficiency to which the agreement relates.

(e) *Income tax reduced by carryback.*—(1) The carryback of a net operating loss shall not affect the computation of interest on any income tax for the period commencing with the last date prescribed for the payment of such tax and ending with the last day of the taxable year in which the loss occurs. For example, if the carryback of a net operating loss to a prior taxable period eliminates or reduces a deficiency in income tax for that period, the full amount of the deficiency will nevertheless bear interest at the rate of 6 percent per annum from the last date prescribed for payment of such tax until the last day of the taxable year in which the loss occurred. Interest will continue to run beyond such last day on any portion of the deficiency which is not eliminated by the carryback.

(2) Where an extension of time for payment of income tax has been granted under section 6164 to a corporation expecting a carryback, interest is payable at the rate of 6 percent per annum on the amount of such unpaid tax from the last date prescribed for payment thereof without regard to such extension.

(3) Where there has been an allowance of an overpayment attributable to a net operating loss carryback and all or part of such allow-

ance is later determined to be excessive, interest shall be computed on the excessive amount from the last day of the year in which the net operating loss arose until the date on which the repayment of such excessive amount is received.

(f) *Applicable rules.*—(1) Any interest prescribed by section 6601 shall be assessed and collected in the same manner as tax and shall be paid upon notice and demand by the district director. Any reference in the Internal Revenue Code of 1954 (except in subchapter B of chapter 63, relating to deficiency procedures) to any tax imposed by such Code shall be deemed also to refer to the interest imposed by section 6601 on such tax. Interest on a tax may be assessed and collected at any time within the period of limitation on collection after assessment of the tax to which it relates. For rules relating to the period of limitation on collection after assessment, see section 6502.

(2) No interest under section 6601 shall be payable on any interest provided by such section.

(3) Interest shall not be imposed on any assessable penalty, addition to the tax, or additional amount unless such assessable penalty, addition to the tax, or additional amount is not paid within 10 days from the date of notice and demand therefor. If interest is imposed, it shall be imposed only for the period from the date of the notice and demand to the date on which payment is received.

(4) If notice and demand is made for any amount and such amount is paid within 10 days after the date of such notice and demand, interest shall not be imposed for the period after the date of such notice and demand.

(5) No interest shall be imposed for failure to pay estimated tax as required by section 59 of the Internal Revenue Code of 1939 or section 6153 or 6154 of the Internal Revenue Code of 1954.

§ 301.6602 STATUTORY PROVISIONS; INTEREST ON ERRONEOUS REFUND RECOVERABLE BY SUIT.

SEC. 6602. INTEREST ON ERRONEOUS REFUND RECOVERABLE BY SUIT.

Any portion of an internal revenue tax (or any interest, assessable penalty, additional amount, or addition to tax) which has been erroneously refunded, and which is recoverable by suit pursuant to section 7405, shall bear interest at the rate of 6 percent per annum from the date of the payment of the refund.

§ 301.6602–1 INTEREST ON ERRONEOUS REFUND RECOVERABLE BY SUIT.—Any portion of an internal revenue tax (or any interest, assessable penalty, additional amount, or addition to tax) which has been erroneously refunded, and which is recoverable by a civil action pursuant to section 7405, shall bear interest at the rate of 6 percent per annum from the date of the payment of the refund.

Interest on Overpayments

§ 301.6611 STATUTORY PROVISIONS; INTEREST ON OVERPAYMENTS.

SEC. 6611. INTEREST ON OVERPAYMENTS.

(a) RATE.—Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the rate of 6 percent per annum.

(b) PERIOD.—Such interest shall be allowed and paid as follows:

(1) CREDITS.—In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment, then to the date of the assessment of that amount.

(2) REFUNDS.—In the case of a refund, from the date of the overpayment to a date (to be determined by the Secretary or his delegate) preceding the date of the refund check by not more than 30 days, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer. The acceptance of such check shall be without prejudice to any right of the taxpayer to claim any additional overpayment and interest thereon.

(c) ADDITIONAL ASSESSMENT DEFINED.—As used in this section, the term "additional assessment" means a further assessment for a tax of the same character previously paid in part, and includes the assessment of a deficiency (as defined in section 6211).

(d) ADVANCE PAYMENT OF TAX, PAYMENT OF ESTIMATED TAX, AND CREDIT FOR INCOME TAX WITHHOLDING.—The provisions of section 6513 (except the provisions of subsection (c) thereof), applicable in determining the date of payment of tax for purposes of determining the period of limitation on credit or refund, shall be applicable in determining the date of payment for purposes of subsection (a).

(e) INCOME TAX REFUND WITHIN 45 DAYS OF DUE DATE OF TAX.—If any overpayment of tax imposed by subtitle A is refunded within 45 days after the last date prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return), no interest shall be allowed under subsection (a) on such overpayment.

(f) REFUND OF INCOME TAX CAUSED BY CARRYBACK.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a carryback of a net operating loss, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such net operating loss arises.

(g) PROHIBITION OF ADMINISTRATIVE REVIEW.—For prohibition of administrative review, see section 6406.

§ 301.6611–1 INTEREST ON OVERPAYMENTS.—(a) *General rule.*—Except as otherwise provided, interest shall be allowed on any overpayment of any tax at the rate of 6 percent per annum from the date of overpayment of the tax.

(b) *Date of overpayment.*—Except as provided in section 6401(a), relating to assessment and collection after the expiration of the applicable period of limitation, there can be no overpayment of tax until the entire tax liability has been satisfied. Therefore, the dates of overpayment of any tax are the date of payment of the first amount which (when added to previous payments) is in excess of the tax liability (including any interest, addition to the tax, or additional amount) and the dates of payment of all amounts subsequently paid with resepct to such tax liability. For rules relating to the determination of the date of payment in the case of an advance payment of tax, a payment of estimated tax, and a credit for income tax withholding, see paragraph (d) of this section.

(c) *Examples.* The application of paragraph (b) may be illustrated by the following examples:

Example (1). Corporation X files an income tax return on March 15, 1955, for the calendar year 1954 disclosing a tax liability of $1,000 and elects to pay the tax in installments. Subsequent to payment of the final installment, the correct tax liability is determined to be $900.

Tax liability		*Record of payments*	
Assessed	$1,000	March 15, 1955	$500
Correct liability	900	June 15, 1955	500
Overassessment	100		

Since the correct liability in this case is $900, the payment of $500 made on March 15, 1955, and $400 of the payment made on June 15, 1955, are applied in satisfaction of the tax liability. The balance of the payment made on June 15, 1955 ($100), constitutes the amount of the overpayment, and the date on which such payment was made would be the date of the overpayment from which interest would be computed.

Example (2). Corporation Y files an income tax return for the calendar year 1954 on March 15, 1955, disclosing a tax liability of $50,000, and elects to pay the tax in installments. On October 15, 1956, a deficiency in the amount of $10,000 is assessed and is paid in equal amounts on November 15 and November 26, 1956. On April 15, 1957, it is determined that the correct tax liability of the taxpayer for 1954 is only $35,000.

Tax liability		*Record of payments*	
Original assessment	$50,000	March 15, 1955	$25,000
Deficiency assessment	10,000	June 15, 1955	25,000
		November 15, 1956	5,000
Total assessed	60,000	November 26, 1956	5,000
Correct liability	35,000		
Overassessment	25,000		

Since the correct liability in this case is $35,000, the entire payment of $25,000 made on March 15, 1955, and $10,000 of the payment made on June 15, 1955, are applied in satisfaction of the tax liability. The balance of the payment made on June 15, 1955 ($15,000), plus the amounts paid on November 15 ($5,000), and November 26, 1956 ($5,000), constitute the amount of the overpayment. The dates of the overpayments from which interest would be computed are as follows:

Date	*Amount of overpayment*
June 15, 1955	$15,000
November 15, 1956	5,000
November 26, 1956	5,000

The amount of any interest paid with respect to the deficiency of $10,000 is also an overpayment.

(d) *Advance payment of tax, payment of estimated tax, and credit for income tax withholding.*—In the case of an advance payment of tax, a payment of estimated income tax, or a credit for income tax withholding, the provisions of section 6513 (except the provisions of subsection (c) thereof), applicable in determining the date of payment of tax for purposes of the period of limitations on credit or refund, shall apply in determining the date of overpayment for purposes of computing interest thereon.

(e) *Refund of income tax caused by carryback.*—If any overpayment of tax imposed by subtitle A results from a carryback of a net operating loss, such overpayment, for purposes of this section, shall be deemed not to have been made prior to the end of the taxable year in which such loss occurs.

(f) *Period for which interest allowable in case of refunds.*—If an overpayment of tax is refunded, interest shall be allowed from the date of the overpayment to a date determined by the district director, which shall be not more than 30 days prior to the date of the refund check. The acceptance of a refund check shall not deprive the taxpayer of the right to make a claim for any additional overpayment and interest thereon, provided the claim is made within the applicable period of limitation. However, if a taxpayer does not accept a refund check, no additional interest on the amount of the overpayment included in such check shall be allowed.

(g) *Period for which interest allowable in case of credits.*—(1) *General rule.*—If an overpayment of tax is credited, interest shall be allowed from the date of overpayment to the due date (as determined under subparagraph (2) of this paragraph) of the amount against which such overpayment is credited.

(2) *Determination of due date.*—(i) *In general.*—The term "due date", as used in this section, means the last day fixed by law or regulations for the payment of the tax (determined without regard to any extension of time), and not the date on which the district director makes demand for the payment of the tax. Therefore, the due date of a tax (other than an additional assessment of such tax) is the date fixed for the payment of the tax or the several installments thereof.

(ii) *Tax payable in installments.*—(*a*) *In general.*—In the case of a credit against a tax, where the taxpayer had properly elected to pay the tax in installments, the due date is the date prescribed for the payment of the installment against which the credit is applied.

(*b*) *Delinquent installment.*—If the taxpayer is delinquent in payment of an installment of tax and the district director has issued a notice and demand for the payment of the delinquent installment and the remaining installments, the due date of each remaining installment shall then be the date of such notice and demand.

(iii) *Tax or installment not yet due.*—If a taxpayer agrees to the crediting of an overpayment against tax or an installment of tax and the schedule of allowance is signed prior to the date on which such tax or installment would otherwise become due, then the due date of such tax or installment shall be the date on which such schedule is signed.

(iv) *Additional assessment.*—In the case of a credit against an additional assessment, as defined in subparagraph (3) of this paragraph, the due date is the date of the additional assessment.

(v) *Assessed interest.*—In the case of a credit against assessed interest, the due date is the date of the assessment of such interest.

(vi) *Additional amount, addition to the tax, or assessable penalty.*—In the case of a credit against an amount assessed as an additional amount, addition to the tax, or assessable penalty, the due date is the date of the assessment.

(vii) *Estimated income tax for succeeding year.*—If the taxpayer elects to have all or part of the overpayment shown by his return applied to his estimated tax for his succeeding taxable year, no interest shall be allowed on such portion of the overpayment credited and such amount shall be applied as a payment on account of the estimated tax for such year or the installments thereof.

(3) *Definition of additional assessment.*—For purposes of this section, the term "additional assessment" means a further assessment of a tax of the same character previously paid in part, and includes the assessment of a deficiency as defined in section 6211.

(h) *Refund within 45 days.*—If an overpayment of tax imposed by subtitle A is refunded within 45 days after the last date prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return), no interest shall be allowed on such overpayment.

§ 301.6612 STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6612. CROSS REFERENCES.

(a) INTEREST ON JUDGMENTS FOR OVERPAYMENTS.—For interest on judgments for overpayments, see 28 U. S. C. 2411 (a).

(b) ADJUSTMENTS.—For provisions prohibiting interest on certain adjustments in tax, see section 6413(a).

(c) OTHER RESTRICTIONS ON INTEREST.—For other restrictions on interest, see section 2011(c) (relating to refunds due to credit for State taxes), 2014(e) (relating to refunds attributable to foreign tax credits), 6412 (relating to floor stock refunds), 6413(d) (relating to taxes under the Federal Unemployment Tax Act), 6416 (relating to certain taxes on sales and services), 6419 (relating to the excise tax on wagering), 6420 (relating to payments in the case of gasoline used on the farm for farming purposes), and 6421 (relating to payments in case of gasoline used for certain nonhighway purposes or by local transit systems).

[Sec. 6612 as amended by sec. 4(f), Act of April 2, 1956, 70 Stat. 91; sec. 208(e)(7), Highway Revenue Act of 1956, 70 Stat. 397]

GENERAL RULES

Effective Date and Related Provisions

§ 301.7851 STATUTORY PROVISIONS; APPLICABILITY OF REVENUE LAWS.

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(a) GENERAL RULES.—Except as otherwise provided in any section of this title—

* * * * * * *

(6) SUBTITLE F.

(A) GENERAL RULE.—The provisions of subtitle F [inc. chapter 67, relating to interest] shall take effect on the day after the date of enactment of this title and shall be applicable with respect to any tax imposed by this title. * * *

* * * * * * *

[NOTE.—Chapter 67 of the Internal Revenue Code of 1954, relating to interest, is applicable only with respect to the taxes imposed by the 1954 Code. The provisions of the Internal Revenue Code of 1939 relating to interest are applicable with respect to the taxes imposed by the 1939 Code.]

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved May 17, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on May 21, 1957, 8:52 a. m., and published in the issue of the Federal Register for May 22, 1957, 22 F. R. 3559.)

SECTION 6602.—INTEREST ON ERRONEOUS REFUND RECOVERABLE BY SUIT

26 CFR 301.6602: Statutory provisions; interest on erroneous refund recoverable by suit.

Regulations under the Internal Revenue Code of 1954. See T. D. 6234, page 441.

SUBCHAPTER B.—INTEREST ON OVERPAYMENTS

SECTION 6611.—INTEREST ON OVERPAYMENTS

Rev. Rul. 57–82

A refund of Federal income tax transmitted to the General Accounting Office for a set-off against an indebtedness claimed by another Government agency, which claim is subsequently dismissed by a court as groundless, should include additional interest to a date preceding the date of issuance of the Treasury Department refund check by not more than 30 days as provided for by section 6611 of the Code, irrespective of the fact that the amount of refund was paid from appropriations other than Internal Revenue Service funds.

Advice has been requested regarding the computation of interest on an overpayment of income tax under the circumstances set forth below.

A Federal income tax refund allowed a taxpayer was transmitted by the Internal Revenue Service to the General Accounting Office for set-off against an indebtedness claimed by another Government agency. In a subsequent court action brought by the taxpayer, this claim was ruled groundless and dismissed. As a result, the General Accounting Office authorized payment to the taxpayer of the original amount of refund including interest. A Treasury Department check issued upon authority of the General Accounting Office, payable from an appropriation other than that made available to the Internal Revenue Service, was drawn in favor of the taxpayer for the amount of refund including interest only to the date of transmittal of the refund check by the Service to the General Accounting Office.

The taxpayer contends he is entitled to additional interest for the period from the date of transmittal of the check to the General Accounting Office to the date of the refund check actually issued to him.

Section 6611 of the Internal Revenue Code of 1954 relates to interest on overpayments. Subsection (b) (2) thereof provides that in the case of a refund interest shall be allowed and paid from the date of the overpayment to a date (to be determined by the secretary or his delegate) preceding the date of the refund check by not more than 30 days, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer.

In Revenue Ruling 55–477, C. B. 1955–2, 498, it was pointed out that there is no provision of law for the payment of interest on a tax refund for any period subsequent to the date of the refund check. Accordingly, claims for additional interest, which are filed by taxpayers as a result of a delay in the delivery of their refund checks, will be rejected except in cases where the refund check, because it was

erroneously drawn, could not be negotiated upon receipt by the taxpayer. In the latter cases, a new check is issued by the Treasury Department with interest allowable to a date preceding the date of issuance of the new check by not more than 30 days.

In the instant case, the Treasury Department check originally issued was used to credit the taxpayer's account with another Government agency in order to satisfy a claim which later proved to be invalid.

Therefore, under the present facts, the check ultimately issued to the taxpayer under authority of the General Accounting Office does not change the character of the amount paid back as a refund of an overpayment of tax dully allowed under provisions of the Internal Revenue Code. Nor does the fact that the amount of such refund was credited to another Government agency and then paid back from a different account seriously affect its character, since the funds used to credit and debit these accounts were first obtained from the proper Internal Revenue Service appropriation.

Accordingly, the check authorized by the General Accounting Office and paid from an appropriation other than that made available to the Internal Revenue Service constitutes a refund check within the purview of section 6611 of the Code and interest is properly payable under authority of that section to a date 30 days preceding the date of the issuance of the refund check.

(Also Part II, Section 3771.) Rev. Rul. 57–242

A claim filed by a taxpayer pursuant to Revenue Ruling 55–477, C. B. 1955–2, 499, on Form 843, claim, for additional interest on a refund of tax will not protect the taxpayer's rights with respect to the statute of limitations. Since a statutory period of limitations for the allowance and payment of interest on an overpayment of tax is not provided for in the Internal Revenue Code of 1954 (nor in the 1939 Code), it is necessary to look to sections 2401 and 2501 of Title 28 of the United States Code, which provide a six-year period in which suit must be filed. A cause of action for interest on an overpayment of internal revenue tax does not arise and the six-year statute of limitations does not begin to run until the refund is allowed. The date of the allowance of the refund is the date the Commissioner or his delegate signs the schedule on which the overpayment is listed. The allowance of interest under section 6611(b)(2) of the Internal Revenue Code of 1954 from the date of overpayment of the tax to a date not more than 30 days prior to the date of the refund is automatic and is usually made at the time the overpayment is scheduled. Any adjustment of such interest may be allowed and paid upon request at any time within six years from the date the schedule, on which the overpayment is listed, is signed. However, a request filed by a taxpayer on Form 843 does not stop the running of the six-year statute of limitations. The only manner in which a taxpayer can fully protect its rights to interest under section 6611 (b)(2) of the Code is by filing a civil suit against the United States prior to the termination of the six-year statutory period under sections 2401 and 2501 of Title 28 of the United States Code. See Rev. Rul. 56–506, C. B. 1956–2, 959.

Rev. Rul. 57–271

When interest was allowed on an overpayment of tax and was later adjusted for the reason that it was determined to be insufficient, a taxpayer will not be entitled to interest compensating him for the delay in the payment of the amount determined to be additional interest on the overpayment.

Advice has been requested whether, in a case where interest was allowed on an overpayment of tax and was later adjusted for the reason that it was determined to be insufficient, the taxpayer is entitled to receive interest compensating him for the delay in payment of the increase in interest allowable on the overpayment.

In the instant case, interest of $4,000 was allowed on an overpayment of $10,000. The taxpayer protested the computation of the amount of interest on the overpayment as being insufficient. On recomputation an additional amount of $2,000 was allowed and paid to the taxpayer. The taxpayer now requests interest on the additional interest for the period from the date of the original payment to the date of the interest adjustment.

It is a well established legal principle that the allowance of interest by a sovereign is a matter of grace, depending in every instance upon its consent. Thus, no fixed right to interest exists except that which is specifically provided and allowed by statute. See *Boston Sand & Gravel Co.* v. *United States*, 278 U. S. 41.

Section 6611 of the Internal Revenue Code of 1954, relating to interest on overpayments, provides that "Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the rate of 6 percent per annum." The Code in this respect is unambiguous and must be strictly construed. Therefore, there appears to be no authority for the payment of interest on the interest which the statute provides shall be allowed on an overpayment.

Accordingly, it is held that where interest was allowed on an overpayment of tax and was later adjusted for the reason that it was determined to be insufficient, a taxpayer will not be entitled to interest compensating him for the delay in the payment of the amount determined to be additional interest on the overpayment.

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26 CFR 301.6611: Statutory provisions; interest on overpayments.

Regulations under the Internal Revenue Code of 1954. See T. D. 6234, page 441.

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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

Rev. Rul. 57-185

A taxpayer who has received additional income not subject to withholding during the taxable year will have complied with the provisions of section 6654(d)(1)(A) of the Internal Revenue Code of 1954 and no addition to the tax will be made for underpayment of an installment of estimated tax, if the total of all payments of estimated tax made on or before the last date prescribed for the payment of the installment equals or exceeds the amount which the taxpayer would have been required to pay on or before the installment date if his estimated tax were the tax shown on his prior year's return, provided, the return filed for the previous year covers a taxable period of twelve months and shows a liability for tax.

Advice has been requested whether, under the facts shown below, the taxpayer will be subject to an addition to the tax for underpayment of an installment of estimated tax.

The taxpayer and his wife filed a timely joint declaration of estimated tax for the taxable year 1956, basing such estimate on their joint Federal income tax for the calendar year 1955. The declaration of estimated tax for 1956 disclosed that their 1955 income tax was $12,500. Their estimated tax for 1956 was $13,000, the estimated tax to be withheld $5,000, and the overpayment credited from 1955 tax $50, leaving a balance of estimated tax unpaid of $7,950. The amount of $1,950 was paid when the declaration was filed.

Three timely payments of $2,000 were paid on the estimated tax. There was no change in the taxpayers' personal exemptions and $5,000 was actually withheld during the year 1956 from the taxpayer's salary. During the summer of 1956, they received a substantial liquidation distribution from the *X* corporation, which was not considered in making their estimate but which was reported in their 1956 Federal income tax return.

Section 6654(d) of the Internal Revenue Code of 1954 provides, in part, as follows:

(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—

(A) The tax shown on the return of the individual for the preceding taxable year, if a return showing a liability for tax was filed by the individual for the preceding taxable year and such preceding year was a taxable year of 12 months * * *.

Accordingly, it is held that, notwithstanding the fact that an amended declaration was not filed reporting the liquidation distribution, since the total of all payments of estimated tax made on or before

the last date prescribed for the payment of the installment equals or exceeds the amount which the taxpayers would have been required to pay on or before the installment date if their estimated tax was the tax shown on their 1955 return, the taxpayers have complied with the provisions of section 6654(d)(1)(A) of the Code and no addition to the tax for underpayment of an installment may be made.

CHAPTER 70.—JEOPARDY, BANKRUPTCY AND RECEIVERSHIPS

SUBCHAPTER A.—JEOPARDY

PART I.—TERMINATION OF TAXABLE YEAR

SECTION 6851.—TERMINATION OF TAXABLE YEAR

26 CFR 301.6851: Statutory provisions; termination of taxable year.

See T. D. 6227, below.

PART II.—JEOPARDY ASSESSMENTS

SECTION 6861.—JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES

26 CFR 301.6861: Statutory provisions; jeopardy assessments of income, estate, and gift taxes. T. D. 6227 [1]

(Also Sections 6851, 6862, 6871; 301.6862, 301.6871(a).)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Regulations under chapter 70 of the Internal Revenue Code of 1954, relating to jeopardy, bankruptcy and receiverships.

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 6, 1956, notice of proposed rulemaking regarding the regulations under chapter 70 of the Internal Revenue Code of 1954, relating to jeopardy, bankruptcy and receiverships, was published

[1] The publication of this Treasury Decision in 22 F. R. 2123, dated March 30, 1957, contains (1) instructions for modifying the notice of proposed rule making published in 21 F. R. 9656, dated December 6, 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.

in the Federal Register (21 F. R. 9656). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so published have been modified and are hereby adopted as set forth below.

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Effective Date and Related Provisions

AUTHORITY: §§ 301.6851 to 301.6873–1, incl., and 301.7851, issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

The following regulations relating to jeopardy, bankruptcy and receiverships are prescribed under chapter 70 of the Internal Revenue Code of 1954, and except as otherwise specifically provided therein are effective on and after August 17, 1954, and are applicable with respect to taxes imposed under the Internal Revenue Code of 1954:

JEOPARDY, BANKRUPTCY AND RECEIVERSHIPS

Jeopardy

§ 301.6851 STATUTORY PROVISIONS; TERMINATION OF TAXABLE YEAR.

SEC. 6851. TERMINATION OF TAXABLE YEAR.

(a) INCOME TAX IN JEOPARDY—

(1) IN GENERAL.—If the Secretary or his delegate finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the income tax for the current or the preceding taxable year unless such proceedings be brought without delay, the Secretary or his delegate shall declare the taxable period for such taxpayer immediately terminated, and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section, the finding of the Secretary or his delegate, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of jeopardy.

(2) CORPORATION IN LIQUIDATION.—If the Secretary or his delegate finds that the collection of the income tax of a corporation for the current or the preceding taxable year will be jeopardized by the distribution of all or a portion of the assets of such corporation in the liquidation of the whole or any part of its capital stock, the Secretary or his delegate shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such taxes as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable.

(b) REOPENING OF TAXABLE PERIOD.—Notwithstanding the termination of the taxable period of the taxpayer by the Secretary or his delegate, as provided in subsection (a), the Secretary or his delegate may reopen such taxable period each time the taxpayer is found by the Secretary or his delegate to have received income, within the current taxable year, since a termination of the period under subsection (a). A taxable period so terminated by the Secretary or his delegate may be reopened by the taxpayer (other than a nonresident alien) if he files with the Secretary or his delegate a true and accurate return of the items of gross income and of the deductions and credits allowed under this title for such taxable period, together with such other information as the Secretary or his delegate may by regulations prescribe. If the taxpayer is a nonresident alien the taxable period so terminated may be reopened by him if he files, or causes to be filed, with the Secretary or his delegate a true and accurate return of his total income derived from all sources within the United States, in the manner prescribed in this title.

(c) CITIZENS.—In the case of a citizen of the United States or of a possession of the United States about to depart from the United States, the Secretary or his delegate may, at his discretion, waive any or all of the requirements placed on the taxpayer by this section.

(d) DEPARTURE OF ALIEN.—No alien shall depart from the United States unless he first procures from the Secretary or his delegate a certificate that he has complied with all the obligations imposed upon him by the income tax laws.

(e) FURNISHING OF BOND WHERE TAXABLE YEAR IS CLOSED BY THE SECRETARY OR HIS DELEGATE.—Payment of taxes shall not be enforced by any proceedings under the provisions of this section prior to the expiration of the time otherwise allowed for paying such taxes if the taxpayer furnishes, under regulations prescribed by the Secretary or his delegate, a bond to insure the timely making of returns with respect to, and payment of, such taxes or any income or excess profits taxes for prior years.

§ 301.6851–1 TERMINATION OF TAXABLE YEAR.—For regulations under section 6851, see § 1.6851–1 of the Income Tax Regulations, 26 CFR Part 1.

§ 301.6861 STATUTORY PROVISIONS; JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES.

SEC. 6861. JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES—

(a) AUTHORITY FOR MAKING.—If the Secretary or his delegate believes that the assessment or collection of a deficiency, as defined in section 6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213(a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the Secretary or his delegate for the payment thereof.

(b) DEFICIENCY LETTERS.—If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 6212(a), then the Secretary or his delegate shall mail a notice under such subsection within 60 days after the making of the assessment.

(c) AMOUNT ASSESSABLE BEFORE DECISION OF TAX COURT.—The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 6212(c) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Tax Court. The Secretary or his delegate may, at any time before the decision of the Tax Court is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. The Secretary or his delegate shall notify the Tax Court of the amount of such assessment, or abatement, if the petition is filed with the Tax Court before the making of the assessment or is subsequently filed, and the Tax Court shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

(d) AMOUNT ASSESSABLE AFTER DECISION OF TAX COURT.—If the jeopardy assessment is made after the decision of the Tax Court is rendered, such assessment may be made only in respect of the deficiency determined by the Tax Court in its decision.

(e) EXPIRATION OF RIGHT TO ASSESS.—A jeopardy assessment may not be made after the decision of the Tax Court has become final or after the taxpayer has filed a petition for review of the decision of the Tax Court.

(f) COLLECTION OF UNPAID AMOUNTS.—When the petition has been filed with the Tax Court and when the amount which should have been assessed has been determined by a decision of the Tax Court which has become final, then any unpaid portion, the collection of which has been stayed by bond as provided in section 6863(b) shall be collected as part of the tax upon notice and demand from the Secretary or his delegate, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in section 6402, without the filing of claim therefor. If the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the difference shall be assessed and shall be collected as part of the tax upon notice and demand from the Secretary or his delegate.

(g) ABATEMENT IF JEOPARDY DOES NOT EXIST.—The Secretary or his delegate may abate the jeopardy assessment if he finds that jeopardy does not exist. Such abatement may not be made after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with the Tax Court, after the expiration of the period for filing such petition. The period of limitation on the making of assessments and levy or a proceeding in court for collection, in respect of any deficiency, shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the day on which such jeopardy assessment is abated.

(h) CROSS REFERENCES.—

(1) For the effect of the furnishing of security for payment, see section 6863.

(2) For provision permitting immediate levy in case of jeopardy, see section 6331(a).

§ 301.6861–1 JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES.—(a) *Authority for making.*—If a district director believes that the assessment or collection of a deficiency in income, estate, or gift tax will be jeopardized by delay, he is required to assess such deficiency immediately, together with the interest, additional amounts, and additions to the tax provided by law. A jeopardy assessment may be made before or after the mailing of the notice of deficiency provided by section 6212. However, a jeopardy assessment for a taxable year under section 6861 cannot be made after a decision of the Tax Court with respect to such taxable year has become final (see section 7481) or after the taxpayer has filed a petition for review of the decision of the Tax Court with respect to such taxable year. In the case of a deficiency determined by a decision of the Tax Court which has become final or with respect to which the taxpayer has filed a petition for review and has not filed a bond as provided in section 7485, assessment may be made in accordance with the provisions of section 6215, without regard to section 6861.

(b) *Amount of jeopardy assessment.*—If a notice of a deficiency is mailed to the taxpayer before it is discovered that delay would jeopardize the assessment or collection of the tax, a jeopardy assessment may be made in an amount greater or less than that included in the deficiency notice. If a deficiency is assessed on account of jeopardy after the decision of the Tax Court is rendered, the jeopardy assessment may be made only with respect to the deficiency determined by the Tax Court.

(c) *Jurisdiction of Tax Court.*—If the jeopardy assessment is made before the notice in respect of the tax to which the jeopardy assessment relates has been mailed pursuant to section 6212(a), the district director shall, within 60 days after the making of the assessment, send the taxpayer a notice of deficiency pursuant to such subsection. The taxpayer may file a petition with the Tax Court for a redetermination of the amount of the deficiency within the time prescribed in section 6213(a). If the petition of the taxpayer is filed with the Tax Court, either before or after the making of the jeopardy assessment, the Commissioner, through his counsel, is required to notify the Tax Court of such assessment or of any abatement thereof, and the Tax Court has jurisdiction to redetermine the amount of the deficiency, together with all other amounts assessed at the same time in connection therewith.

(d) *Payment and collection of jeopardy assessment.*—After a jeopardy assessment has been made, the district director is required to

send notice and demand to the taxpayer for the amount of the jeopardy assessment. Regardless of whether the taxpayer has filed a petition with the Tax Court, he is required to make payment of the amount of such assessment (to the extent that it has not been abated) within 10 days after the sending of notice and demand by the district director, unless before the expiration of such 10-day period he files with the district director a bond as provided in section 6863. Section 6331 provides that, if the district director makes a finding that the collection of the tax is in jeopardy, he may make demand for immediate payment of the amount of the jeopardy assessment and, in such case, the taxpayer shall immediately pay such amount or shall immediately file the bond provided in section 6863. If a petition is not filed with the Tax Court within the period prescribed in section 6213(a), the district director will be so advised, and, if collection of the deficiency has been stayed by the timely filing of a bond as provided in section 6863, he should then give notice and make demand for payment of the amount assessed plus interest. After the Tax Court has rendered its decision and such decision has become final, the district director will be notified of the action taken. He will then send notice and demand for payment of the unpaid portion of the amount determined by the Tax Court, the collection of which has been stayed by the bond. If the amount of the jeopardy assessment is less than the amount determined by the Tax Court, the difference will be assessed and collected as part of the tax upon notice and demand from the district director. If the amount of the jeopardy assessment is in excess of the amount determined by the Tax Court, the unpaid portion of such excess will be abated. If any part of the excess amount has been paid, it will be credited or refunded to the taxpayer as provided in section 6402, without the filing of claim therefor.

(e) *Abatement of excessive assessment.*—The district director may, at any time before the decision of the Tax Court is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount.

(f) *Abatement if jeopardy does not exist.*—(1) The district director may abate a jeopardy assessment in whole or in part, if it is shown to his satisfaction that jeopardy does not exist. An abatement may not be made under this paragraph after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with such court, after the expiration of the period for filing such petition.

(2) After abatement of a jeopardy assessment in whole or in part, the district director may proceed to assess and collect a deficiency in the manner authorized by law as if the jeopardy assessment or part thereof so abated had not existed. If a notice of deficiency has been sent to the taxpayer before the abatement of the jeopardy assessment in whole or in part, whether such notice was sent before or after the making of the assessment, such abatement will not affect the validity of the notice or of any proceedings for redetermination based thereon. The period of limitation on the making of assessments and the beginning of levy or a proceeding in court for collection in respect of any deficiency shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the

date of such jeopardy assessment until the expiration of the tenth day after the date on which such jeopardy assessment is abated in whole or in part. The provisions of this subparagraph may be illustrated by the following example:

Example.—On March 18, 1958, 28 days before the last day of the 3-year period of limitations on assessment, a jeopardy assessment is made in respect of a proposed deficiency. On May 2, 1958, before the mailing of the notice of deficiency provided by section 6861(b), this assessment is abated. By virtue of this subparagraph, the last day of the period of limitations for the making of an assessment is June 9, 1958, that is, the thirty-eighth day after the date of the abatement. If the notice of deficiency provided for in section 6861(b) had been sent before the abatement, the running of the period of limitations on assessment would have been suspended pursuant to the provisions of section 6503(a).

(3) Request for abatement of a jeopardy assessment, because jeopardy does not exist, shall be filed with the district director, shall state fully the reasons for the request, and shall be supported by such evidence as will enable the district director to determine that the collection of the deficiency is not in jeopardy. See paragraph (e) of this section with respect to the abatement of jeopardy assessments which are excessive in amount.

§ 301.6862 Statutory provisions: jeopardy assessment of taxes other than income, estate, and gift taxes.

SEC. 6862. JEOPARDY ASSESSMENT OF TAXES OTHER THAN INCOME, ESTATE, AND GIFT TAXES.

(a) IMMEDIATE ASSESSMENT.—If the Secretary or his delegate believes that the collection of any tax (other than income tax, estate tax, and gift tax) under any provision of the internal revenue laws will be jeopardized by delay, he shall, whether or not the time otherwise prescribed by law for making return and paying such tax has expired, immediately assess such tax (together with all interests, additional amounts, and additions to the tax provided for by law). Such tax, additions to the tax, and interest shall thereupon become immediately due and payable, and immediate notice and demand shall be made by the Secretary or his delegate for the payment thereof.

(b) IMMEDIATE LEVY.—For provision permitting immediate levy in case of jeopardy, see section 6331(a).

§ 301.6862-1 JEOPARDY ASSESSMENT OF TAXES OTHER THAN INCOME, ESTATE, AND GIFT TAXES.—(a) If the district director believes that the collection of any taxes (other than income, estate, or gift tax) will be jeopardized by delay, he shall, whether or not the time otherwise prescribed by law for filing the return or paying such tax has expired, immediately assess such tax, together with all interest, additional amounts and additions to the tax provided by law. For example, assume that a taxpayer incurs on January 18, 1955, liability for admissions tax imposed by section 4231, that the last day on which return and payment of such tax is required to be made is April 30, 1955, and that on January 18, 1955, the district director determines that collection of such tax would be jeopardized by delay. In such case, the district director shall immediately assess the tax.

(b) The tax, interest, additional amounts, and additions to the tax will, upon assessment, become immediately due and payable, and the district director shall, without delay issue a notice and demand for

payment thereof in full. Upon failure or refusal to pay the amount demanded, collection thereof by levy shall be lawful without regard to the 10-day period provided in section 6331(a). However, the collection of the whole or any part of the amount of the jeopardy assessment may be stayed by timely filing with the district director a bond as provided in section 6863.

§ 301.6863 STATUTORY PROVISIONS: STAY OF COLLECTION OF JEOPARDY ASSESSMENTS.

SEC. 6863. STAY OF COLLECTION OF JEOPARDY ASSESSMENTS.

(a) BOND TO STAY COLLECTION.—When a jeopardy assessment has been made under section 6861 or 6862, the collection of the whole or any amount of such assessment may be stayed by filing with the Secretary or his delegate, within such time as may be fixed by regulations prescribed by the Secretary or his delegate, a bond in an amount equal to the amount as to which the stay is desired, conditioned upon the payment of the amount (together with interest thereon) the collection of which is stayed, at the time at which, but for the making of the jeopardy assessment, such amount would be due. Upon the filing of the bond the collection of so much of the amount assessed as is covered by the bond shall be stayed. The taxpayer shall have the right to waive such stay at any time in respect of the whole or any part of the amount covered by the bond, and if as a result of such waiver any part of the amount covered by the bond is paid, then the bond shall, at the request of the taxpayer, be proportionately reduced. If any portion of the jeopardy assessment is abated, the bond shall, at the request of the taxpayer, be proportionately reduced.

(b) FURTHER CONDITIONS IN CASE OF INCOME, ESTATE, OR GIFT TAXES.—In the case of taxes subject to the jurisdiction of the Tax Court—

(1) PRIOR TO PETITION TO TAX COURT.—If the bond is given before the taxpayer has filed his petition under section 6213(a), the bond shall contain a further condition that if a petition is not filed within the period provided in such section, then the amount, the collection of which is stayed by the bond, will be paid on notice and demand at any time after the expiration of such period, together with interest thereon from the date of the jeopardy notice and demand to the date of notice and demand under this paragraph.

(2) EFFECT OF TAX COURT DECISION.—The bond shall be conditioned upon the payment of so much of such assessment (collection of which is stayed by the bond) as is not abated by a decision of the Tax Court which has become final. If the Tax Court determines that the amount assessed is greater than the amount which should have been assessed, then when the decision of the Tax Court is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.

(3) STAY OF SALE OF SEIZED PROPERTY PENDING TAX COURT DECISION.—

(A) GENERAL RULE.—Where, notwithstanding the provisions of section 6213(a), a jeopardy assessment has been made under section 6861 the property seized for the collection of the tax shall shall not be sold—

(i) if section 6861(b) is applicable, prior to the issuance of the notice of deficiency and the expiration of the time provided in section 6213(a) for filing petition with the Tax Court, and

(ii) if petition is filed with the Tax Court (whether before or after the making of such jeopardy assessment under section 6861), prior to the expiration of the period during which the assessment of the deficiency would be prohibited if section 6861(a) were not applicable.

(B) EXCEPTIONS.—Such property may be sold if—

(i) the taxpayer consents to the sale,

(ii) the Secretary or his delegate determines that the expenses of conservation and maintenance will greatly reduce the net proceeds, or

(iii) the property is of the type described in section 6336.

(C) APPLICABILITY.—Subparagraphs (A) and (B) shall be applicable only with respect to a jeopardy assessment made on or after January 1, 1955, and shall apply with respect to taxes imposed by this title and with respect to taxes imposed by the Internal Revenue Code of 1939.

§ 301.6863–1 STAY OF COLLECTION OF JEOPARDY ASSESSMENTS: BOND TO STAY COLLECTION.—(a) *General rule.*—(1) The collection of a jeopardy assessment of any tax may be stayed by filing with the district director a bond on the form to be furnished by the district director upon request.

(2) The bond may be filed—

(i) At any time before the time collection by levy is authorized under section 6331(a), or

(ii) After collection by levy is authorized and before levy is made on any property or rights to property, or

(iii) In the discretion of the district director, after any such levy has been made and before the expiration of the period of limitations on collection.

(3) The bond must be in an amount equal to the portion (including interest thereon to the date of payment as calculated by the district director) of the jeopardy assessment collection of which is sought to be stayed. See section 7101 and the regulations thereunder, relating to the form of bond and the sureties thereon. The bond shall be conditioned upon the payment of the amount (together with interest thereon), the collection of which is stayed, at the time at which, but for the making of the jeopardy assessment, such amount would be due.

(4) Upon the filing of a bond in accordance with this section, the collection of so much of the assessment as is covered by the bond will be stayed. The taxpayer may at any time waive the stay of collection of the whole or any part of the amount covered by the bond. If as a result of such waiver any part of the amount covered by the bond is paid, or if any portion of the jeopardy assessment is abated by the district director, then the bond shall at the request of the taxpayer be proportionately reduced.

(b) *Additional conditions applicable to income, estate, and gift tax assessment.*—In the case of a jeopardy assessment of income, estate, or gift tax, the bond must be conditioned upon the payment of so much of the amount included therein as is not abated by a decision of the Tax Court which has become final, together with the interest on such amount. If the Tax Court determines that the amount assessed is greater than the correct amount of the tax, the bond will be proportionately reduced at the request of the taxpayer after the Tax Court renders its decision. If the bond is given before the taxpayer has filed his petition with the Tax Court, it must contain a further condition that if a petition is not filed before the expiration of the period provided in section 6213(a) for the filing of such petition, the amount stayed by the bond will be paid upon notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 percent per annum from the date of the jeopardy notice and

demand to the date of the notice and demand made after the expiration of the period for filing petition with the Tax Court.

§ 301.6863–2 COLLECTION OF JEOPARDY ASSESSMENT; STAY OF SALE OF SEIZED PROPERTY PENDING TAX COURT DECISION.—(a) *General rule.*—In the case of a jeopardy assessment made after December 31, 1954, of income, estate, or gift tax imposed by the Internal Revenue Code of 1954 or 1939, any property seized for the collection of such assessment shall not (except as provided in paragraph (b) of this section) be sold—

(1) Until the expiration of the period provided in section 6213(a) within which the taxpayer may file a petition for redetermination with the Tax Court, and

(2) If a petition for redetermination is filed with the Tax Court (whether before or after the making of the jeopardy assessment), until the decision of the Tax Court becomes final, except that a petition for review of the Tax Court decision will not operate as a further stay of the sale of the seized property unless the taxpayer files a bond as provided in section 7485.

(b) *Exceptions.*—Notwithstanding the provisions of paragraph (a) of this section, any property seized may be sold—

(1) If the taxpayer files with the district director a written consent to the sale, or

(2) If the district director determines that the expenses of conservation and maintenance of the property will greatly reduce the net proceeds from the sale of such property, or

(3) If the property is of a type to which section 6336 (relating to sale of perishable goods) is applicable.

§ 301.6864 STATUTORY PROVISIONS: TERMINATION OF EXTENDED PERIOD FOR PAYMENT IN CASE OF CARRYBACK.

SEC. 6864. TERMINATION OF EXTENDED PERIOD FOR PAYMENT IN CASE OF CARRYBACK.

For termination of extensions of time for payment of income tax granted to corporations expecting carrybacks in case of jeopardy, see section 6164(h).

Bankruptcy and Receiverships

§ 301.6871(a) STATUTORY PROVISIONS; CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEEDINGS.

SEC. 6871. CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEDINGS.

(a) IMMEDIATE ASSESSMENT.—Upon the adjudication of bankruptcy of any taxpayer in any liquidating proceeding, the approval of a petition of, or against, any taxpayer in any other bankruptcy proceeding, or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency (together with all interest, additional amounts, or additions to the tax provided by law) determined by the Secretary or his delegate in respect of a tax imposed by subtitle A or B upon such taxpayer shall, despite the restrictions imposed by section 6213(a) upon assessments, be immediately assessed if such deficiency has not theretofore been assessed in accordance with law.

§ 301.6871(a)-1 IMMEDIATE ASSESSMENT OF CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEEDINGS.—(a) Upon the adjudication of bankruptcy of any taxpayer in any liquidating proceeding, or the approval of a petition of, or against, any taxpayer in any other proceeding under the Bankruptcy Act, or the appointment of any receiver for any taxpayer in a receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, the district director shall immediately assess any deficiency of income, estate, or gift tax (together with all interest, additional amounts, or additions to the tax provided by law), determined by him, if such deficiency has not theretofore been assessed in accordance with law. Such assessment shall be made immediately, whether or not a notice of deficiency has been issued, and without regard to the restrictions upon assessments under section 6213.

(b) As used in this section and §§ 301.6871(a)-2 to 301.6873-1, inclusive, (1) the term "proceeding under the Bankruptcy Act" includes a proceeding under chapters I to VII, inclusive, of the Bankruptcy Act (11 U. S. C. cc. I–VII), or under section 75 or 77, or chapters X to XIII, inclusive, of such Act, or any other proceeding under the Act; and (2) the term "approval of a petition * * * in any other proceeding under the Bankruptcy Act" includes the filing of a petition under section 75 or chapters XI to XIII, inclusive, of the Bankruptcy Act with a court of competent jurisdiction.

§ 301.6871(a)-2 COLLECTION OF ASSESSED TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEEDINGS.—(a) During a proceeding under the Bankruptcy Act or a receivership proceeding in either a Federal or State court, generally the assets of the taxpayer are under the control of the court in which such proceeding is pending, and the collection of taxes cannot be made by levying upon such assets. However, any assets which under applicable provisions of law are not under the control of the court may be subject to levy. See paragraph (b) of this section and § 301.6871(b)-1 with respect to claims for such taxes. See section 6873 with respect to collection of unpaid claims.

(b) District directors should, promptly after ascertaining the existence of any outstanding liability against a taxpayer in any proceeding under the Bankruptcy Act or in any receivership proceeding, and in any event within the time limited by the appropriate provisions of the Bankruptcy Act, or by the appropriate orders of the court in which such proceeding is pending, file proof of claim covering such liability in the court in which such proceeding is pending. Such proof of claim should be filed whether the unpaid taxes involved have been assessed or not, except in cases where the instructions of the Commissioner direct otherwise; for example where the payment of the taxes is secured by a sufficient bond. At the same time proof of claim is filed with the bankruptcy or receivership court, the district director will send notice and demand for payment to the taxpayer, together with a copy of such proof of claim.

(c) Under sections 3466 and 3467 of the Revised Statutes and section 64 of the Bankruptcy Act, taxes are entitled to the priority over other claims therein specified, and the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the proceeding under the Bankruptcy

Act or receivership proceeding is pending, may be held personally liable for failure on his part to protect the priority of the Government respecting taxes of which he has notice. Sections 75(1), 77(e), 199, 337(2), 455, and 659(6) of the Bankruptcy Act (11 U. S. C. 203(1), 205(e), 599, 737(2), 855, and 1059(6)) also contain provisions with respect to the rights of the United States relative to priority of payment. For the filing of returns by a trustee in bankruptcy or by a receiver, see section 6012(b)(3) and 28 U. S. C. 960. Bankruptcy courts have jurisdiction under the Bankruptcy Act to determine all disputes regarding the amount and validity of taxes claimed in a proceeding under the Bankruptcy Act. A proceeding under the Bankruptcy Act or receivership proceedings does not discharge any portion of a claim of the United States for taxes except in the case of a proceeding under section 77 or chapter X of the Bankruptcy Act. However, the claim may be settled or compromised as in other cases in court.

(d) For the requirement that a receiver, trustee in bankruptcy, or other like fiduciary give notice as to his qualification as such, see section 6036 and the regulations thereunder.

§ 301.6871(b) STATUTORY PROVISIONS; CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEEDINGS.

SEC. 6871. CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEEDINGS. * * *

(b) CLAIM FILED DESPITE PENDENCY OF TAX COURT PROCEEDINGS.—In the case of a tax imposed by subtitle A or B claims for the deficiency and such interest, additional amounts, and additions to the tax may be presented, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the deficiency in pursuance of a petition to the Tax Court; but no petition for any such redetermination shall be filed with the Tax Court after the adjudication of bankruptcy, approval of the petition in any other bankruptcy proceeding, or the appointment of the receiver.

§ 301.6871(b)-1 CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN PROCEEDINGS UNDER THE BANKRUPTCY ACT AND RECEIVERSHIP PROCEEDINGS; CLAIM FILED DESPITE PENDENCY OF TAX COURT PROCEEDINGS.—(a) If the district director has determined that a deficiency is due in respect of income, estate, or gift tax and the taxpayer has filed a petition with the Tax Court before the adjudication of bankruptcy in any liquidating proceeding or before the approval of a petition in any other proceeding under the Bankruptcy Act or before the appointment of a receiver, the trustee, receiver, debtor in possession, or other like fiduciary, may, upon his own motion, be made a party to the Tax Court proceeding and thereafter may prosecute the appeal before the Tax Court as to that particular determination. No petition shall be filed with the Tax Court for a redetermination of the deficiency after the adjudication of bankruptcy in a liquidating proceeding or after the approval of a petition in any other proceeding under the Bankruptcy Act or after the appointment of a receiver.

(b) Even though the determination of a deficiency is pending before the Tax Court for redetermination, proof of claim for the amount of such deficiency may be filed with the court in which the proceeding under the Bankruptcy Act or receivership proceeding

is pending without awaiting final decision of the Tax Court. In case of a final decision of the Tax Court before the payment or the disallowance of the claim in the proceeding under the Bankruptcy Act or receivership proceeding, a copy of the Tax Court's decision may be filed by the district director with the court in which such proceeding is pending.

(c) While a district director is required by section 6871(a) to make immediate assessment of any deficiency, such assessment is not made as a jeopardy assessment within the meaning of section 6861, and consequently the provisions of that section do not apply to any assessment made under section 6871. Therefore, the notice of deficiency provided in section 6861(b) will not be mailed. Although such notice will not be issued, a letter will be sent to the taxpayer or to the trustee, receiver, debtor in possession, or other like fiduciary, notifying him in detail how the deficiency was computed, that he may furnish evidence showing wherein the deficiency is incorrect, and that upon request he will be granted a conference by the district director with respect to such deficiency. However, such letter will not provide for such a conference where a petition was filed with the Tax Court before the adjudication of bankruptcy in a liquidating proceeding, before the approval of a petition in any other proceeding under the Bankruptcy Act, or before the appointment of a receiver.

§ 301.6872 STATUTORY PROVISIONS: SUSPENSION OF PERIOD ON ASSESSMENT.

SEC. 6872. SUSPENSION OF PERIOD ON ASSESSMENT.

If the regulations issued pursuant to section 6036 require the giving of notice by any fiduciary in any proceeding under the Bankruptcy Act, or by a receiver in any other court proceeding, to the Secretary or his delegate of his qualification as such, the running of the period of limitations on the making of assessments shall be suspended for the period from the date of the institution of the proceeding to a date 30 days after the date upon which the notice from the receiver or other fiduciary is received by the Secretary or his delegate; but the suspension under this sentence shall in no case be for a period in excess of 2 years.

§ 301.6872–1 SUSPENSION OF RUNNING OF PERIOD OF LIMITATIONS ON ASSESSMENT.—If any fiduciary in any proceeding under the Bankruptcy Act (including a trustee, receiver, or debtor in possession) or a receiver in any other court proceeding is required, pursuant to section 6036, to give notice in writing to the district director of his qualification as such, then the running of the period of limitations on assessment shall be suspended from the date the proceeding is instituted to the date such notice is received by the district director, and for an additional 30 days thereafter. However, the suspension under this section of the running of the period of limitation on assessment shall in no case exceed 2 years.

§ 301.6873 STATUTORY PROVISIONS: UNPAID CLAIMS.

SEC. 6873. UNPAID CLAIMS.

(a) GENERAL RULE.—Any portion of a claim for taxes allowed in a receivership proceeding or any proceeding under the Bankruptcy Act which is unpaid shall be paid by the taxpayer upon notice and demand from the Secretary or his delegate after the termination of such proceeding.

(b) CROSS REFERENCES. (1) For suspension of running of period of limitations on collection, see section 6503(b).

(2) For extension of time for payment, see section 6161(c).

§ 301.6873-1 UNPAID CLAIMS IN BANKRUPTCY OR RECEIVERSHIP PROCEEDINGS.—(a) If any portion of the claim allowed by the court in a receivership proceeding, or in any proceeding under the Bankruptcy Act, remains unpaid after the termination of such proceeding, the district director will send notice and demand for payment thereof to the taxpayer. Such unpaid portion with interest as provided in section 6601 may be collected from the taxpayer by levy or proceeding in court within the period of limitation for collection after assessment. For the general rule as to such period of limitation, see section 6502, and for suspensions of the running of the period provided in section 6502, see, for example, section 6503. For suspensions under other provisions of law, see, for example, section 11f of the Bankruptcy Act (11 U. S. C. 29(f)). Extension of time for the payment of such unpaid amount may be granted in the same manner and subject to the same provisions and limitations as provided in section 6161(c).

(b) Section 6873 is applicable only where a claim for taxes is allowed in a receivership proceeding or in a proceeding under the Bankruptcy Act. Claims for taxes, interest, additional amounts, or additions to the tax may be collectible in equity or under other provisions of law although no claim was allowed in the proceeding because for example, such items were not included in a proof of claim filed in the proceeding or no proof of claim was filed. Except in the case of a proceeding under section 77 or chapter X of the Bankruptcy Act, a tax or a liability in respect thereof is not discharged by a proceeding under such Act, whether or not a claim is filed in such proceeding, and provisions suspending the running of the period of limitation on the collection of taxes are applicable, whether or not a claim is filed in such proceeding.

GENERAL RULES

Effective Date and Related Provisions

§ 301.7851 STATUTORY PROVISIONS; APPLICABILITY OF REVENUE LAWS.

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(a) GENERAL RULES.—Except as otherwise provided in any section of this title—

* * * * * * *

(6) Subtitle F.

(A) GENERAL RULE.—The provisions of subtitle F [including chapter 70, relating to jeopardy, bankruptcy and receiverships] shall take effect on the day after the date of enactment of this title and shall be applicable with respect to any tax imposed by this title. * * *

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RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved Mar. 27, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on March 29, 1957, 8:49 a. m., and published in the issue of the Federal Register for March 30, 1957, 22 F. R. 2123).

SECTION 6862.—JEOPARDY ASSESSMENT OF TAXES OTHER THAN INCOME, ESTATE, AND GIFT TAXES

26 CFR 301.6862: Statutory provisions: jeopardy assessment of taxes other than income, estate, and gift taxes.

Regulations under the Internal Revenue Code of 1954. See T. D. 6227, page 455.

SUBCHAPTER B.—BANKRUPTCY AND RECEIVERSHIPS

SECTION 6871.—CLAIMS FOR INCOME, ESTATE, AND GIFT TAXES IN BANKRUPTCY AND RECEIVERSHIP PROCEEDINGS

26 CFR 301.6871(a): Statutory provisions: claims for income, estate, and gift taxes in bankruptcy and receivership proceedings.

Regulations under the Internal Revenue Code of 1954. See T. D. 6227, page 455.

CHAPTER 77.—MISCELLANEOUS PROVISIONS

SECTION 7501.—LIABILITY FOR TAXES WITHHELD OR COLLECTED

26 CFR 301.7501: Statutory provisions; liability for taxes withheld or collected. T. D. 6232 [1]
(Also Sections 7502 through 7511; 301.7502 through 301.7511.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

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

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

On February 1, 1957, notice of proposed rulemaking regarding the regulations under chapter 77 of the Internal Revenue Code of 1954, relating to miscellaneous provisions, was published in the Federal Register (22 F. R. 670). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the regulations as so published have been modified and are hereby adopted as set forth below. Except as otherwise specifically provided therein, such regulations shall be effective on and after August 17, 1954,

[1] The publication of this Treasury Decision in 22 F. R. 3143, dated May 3, 1957, contains (1) instructions for modifying the notice of proposed rulemaking published in 22 F. R. 670, dated February 1, 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.

and shall apply with respect to any tax imposed by the Internal Revenue Code of 1954 or a prior internal revenue law.

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MISCELLANEOUS PROVISIONS

GENERAL RULES

Effective Date and Related Provisions

AUTHORITY: §§ 301.7501 to 301.7511, incl., and 301.7851, issued under sec. 7805, I. R. C. 1954; 68A Stat. 917; 26 U. S. C. 7805.

MISCELLANEOUS PROVISIONS

§ 301.7501 STATUTORY PROVISIONS; LIABILITY FOR TAXES WITHHELD OR COLLECTED.

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) GENERAL RULE.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same

manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(b) PENALTIES.—For penalties applicable to violations of this section, see sections 6672 and 7202.

§ 301.7502 STATUTORY PROVISIONS; TIMELY MAILING TREATED AS TIMELY FILING.

SEC. 7502. TIMELY MAILING TREATED AS TIMELY FILING.

(a) GENERAL RULE.—If any claim, statement, or other document (other than a return or other document required under authority of chapter 61), required to be filed within a prescribed period or on or before a prescribed date under authority of any provision of the internal revenue laws is, after such period or such date, delivered by United States mail to the agency, officer, or office with which such claim, statement, or other document is required to be filed, the date of the United States postmark stamped on the cover in which such claim, statement, or other document is mailed shall be deemed to be the date of delivery. This subsection shall apply only if the postmark date falls within the prescribed period or on or before the prescribed date for the filing of the claim, statement, or other document, determined with regard to any extension granted for such filing, and only if the claim, statement, or other document was, within the prescribed time, deposited in the mail in the United States in an envelope or other appropriate wrapper, postage prepaid, properly addressed to the agency, office, or officer with which the claim, statement, or other document is required to be filed.

(b) STAMP MACHINE.—This section shall apply in the case of postmarks not made by the United States Post Office only if and to the extent provided by regulations prescribed by the Secretary or his delegate.

(c) REGISTERED MAIL.—If any such claim, statement, or other document is sent by United States registered mail, such registration shall be prima facie evidence that the claim, statement, or other document was delivered to the agency, office, or officer to which addressed, and the date of registration shall be deemed the postmark date.

(d) EXCEPTION.—This section shall not apply with respect to the filing of a document in any court other than the Tax Court.

§ 301.7502–1 TIMELY MAILING TREATED AS TIMELY FILING.—(a) *General rule.*—Section 7502 provides that, if the requirements of such section are met, a document shall be deemed to be filed on the date of the postmark stamped on the cover in which such document was mailed. Thus, if the cover containing such document bears a timely postmark, the document will be considered filed timely although it is received after the last date, or the last day of the period, prescribed for filing such document. Section 7502 does not apply to the payment of any tax. Section 7502 is applicable only to those documents which come within the definition of such term provided by paragraph (b) of this section and only if the document is mailed in accordance with paragraph (c) of this section and is delivered in accordance with paragraph (d) of this section.

(b) *Document defined.*—(1) The term "document", as used in this section, means any claim, statement, or other document required to be filed within a prescribed period or on or before a prescribed date under authority of any provision of the internal revenue laws, except as provided in the following subdivisions of this subparagraph:

(i) The term does not include any return required under authority of any internal revenue law or any other document required under authority of chapter 61. Thus, for example, such term does not include the income tax returns required by section 6012, the declarations

of estimated income tax by individuals and corporations required by sections 6015 and 6016, and the estate tax and gift tax returns required by sections 6018 and 6019. Nor does the term include any return required under authority of subtitle E, relating to alcohol, tobacco, and certain other excise taxes.

(ii) The term does not include any document filed in any court other than the Tax Court, but the term does include any document filed with the Tax Court, including a petition for redetermination of a deficiency and a petition for review of a decision of the Tax Court.

(iii) The term does not include any document which is required to be filed with a bank or other depositary pursuant to section 6302(c).

(2) A return may contain, or have attached to it, a statement which sets forth an election under the internal revenue laws. In such a case, section 7502 is applicable to the statement if the conditions of such section are met, although it does not apply to the return. Moreover, in the case of certain taxes, a return may constitute a claim for refund or credit. In such a case, section 7502 is applicable to the claim for refund or credit if the conditions of such section are met, irrespective of whether the claim is also a return.

(c) *Mailing requirements.*—(1) Section 7502 is not applicable unless the document is mailed in accordance with the following requirements:

(i) The document must be contained in an envelope or other appropriate wrapper, properly addressed to the agency, officer, or office with which the document is required to be filed.

(ii) The document must be deposited within the prescribed time in the mail in the United States with sufficient postage prepaid. For this purpose, a document is deposited in the mail in the United States when it is deposited with the domestic mail service of the United States Post Office. The domestic mail service of the United States Post Office, as defined by the postal regulations, includes mail trnasmitted within, among, and between the United States, its Territories and possessions, and Army-Air Force (APO) and Navy (FPO) post offices (see 39 CFR 2.1). Section 7502 does not apply to any document which is deposited with the mail service of any other country.

(iii) (*a*) If the postmark on the envelope or wrapper is made by the United States Post Office, such postmark must bear a date on or before the last date, or the last day of the period, prescribed for filing the document. If the postmark does not bear a date on or before the last date, or the last day of the period, prescribed for filing the document, the document will be considered not to be filed timely, regardless of when the document is deposited in the mail. Acordingly, the sender who relies upon the applicability of section 7502 assumes the risk that the postmark will bear a date on or before the last date, or the last day of the period, prescribed for filing the document, but see subparagraph (2) of this paragraph with respect to the use of registered mail to avoid this risk. If the postmark on the envelope or wrapper is not legible, the person who is required to file the document has the burden of proving the time when the postmark was made.

(*b*) If the postmark on the envelope or wrapper is made other than by the United States Post Office, (*1*) the postmark so made must bear a date on or before the last date, or the last day of the period, prescribed for filing the document, and (*2*) the document must be received by the

agency, officer, or office with which it is required to be filed not later than the time when a document contained in an envelope or other appropriate wrapper which is properly addressed and mailed and sent by the same class of mail would ordinarily be received if it were postmarked at the same point of origin by the United States Post Office on the last date, or the last day of the period, prescribed for filing the document. However, in case the document is received after the time when a document so mailed and so postmarked by the United States Post Office would ordinarily be received, such document will be treated as having been received at the time when a document so mailed and so postmarked would ordinarily be received, if the person who is required to file the document establishes (*i*) that it was actually deposited in the mail before the last collection of the mail from the place of deposit which was postmarked (except for the metered mail) by the United States Post Office on or before the last date, or the last day of the period, prescribed for filing the document, (*ii*) that the delay in receiving the document was due to a delay in the transmission of the mail, and (*iii*) the cause of such delay. If the envelope has a postmark made by the United States Post Office in addition to the postmark not so made, the postmark which was not made by the United States Post Office shall be disregarded, and whether the envelope was mailed in accordance with this subdivision shall be determined solely by applying the rule of (*a*) of this subdivision.

(2) If the document is sent by United States registered mail, the date of registration of the document shall be treated as the postmark date. Accordingly, the risk that the document will not be postmarked on the day that it is deposited in the mail may be overcome by the use of registered mail.

(3) As used in this section, the term "the last date, or the last day of the period, prescribed for filing the document" includes any extension of time granted for such filing. When the last date, or the last day of the period, prescribed for filing the document falls on a Saturday, Sunday, or legal holiday, section 7503 is also applicable, so that, in applying the rules of this paragraph, the next succeeding day which is not a Saturday, Sunday or legal holiday shall be treated as the last date, or the last day of the period, prescribed for filing the document.

(d) *Delivery.*—(1) Section 7502 is not applicable unless the document is delivered by United States mail to the agency, officer, or office with which it is required to be filed. However, if the document is sent by registered mail, proof that the document was properly registered and that the envelope or wrapper was properly addressed to such agency, officer, or office shall constitute prima facie evidence that the document was delivered to such agency, officer, or office.

(2) Section 7502 is applicable only when the document is delivered after the last date, or the last day of the period, prescribed for filing the document. However, section 7502 is also applicable when a claim for credit or refund is delivered after the last day of the period specified in section 322(b)(2) of the Internal Revenue Code of 1939 or in any other corresponding provision of law relating to the limit on the amount of credit or refund that is allowable. For example, taxpayer A was required to file his income tax return for 1953 on or before March 15, 1954, but he secured an extension until June 15, 1954 to file such return. His return was filed on June 15, 1954, but no tax was paid

at such time because the tax liability disclosed by the return had been completely satisfied by the income tax that had been withheld on his wages and by the payments of estimated tax. On March 14, 1957, A mailed in accordance with the requirements of this section a claim for refund of a portion of his 1953 tax. The envelope containing the claim was postmarked on such day, but it was not delivered to the district director's office until March 18, 1957. Under section 322(b)(1) of the Internal Revenue Code of 1939, A's claim for refund is timely if filed within three years from June 15, 1954. However, as a result of the limitation of section 322(b)(2) of the 1939 code, if his claim is not filed within three years after March 15, 1954, the date on which he is deemed under section 322(e) of the 1939 Code to have paid his 1953 tax, he is not entitled to any refund. Thus, since A's claim for refund was mailed in accordance with the requirements of this section and was delivered after the last day of the period specified in such section 322(b)(2), section 7502 is applicable, and the claim is deemed to have been filed on March 14, 1957.

(e) *Applicability.*—Section 7502 and this section are applicable with respect to any document which is mailed and delivered in accordance with the requirements of this section and which is mailed in an envelope having a postmark bearing a date after August 16, 1954, irrespective of whether the postmark is made by the United States Post Office, and irrespective of whether the tax to which the document pertains is imposed by the Internal Revenue Code of 1954 or a prior internal revenue law.

§ 301.7503 STATUTORY PROVISIONS; TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY, OR LEGAL HOLIDAY.

SEC. 7503. TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY, OR LEGAL HOLIDAY.

When the last day prescribed under authority of the internal revenue laws for performing any act falls on Saturday, Sunday, or a legal holiday, the performance of such act shall be considered timely if it is performed on the next succeeding day which is not a Saturday, Sunday, or a legal holiday. For purposes of this section, the last day for the performance of any act shall be determined by including any authorized extension of time; the term "legal holiday" means a legal holiday in the District of Columbia; and in the case of any return, statement, or other document required to be filed, or any other act required under authority of the internal revenue laws to be performed, at any office of the Secretary or his delegate, or at any other office of the United States or any agency thereof, located outside the District of Columbia but within an internal revenue district, the term "legal holiday" also means a Statewide legal holiday in the State where such office is located.

§ 301.7503-1 TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY, OR LEGAL HOLIDAY.—(a) *In general.*—Section 7503 provides that when the last day prescribed under authority of any internal revenue law for the performance of any act falls on a Saturday, Sunday, or legal holiday, such act shall be considered performed timely if performed on the next succeeding day which is not a Saturday, Sunday, or legal holiday. For this purpose, any authorized extension of time shall be included in determining the last day for performance of any act. Section 7503 is applicable only in case an act is required under authority of any internal revenue law to be performed on or before a prescribed date or within a prescribed

period. For example, if the 2-year period allowed by section 6532 (a) (1) to bring a suit for refund of any internal revenue tax expires on Thursday, November 22, 1956 (Thanksgiving Day), the suit will be timely if filed on Friday, November 23, 1956, in the Court of Claims, or in a district court. Section 7503 applies to acts to be performed by the taxpayer (such as, the filing of any return of, and the payment of, any income, estate, or gift tax; the filing of a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by such Court; the filing of a claim for credit or refund of any tax) and acts to be performed by the Commissioner or a district director (such as, the giving of any notice with respect to, or making any demand for the payment of, any tax; the assessment or collection of any tax).

(b) *Legal holiday.*—(1) For the purpose of section 7503, the term "legal holiday" includes the legal holidays in the District of Columbia. Such legal holidays are—

(i) January 1, New Year's Day (D. C. Code, Title 28, sec. 616),

(ii) January 20, when such day is Inauguration Day (D. C. Code, Title 28, sec. 616),

(iii) February 22, Washington's Birthday (D. C. Code, Title 28, sec. 616),

(iv) May 30, Memorial Day (D. C. Code, Title 28, sec. 616),

(v) July 4, Independence Day (D. C. Code, Title 28, sec. 616),

(vi) First Monday in September, Labor Day (5 U.S.C. 87),

(vii) November 11, Veterans' Day (5 U.S.C. 87a, as amended),

(viii) Fourth Thursday in November, Thanksgiving Day (5 U.S.C. 87b), and

(ix) December 25, Christmas Day (D.C. Code Title 28, sec. 616).

When a legal holiday in the District of Columbia falls on a Sunday, the next day is a legal holiday in the District of Columbia (see D. C. Code, Title 28, sec. 616).

(2) In the case of any return, statement, or other document required to be filed, or any other act required under the authority of the internal revenue laws to be performed, at any office of the Internal Revenue Service, or any office or agency of the United States, located outside the District of Columbia, but within an internal revenue district, the term "legal holiday" includes, in addition to the legal holidays enumerated in subparagraph (1) of this paragraph, any State-wide legal holiday of the State where the act is required to be performed. If the act is performed in accordance with law at an office of the Internal Revenue Service or any other office or agency of the United States located in a Territory or possession of the United States, the term "legal holiday" includes, in addition to the legal holidays described in subparagraph (1) of this paragraph, any legal holiday which is recognized throughout the Territory or possession in which the office is located. Accordingly, if a resident of Alaska files his return with the District Director at Seattle, Washington, the extension provided by section 7503 is applicable in case the last day for filing the return is a legal holiday in the District of Columbia or in the State of Washington. However, if he files his return with an office of the Internal Revenue Service

located in Alaska, such extension is applicable in case the last day for filing the return is a legal holiday in the District of Columbia or in Alaska.

(c) *Applicability.*—Section 7503 and this section are applicable in any case when the last day prescribed under authority of any internal revenue law for the performance of any act falls on a Saturday, Sunday, or legal holiday, which occurs after August 16, 1954, irrespective of whether the tax in connection with which the act is required to be performed is imposed by this title or a prior internal revenue law.

§ 301.7504 STATUTORY PROVISIONS; FRACTIONAL PARTS OF A DOLLAR,

SEC. 7504. FRACTIONAL PARTS OF A DOLLAR.

The Secretary or his delegate may by regulations provide that in the allowance of any amount as a credit or refund, or in the collection of any amount as a deficiency or underpayment, of any tax imposed by this title, a fractional part of a dollar shall be disregarded, unless it amounts to 50 cents or more, in which case it shall be increased to 1 dollar.

§ 301.7505 STATUTORY PROVISIONS; SALE OF PERSONAL PROPERTY PURCHASED BY THE UNITED STATES

SEC. 7505. SALE OF PERSONAL PROPERTY PURCHASED BY THE UNITED STATES.

(a) SALE.—Any personal property purchased by the United States under the authority of section 6335 (e) (relating to purchase for the account of the United States of property sold under levy) may be sold by the Secretary or his delegate in accordance with such regulations as may be prescribed by the Secretary or his delegate.

(b) ACCOUNTING.—In case of the resale of such property, the proceeds of the sale shall be paid into the Treasury as internal revenue collections, and there shall be rendered a distinct account of all charges incurred in such sales.

§ 301.7505–1 SALE OF PERSONAL PROPERTY PURCHASED BY THE UNITED STATES.—(a) *Sale.*—(1) *In general.*—Any personal property (except bonds, notes, checks, and other securities) purchased by the United States under the authority of section 6335 (e) (relating to purchase for the account of the United States of property sold under levy) or the corresponding provisions of prior law may be sold by the district director who purchased such property for the United States. United States Savings Bonds shall not be sold by the district director but shall be transferred to the Division of Loans and Currency, Treasury Department, for redemption. Other bonds, notes, checks, and other securities shall be disposed of in accordance with instructions issued by the Commissioner.

(2) *Time, place, manner, and terms of sale.*—The time, place, manner, and terms of sale of personal property purchased for the United States shall be as follows—

(i) *Time, notice, and place of sale.*—The property may be sold at any time after it has been purchased by the United States. A public notice of sale shall be posted at the post office nearest the place of sale and in at least two other public places. The notice shall specify the property to be sold and the time, place, manner, and conditions of sale. In addition, the district director may use such other methods of advertising as he believes will result in obtaining the highest price for the property. The place of sale shall be within the internal revenue district where the property was originally purchased for the United States. However, if the district director believes that a substantially

higher price may be obtained, the sale may be held outside his district.

(ii) *Rejection of bids and adjournment of sale.*—The internal revenue officer conducting the sale reserves the right to reject any and all bids and withdraw the property from the sale. When it appears to the internal revenue officer conducting the sale that an adjournment of the sale will best serve the interest of the United States, he may order the sale adjourned from time to time. If the sale is adjourned for more than 30 days in the aggregate, public notice of the sale must again be given in accordance with subdivision (i) of this subparagraph.

(iii) *Liquidated damages.*—The notice shall state whether, in the case of default in payment of the bid price, any amount deposited with the United States will be retained as liquidated damages. In case liquidated damages are provided, the amount thereof shall not exceed $200.

(3) *Agreement to bid.*—The district director may, before giving notice of sale, solicit offers from prospective bidders and enter into agreements with such persons that they will bid at least a specified amount in case the property is offered for sale. In such cases, the district director may also require such persons to make deposits to secure the performance of their agreements. Any such deposit, but not more than $200, shall be retained as liquidated damages in case such person fails to bid the specified amount and the property is not sold for as much as the amount specified in such agreement.

(4) *Terms of payment.*—The property shall be offered for sale upon whichever of the following terms is fixed by the district director in the public notice of sale—

(i) Payment in full upon acceptance of the highest bid, without regard to the amount of such bid, or

(ii) If the aggregate price of all property purchased by a successful bidder at the sale is more than $200, an initial payment of $200 or 20 percent of the purchase price, whichever is the greater, and payment of the balance (including all costs incurred for the protection or preservation of the property subsequent to the sale and prior to final payment) within a specified period, not to exceed one month from the date of the sale.

(5) *Method of sale.*—The property may be sold either—

(i) At public auction, at which open competitive bids shall be received, or

(ii) At public sale under sealed bids.

(6) *Sales under sealed bids.*—The following rules, in addition to the other rules provided in this paragraph, shall be applicable to public sales under sealed bids:

(i) *Invitation to bidders.*—Bids shall be solicited through a public notice of sale.

(ii) *Form for use by bidders.*—A bid shall be submitted on a form which will be furnished by the district director upon request. The form shall be completed in accordance with the instructions thereon.

(iii) *Remittance with bid.*—If the total bid is $200 or less, the full amount of the bid shall be submitted therewith. If the total bid is more than $200, 20 percent of such bid or $200, whichever is greater, shall be submitted therewith. Such remittance shall be by a certified, cashier's, or treasurer's check drawn on any bank or trust company in-

corporated under the laws of the United States or under the laws of any State, Territory, or possession of the United States, or by a United States postal, bank, express, or telegraph money order.

(iv) *Time for receiving and opening bids.*—Each bid shall be submitted in a securely sealed envelope. The bidder shall indicate in the upper left hand corner of the envelope his name and address and the time and place of sale as announced in the public notice of sale. A bid will not be considered unless it is received by the internal revenue officer conducting the sale prior to the opening of the bids. The bids will be opened at the time and place stated in the notice of sale, or at the time fixed in the announcement of the adjournment of the sale.

(v) *Consideration of bids.*—The internal revenue officer conducting the sale shall have the right to waive any technical defects in a bid. After the opening, examination, and consideration of all bids, the internal revenue officer conducting the sale shall announce the amount of the highest bid or bids and the name of the successful bidder or bidders, unless in the opinion of the officer a higher price can be obtained for the property than has been bid. In the event the highest bids are equal in amount (and unless in the opinion of the internal revenue officer conducting the sale a higher price can be obtained for the property than has been bid), the officer shall determine the successful bidder by drawing lots. Any remittance submitted in connection with an unsuccessful bid shall be returned to the bidder at the conclusion of the sale.

(vi) *Withdrawal of bids.*—A bid may be withdrawn on written or telegraphic request received from the bidder prior to the time fixed for opening the bids. A technical defect in a bid confers no right on the bidder for the withdrawal of his bid after it has been opened.

(7) *Payment of bid price.*—All payments for property sold pursuant to this section shall be made by cash or by a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States or under the laws of any State, Territory, or possession of the United States, or by a United States postal, bank, express, or telegraph money order. If payment in full is required upon acceptance of the highest bid, the payment shall be made at such time. If payment in full is not made at such time, the internal revenue officer conducting the sale may forthwith proceed again to sell the property in the manner provided in subparagraph (5) of this paragraph. If deferred payment is permitted, the initial payment shall be made uon acceptance of the bid, and the balance shall be paid on or before the date fixed for payment thereof. Any remittance submitted with a successful sealed bid shall be applied toward the purchase price.

(8) *Delivery and removal of personal property.*—The risk of loss is on the purchaser of the property upon acceptance of his bid. Possession of any property shall not be delivered to the purchaser until the purchase price has been paid in full. If payment of part of the purchase price for the property is deferred, the United States will retain possession of such property as security for the payment of the balance of the purchase price and, as agent for the purchaser, will cause the property to be cared fro until the purchase price has been paid in full or the sale is declared null and void for failure to make full payment of the purchase price. In such case, all charges and expenses incurred

in caring for the property after acceptance of the bid shall be borne by the purchaser.

(9) *Certificate of sale.*—The internal revenue officer conducting the sale shall issue a certificate of sale to the purchaser upon payment in full of the purchase price.

(b) *Accounting.*—In case of the resale of such property, the proceeds of the sale shall be paid into the Treasury as internal revenue collections, and there shall be rendered by the district director a distinct account of all charges incurred in such sale. For additional accounting rules, see section 7809 and the instructions thereunder.

§ 301.7506 STATUTORY PROVISIONS; ADMINISTRATION OF REAL ESTATE ACQUIRED BY THE UNITED STATES.

SEC. 7506. ADMINISTRATION OF REAL ESTATE ACQUIRED BY THE UNITED STATES.

(a) PERSON CHARGED WITH.—The Secretary or his delegate shall have charge of all real estate which is or shall become the property of the United States by judgment of forfeiture under the internal revenue laws, or which has been or shall be assigned, set off, or conveyed by purchase or otherwise to the United States in payment of debts or penalties arising under the laws relating to internal revenue, or which has been or shall be vested in the United States by mortgage or other security for the payment of such debts, and of all trusts created for the use of the United States in payment of such debts due them.

(b) SALE.—The Secretary or his delegate, may, at public sale, and upon not less than 20 days' notice, sell and dispose of any real estate owned or held by the United States as aforesaid.

(c) LEASE.—Until such sale, the Secretary or his delegate may lease such real estate owned as aforesaid on such terms and for such period as the Secretary or his delegate shall deem proper.

(d) RELEASE TO DEBTOR.—In cases where real estate has or may become the property of the United States by conveyance or otherwise, in payment of or as security for a debt arising under the laws relating to internal revenue, and such debt shall have been paid, together with the interest thereon, at the rate of 1 percent per month, to the United States, within 2 years from the date of the acquisition of such real estate, it shall be lawful for the Secretary or his delegate to release by deed or otherwise convey such real estate to the debtor from whom it was taken, or to his heirs or other legal representatives.

§ 301.7506–1 ADMINISTRATION OF REAL ESTATE ACQUIRED BY THE UNITED STATES.—(a) *Persons charged with.*—The district director for the internal revenue district in which the property is situated shall have charge of all real estate which is or shall become the property of the United States by judgment or forfeiture under the internal revenue laws, or which has been or shall be assigned, set off, or conveyed by purchase or otherwise to the United States in payment of debts or penalties arising under the laws relating to internal revenue, or which has been or shall be vested in the United States by mortgage, or other security for the payment of such debts, or which has been or shall be purchased for the United States under section 6335(e) or under a corresponding provision of prior law, and of all trusts created for the use of the United States in payment of such debts due the United States.

(b) *Sale.*—The district director for the internal revenue district in which the property is situated may sell any real estate owned or held by the United States as aforesaid, subject to the following rules—

(1) *Property purchased at sale under levy.*—If the property was acquired as a result of being declared purchased for the United States

at a sale under section 6335, relating to sale of seized property, the property shall not be sold until after the expiration of one year after such sale under levy.

(2) *Notice of sale.*—A notice of sale shall be published in some newspaper published or generally circulated within the county where the property is situated, or a notice shall be posted at the post office nearest the place where the property is situated and in at least two other public places. The notice shall specify the property to be sold and the time, place, manner, and conditions of sale. In addition, the district director may use other methods of advertising and of giving notice of sale if he believes such method will enhance the possibility of obtaining a higher price for the property.

(3) *Time and place of sale.*—The time of the sale shall be not less than 20 days from thed ate of giving public notice of sale under subparagraph (2) of this paragraph. The place of sale shall be within the county where the property is suited. However, if the district director believes a substantially better price maye be obtained, he may hold the sale outside such county.

(4) *Rejection of bids and adjournment of sale.*—The internal revenue officer conducting the sale reserves the right to reject any and all bids and withdraw the property from the sale. When it appears to the internal revenue officer conducting the sale that an adjournment of the sale will best serve the interest of the United States, he may order the sale adjourned from time to time. If the sale is adjourned for more than 30 days in the aggregate, public notice of the sale must be given again in accordance with subparagraph (2) of this paragraph.

(5) *Liquidated damages.*—The notice shall state whether, in the case of default in payment of the bid price, any amount deposited with the United States will be retained as liquidated damages. In case liquidated damages are provided, the amount thereof shall not exceed $200.

(6) *Agreement to bid.*—The district director may, before giving notice of sale, solicit offers from prospective bidders and enter into agreements with such persons that they will bid at least a specified amount in case the property is offered for sale. In such cases, the district director may also require such persons to make deposits to secure the performance of their agreements. Any such deposit, but not more than $200, shall be retained as liquidated damages in case such person fails to bid the specified amount and the property is not sold for as much as the amount specified in such agreement.

(7) *Terms.*—The property shall be offered for sale upon whichever of the following terms is fixed by the district director in the public notice of sale:

(i) Payment in full upon acceptance of the highest bid, or

(ii) If the price of the property purchased by a successful bidder at the sale is more than $200, an initial payment of $200 or 20 percent of the purchase price, whichever is the greater, and payment of the balance within a specified period, not to exceed one month from the date of the sale.

(8) *Method of sale.*—The property may be sold either—

(i) At public auction, at which open competitive bids shall be received, or

(ii) At public sale under sealed bids.

(9) *Sales under sealed bids.*—The following rules, in addition to the other rules provided in this paragraph, shall be applicable at public sales under sealed bids.

(i) *Invitation to bidders.*—Bids shall be solicited through a public notice of sale.

(ii) *Form for use by bidders.*—A bid shall be submitted on a form which will be furnished by the district director upon request. The form shall be completed in accordance with the instructions thereon.

(iii) *Remittance with bid.*—If the total bid is $200 or less, the full amount of the bid shall be submitted therewith. If the total bid is more than $200, 20 percent of such bid or $200, whichever is greater, shall be submitted therewith. Such remittance shall be by a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States or under the laws of any State, Territory, or possession of the United States, or by a United States postal, bank, express, or telegraph money order.

(iv) *Time for receiving and opening bids.*—Each bid shall be submitted in a securely sealed envelope. The bidder shall indicate in the upper left hand corner of the envelope his name and address and the time and place of sale as announced in the public notice of sale. A bid shall not be considered unless it is received by the internal revenue officer conducting the sale prior to the opening of the bids. The bids will be opened at the time and place stated in the notice of sale, or at the time fixed in the announcement of the adjournment of the sale.

(v) *Consideration of bids.*—The internal revenue officer conducting the sale shall have the right to waive any technical defects in a bid. After the opening, examination, and consideration of all bids, the internal revenue officer conducting the sale shall announce the amount of the highest bid or bids and the name of the successful bidder or bidders, unless in the opinion of the officer a higher price can be obtained for the property than has been bid. In the event the highest bids are equal in amount (and unless in the opinion of the internal revenue officer conducting the sale a higher price can be obtained for the property than has been bid), the officer shall determine the successful bidder by drawing lots. Any remittance submitted in connection with an unsuccessful bid shall be returned to the bidder at the conclusion of the sale.

(vi) *Withdrawal of bids.*—A bid may be withdrawan on written or telegraphic request received from the bidder prior to the time fixed for opening the bids. A technical defect in a bid confers no right on the bidder for the withdrawal of his bid after it has been opened.

(10) *Payment of bid price.*—All payments for property sold pursuant to this section shall be made by cash or by a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States or under the laws of any State, Territory, or possession of the United States, or by a United States postal, bank, express, or telegraph money order. If payment in full is required upon acceptance of the highest bid, the payment shall be made at such time. If payment in full is not made at such time, the internal revenue officer conducting the sale may forthwith proceed again to sell the property in the manner provided in subparagraph (8) of this paragraph. If deferred payment is permitted, the initial

payment shall be made upon acceptance of the bid, and the balance shall be paid on or before the date fixed for payment thereof. Any remittance submitted with a successful sealed bid shall be applied toward the purchase price.

(11) *Deed.*—Upon payment in full of the purchase price, the district director shall execute a quitclaim deed to the purchaser.

(c) *Lease.*—Until real estate is sold, the district director for the internal revenue district in which the property is situated may, in accordance with instructions issued by the Commissioner, lease such property.

(d) *Release to debtor.*—In cases where real estate has or may become the property of the United States by conveyance or otherwise, in payment of or as security for a debt arising under the laws relating to internal revenue, and such debt shall have been paid, together with the interest thereon (at the rate of one percent per month), to the United States within two years from the date of the acquisition of such real estate, the district director for the internal revenue district in which the property is located may release by deed or otherwise convey such real estate to the debtor from whom it was taken, or to his heirs or other legal representatives. If property is declared purchased by the United States under section 6335, then, for the purpose of this paragraph, the date of such declaration shall be deemed to be the date of acquisition of such real estate.

(e) *Accounting.*—The district director for the internal revenue district in which the property is situated shall, in accordance with section 7809 and the instructions thereunder account for the proceeds of all sales or leases of the property and all expenses connected with the maintenance, sale, or lease of the property.

(f) *Authority of Commissioner.*—Notwithstanding the other paragraphs of this section, the Commissioner may, when he deems it advisable, take charge of and assume responsibility for any real estate to which this section is applicable. In such case, the Commissioner will notify in writing the district director for the internal revenue district in which the property is situated. In any case where a single parcel of real estate is situated in more than one internal revenue district, the Commissioner may designate in writing a district director who shall have charge of and be responsible for the entire property.

§ 301.7507 Statutory Provisions; Exemption of Insolvent Banks From Tax.

SEC. 7507. EXEMPTION OF INSOLVENT BANKS FROM TAX.

(a) Assets in General.—Whenever and after any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has ceased to do business by reason of insolvancy or bankruptcy, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank or trust company, which shall diminish the assets thereof necessary for the full payment of all its depositors; and such tax shall be abated from such national banks as are found by the Comptroller of the Currency to be insolvent; and the Secretary or his delegate, when the facts shall appear to him, is authorized to remit so much of the said tax against any such insolvent banks and trust companies organized under State law as shall be found to affect the claims of their depositors.

(b) Segregated Assets; Earnings.—Whenever any bank or trust company, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, has been released or discharged from its liablity to its depositors for any part of their claims

against it, and such depositors have accepted, in lieu thereof, a lien upon subsequent earnings of such bank or trust company, or claims against assets segregated by such bank or trust company or against assets transferred from it to an individual or corporate trustee or agent, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank or trust company, such individual or corporate trustee or such agent, which shall diminish the assets thereof which are available for the payment of such depositor claims and which are necessary for the full payment thereof. The term "agent", as used in this subsection, shall be deemed to include a corporation acting as a liquidating agent.

(c) REFUND; REASSESSMENT; STATUTES OF LIMITATION.

(1) Any such tax collected shall be deemed to be erroneously collected, and shall be refunded subject to all provisions and limitations of law, so far as applicable, relating to the refunding of taxes.

(2) Any tax, the assessment, collection, or payment of which is barred under subsection (a), or any such tax which has been abated or remitted after May 28, 1938, shall be assessed or reassessed whenever it shall appear that payment of the tax will not diminish the assets as aforesaid.

(3) Any tax, the assesment, collection, or payment of which is barred under subsection (b), or any such tax which has been refunded after May 28, 1938, shall be assessed or reassessed after full payment of such claims of depositors to the extent of the remaining assets segregated or transferred as described in subsection (b).

(4) The running of the statute of limitations on the making of assessment and collection shall be suspended during, and for 90 days beyond, the period for which, pursuant to this section, assessment or collection may not be made, and a tax may be reassessed as provided in paragraphs (2) and (3) of this subsection and collected, during the time within which, had there been no abatement, collection might have been made

(d) EXCEPTION OF EMPLOYMENT TAXES.—This section shall not apply to any tax imposed by chapter 21 or chapter 23.

§ 301.7507–1 BANKS AND TRUST COMPANIES COVERED.—(a) Section 7507 applies to any national bank, or bank or trust company organized under State law, a substantial portion of the business of which consists of receiving deposits and making loans and discounts, and which has—

(1) Ceased to do business by reason of insolvency or bankruptcy, or

(2) Been released or discharged from its liability to its depositors for any part of their deposit claims, and the depositors have accepted in lieu thereof a lien upon its subsequent earnings or claims against its assets either (i) segregated and held by it for benefit of the depositors or (ii) transferred to an individual or corporate trustee or agent who liquidates, holds or operates the assets for the benefit of the depositors.

(b) As used in the regulations under section 7507:

(1) The term "bank", unless otherwise indicated by the context, means any national bank, or bank or trust company organized under State law, within the scope of such section.

(2) The terms "statute of limitations" and "limitations" mean all applicable provisions of law (including section 7507) which impose, change, or affect the limitations, conditions, or requirements relative to the allowance of refunds and abatements or the assessment or collection of tax, as the case may be.

(3) The term "segregated assets" includes transferred or trusteed assets, or assets set aside or earmarked, to all or a portion of which, or the proceeds of which, the depositors are absolutely or conditionally entitled.

§ 301.7507–2 Scope of Section Generally—(a) *Purpose.*—Section 7507 is intended to assist depositors of a bank which had ceased to do business by reason of insolvency to recover their deposits, by prohibiting collection of taxes of the bank which would diminish the assets necessary for payment of its depositors and also assist depositors of banks which are in financial difficulties but which, in certain conditions, continue in business.

(b) *Requisites of application.*—In order that section 7507 shall operate in a case where the bank continues business it is necessary that the depositors shall agree to accept, in lieu of all or a part of their deposit claims as such, claims against segregated assets, or a lien upon subsequent earnings of the bank, or both. When such an agreement exists, no tax diminishing such assets or earnings, or both, otherwise available and necessary for payment of depositors, may be collected therefrom. If, under such an agreement, the depositors have the right also to look to the unsegregated assets of the bank for recovery, in whole or in part, the unsegregated assets are likewise, until they exceed the amount of the depositors' claims chargeable thereto, unavailable for tax collection. Any tax of such a bank, or part of any tax, which is once uncollectible under section 7507, cannot thereafter be collected except from any residue of segregated assets remaining after claims of depositors against such assets have been paid.

(c) *Interest.*—For the purposes of section 7507, depositors' claims include bona fide interest, either on the deposits as such, or on the claims accepted in lieu of deposits as such.

(d) *Limitations on immunity.*—Section 7507 is not primarily intended for the relief of banks as such. It does not prevent tax collection, from assets not necessary, or not available, for payment of depositors, from a bank within section 7507(a), at any time within the statute of limitations. In other words, the immunity of such a bank is not complete, but ceases whenever, within the statutory period for collection, it becomes possible to make collection without diminishing assets necessary for payment of depositors. In the case of a bank within section 7507(b), any immunity to which the bank is entitled is absolute except as to segregated assets. Any tax coming within such immunity may never be collected. With respect to segregated assets, such a bank is subject to the same rule as a bank within section 7507(a), that is to say, after claims of depositors against segregated assets have been paid, any surplus is subject, within the statute of limitations, to collection of any tax, due at any time, the collection of which was suspended by the section. The section is not for the relief of creditors other than depositors, although it may incidentially operate for their benefit. See §§ 301.7507–4 and 301.7507–9(b).

§ 301.7507–3 Segregated or Transferred Assets.—(a) *In general.*—In a case involving segregated or transferred assets, it is not necessary, for application of section 7507, that the assets shall technically constitute a trust fund. It is sufficient that segregated assets be definitely separated from other assets of the bank and that transferred assets be definitely separated both from other assets of the bank and from other assets held or owned by the trustee or agent to whom assets of the bank have been transferred; that the bank be wholly or partially released from liability for repayment of deposits as such; and that the depositors have claims against the separated assets. Any

excess of separated assets over the amount necessary for payment of such depositors will be available for tax collection after full payment of depositors' claims under the agreement against such assets. But see § 301.7507-9(a).

(b) *Corporate transferees.*—Where the segregated assets are transferred to a separate corporate trustee or corporate agent, the assets and earnings therefrom are within the protection of the section, until full payment of depositors' claims against such assets and earnings, no matter by whom the stock of such corporation is held, and no matter whether the assets be liquidated or operated or held for benefit of the depositors.

§ 301.7507-4 UNSEGREGATED ASSETS.—(a) *Depositors claims against assets.*—(1) Claims of depositors, to the extent that they are to be satisfied out of segregated assets, will not be considered in determining the availability of unsegregated assets for tax collection. If depositors have agreed to accept payment out of segregated assets only, collection of tax from unsegregated assets will not diminish the assets available and necessary for payment of the depositors' claims. Thus, it may be possible to collect taxes from the unsegregated assets of a bank although the segregated assets are immune under the section.

(2) If the unsegregated assets of the bank are subject to any portion of the depositors' claims, such unsegregated assets will be within the immunity of the section only to the extent necessary to satisfy the claims to which such assets are subject. Taxes will still be collectible from the unsegregated assets to the extent of the amount by which the total value of such assets exceeds the liability to depositors to be satisfied therefrom. Therefore, if, for example, in the case of a bank having a tax liability, not previously immune under the section, of $50,000, the deposit claims against the bank are in the amount of $75,000, and the assets available for satisfaction of deposit claims amount to $100,000, the $50,000 tax is collectible to the extent of the $25,000 excess of assets over deposit claims. Collection is not to be postponed until the full amount of the tax is collectible.

(b) *Depositors' claims against earnings.*—Even though under a bona fide agreement a bank has been released from depositors' claims as to unsegregated assets, if all or a portion of its earnings are subject to depositors' claims, all assets the earnings from which, in whole or part, are charged with the payment of depositors' claims, will be immune from tax collection. But see § 301.7507-5(a).

§ 301.7507-5 EARNINGS.—(a) *Availability for tax collection.*—Earnings of a bank within section 7507(b), whether from segregated or unsegregated assets, which are necessary for, applicable to, and actually used for, payment of depositors' claims under an agreement, are within the immunity of the section. If only a portion or percentage of income from segregated or unsegregated assets is available and necessary for payment of depositors' claims, the remaining income is available for tax collection. Earnings of the bank's first fiscal year ending after the making of the agreement not applicable to payment of depositors will be assumed to be applicable for collection of any tax due prior or subsequent to execution of the agreement. Earnings of subsequent fiscal periods from unsegregated assets not applicable to depositors' claims will be assumed to be applicable to payment of

taxes as to which immunity under the section has not previously attached. Earnings from segregated assets are available for collection of tax, whether previously uncollectible under the section or not, after depositors' claims against such assets have been paid in full. See §§ 301.7507-3(a) and 301.7507-9(a).

(b) *Tax computation.*—The fact that earnings of a given year may be wholly or partly unavailable under section 7507 for collection of taxes does not exempt the income for that year, or any part thereof, from tax liability. The section affects collectibility only, and is not concerned with taxability. Accordingly, the taxpayer's income tax return shall correctly compute the tax liability, even though in the opinion of the taxpayer it is immune from tax collection under the section. The tax shall be determined with respect to the entire gross income and not merely with respect to the portion of the earnings out of which tax may be collected. As to establishment of immunity from tax collection see § 301.7507-7.

Example. (1) An agreement, executed in the year 1954 between a bank and its depositors, provides (1) that certain assets are to be segregated for the benefit of the depositors who have waived (as claims against unsegregated assets of the bank) a percentage of their deposits; (2) that 40 percent of the bank's net earnings, for years beginning with 1954, from unsegregated assets, shall be paid to the depositors until the portion of their claims waived with respect to unsegregated assets of the bank has been paid; and (3) that the unsegregated assets shall not be subject to depositors' claims. The net income of the bank for the calendar year 1954 is $10,000, $4,000 produced by the segregated, and $6,000 produced by the unsegregated assets. Such amount shall be considered the net earnings for the purpose of section 7507 in computing the portion of the earnings to be paid to depositors. The bank has an outstanding tax liability for prior years of $7,000. The income tax liability of the bank for 1954 is 30 percent of $10,000, or $3,000, making a total outstanding tax liability of $10,000. The portion of the earnings of the bank for 1954 remaining after provision for depositors is $3,600 ($6,000 less 40 percent thereof, or $2,400). It will be assumed that of the total outstanding tax liability of $10,000, $3,600 may be assessed and collected, leaving $6,400 to be collected from any excess of the segregated assets after claims of depositors against such segregated assets have been paid in full. No part of the $6,400 immune from collection from 1954 earnings may be collected thereafter from unsegregated assets of the bank or earnings therefrom, so that except for any possible surplus of the segregated assets the $6,400 is uncollectible.

(2) In the year 1955, the earnings are again $10,000, $4,000 from segregated and $6,000 from unsegregated assets, as in 1954. However, the return filed shows income of $5,000 and a tax liability of $1,500. An investigation shows the true income to be $10,000, on which the tax is $3,000. The full $3,000 will be assumed to be collectible. The $600 difference between $3,600 (the excess of earnings from unsegregated assets over the amount going to the depositors), and the $3,000 tax for 1955, is not available for collection of the tax for prior years, which became immune as described above, but may be available for collection of tax for subsequent years.

(c) No significance attaches to the selection of the years 1954 and 1955 in the example set forth in paragraph (b) of this section. The rules indicated by the example are equally applicable to subsequent or prior years not excluded by limitations.

§ 301.7507-6 ABATEMENT AND REFUND.—(a) An assessment or collection, no matter when made, if contrary to section 7507, is subject to abatement or refund within the applicable statutory period of limitations.

(b) Collection from a bank within section 7507(b) which diminishes assets necessary for payment of depositors, if made prior to agreement with depositors, is not contrary to the section, and affords no ground for refund.

(c) Any abatement or refund is subject to existing statutory periods of limitation, which periods are not suspended or extended by section 7507. In order to secure a refund of any taxes paid for any taxable year during the period of immunity the bank must file claim therefor.

§ 301.7507-7 ESTABLISHMENT OF IMMUNITY.—(a) The mere allegation of insolvency, or that depositors have claims against segregated or other assets or earnings, will not of itself secure immunity from tax collection. It must be affirmatively established to the satisfaction of the district director that collection of tax will be contrary to section 7507. See also § 301.7507-8.

(b) Any claim, by a bank, of immunity under section 7507 (b), shall be supported by a statement, under oath or affirmation, which shall show: (1) the total of depositors' claims outstanding, and (2) separately and in detail, the amount of each of the following, and the amount of depositors' claims properly chargeable against each: (i) segregated or transferred assets; (ii) unsegregated assets; (iii) estimated future average annual earnings and profits; (iv) amount collectible from shareholders; and (v) any other resources available for payment of depositors' claims. The detail shall show the full amount of depositors' claims chargeable against each of the items in subdivisions (i) to (v), inclusive, of this paragraph even though part or all of the amount chargeable against a particular item is also chargeable against some other item or items. There shall also be filed a copy of any agreement between the bank and its depositors, and any other agreement or document bearing on the claim of immunity. The statement shall show the basis, as "book", "market", etc., of valuation of the assets.

§ 301.7507-8 PROCEDURE DURING IMMUNITY.—(a) *Statements to be filed.*—As long as complete or partial immunity is claimed, a bank within section 7507(b) shall file with each income tax return a statement as required by § 301.7507-7, in duplicate, and shall also file such additional statements as the district director may require. Whether or not additional statements shall be required, and the frequency thereof, will depend on the circumstances, including the financial status and apparent prospects of the bank, and the time which is available for assessment and collection. If a copy of an agreement or document has once been filed, a copy of the same agreement or document need not again be filed with a subsequent statement, if it is shown by the subsequent statement, when and where and with what return the copy

was filed. In case of amendment a copy of the amendment must be filed with the return for the taxable year in which the amendment is made.

(b) *Failure to file.*—Failure of a bank to file any required statement will be treated as indicating that the bank is not entitled to immunity.

§ 301.7507–9 TERMINATION OF IMMUNITY.—(a) *In general.*—(1) In the case of a bank within section 7507(a), immunity will end whenever, and to the extent that, taxes may be assessed and collected, within the applicable limitation periods as extended by section 7507, without diminishing the assets available and necessary for payment of depositors. Immunity of a bank within section 7507(b) is terminated, as to segregated assets, whenever claims of depositors against such assets have been paid in full. See § 301.7507–3. As to segregated assets, the termination of immunity is complete, and any balance remaining after payment of depositors is available, within statutory limitations, for collection of tax due at any time. However, taxes of the bank will be collectible from segregated assets only to the extent that the bank has a legal or equitable interest therein. Assets as to which there has been a complete conveyance for benefit of depositors, and the bank has bona fide been divested of all legal and equitable interest, are not available for collection of the bank's tax liability.

(2) As to unsegregated assets of a bank within section 7507(b), immunity terminates only as to taxes thereafter becoming due. When taxes are once immune from collection, the immunity as to unsegregated assets is absolute. But see § 301.7507–4(a).

(b) *General creditors.*—While the immunity from tax collection is for protection of depositors, and not for benefit of general creditors, in some cases the immunity will not end until the assets are sufficient to cover indebtedness of creditors generally. This situation will exist where under applicable law the claims of general creditors are on a parity with those of depositors, so that to pay depositors in full it is necessary to pay all creditors in full.

(c) *Shareholder liability.*—In determining the sufficiency of the assets to satisfy the depositors' claims, shareholders' liability to the extent collectible shall be treated as available assets. See § 301.7507–7.

(d) *Deposit insurance.*—Deposit insurance payable to depositors shall not be treated as an asset of the bank and shall be disregarded in determining the sufficiency of the assets to meet the claims of depositors.

(e) *Notice by bank.*—A bank within section 7507(b), upon termination of immunity with respect to (1) earnings, (2) segregated or transferred assets, or (3) unsegregated assets, shall immediately notify the district director of internal revenue for the internal revenue district in which the taxpayer's returns were filed of such termination of immunity. See § 301.7507–8(b).

(f) *Payment by bank.*—As immunity terminates with respect to any assets, it will be the duty of the bank, without notice from the district director of internal revenue, to make payment of taxes collectible from such assets.

§ 301.7507–10 COLLECTION OF TAX AFTER TERMINATION OF IMMUNITY.—If, in the case of a bank within section 7507(b), segregated assets (including earnings therefrom), in excess of those necessary

for payment of outstanding deposits become available, such excess of segregated assets shall be applied toward satisfaction of accumulated outstanding taxes previously immune under the section, and not barred by the statute of limitations. But see § 301.7507–3. Where sufficient segregated or unsegregated assets are available, statutory interest shall be collected with the tax. When unsegregated assets or earnings therefrom previously immune become available for tax collection, they will be available only for collection of taxes (including interest and other additions) becoming due after immunity ceases. See the example in §301.7507–5(b).

§ 301.7507–11 EXCEPTION OF EMPLOYMENT TAXES.—The immunity granted by section 7507 does not apply to taxes imposed by chapter 21 or chapter 23.

§ 301.7508 STATUTORY PROVISIONS; TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF WAR.

SEC. 7508. TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF WAR.

(a) TIME TO BE DISREGARDED.—In the case of an individual serving in the Armed Forces of the United States, or serving in support of such Armed Forces, in an area designated by the President of the United States by Executive order as a "combat zone" for purposes of section 112, at any time during the period designated by the President by Executive order as the period of combatant activities in such zone for purposes of such section, or hospitalized outside the States of the Union and the District of Columbia as a result of injury received while serving in such an area during such time, the period of service in such area, plus the period of continuous hospitalization outside the States of the Union and the District of Columbia attributable to such injury, and the next 180 days thereafter, shall be disregarded in determining, under the internal revenue laws, in respect of any tax liability (including any interest, penalty, additional amount, or addition to the tax) of such individual—

(1) Whether any of the following acts was performed within the time prescribed therefor:

(A) Filing any return of income, estate, or gift tax (except income tax withheld at source and income tax imposed by subtitle C or any law superseded thereby):

(B) Payment of any income, estate, or gift tax (except income tax withheld at source and income tax imposed by subtitle C or any law superseded thereby) or any installment thereof or of any other liability to the United States in respect thereof;

(C) Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court;

(D) Allowance of a credit or refund of any tax;

(E) Filing a claim for credit or refund of any tax;

(F) Bringing suit upon any such claim for credit or refund;

(G) Assessment of any tax;

(H) Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;

(I) Collection, by the Secretary or his delegate, by levy or otherwise, of the amount of any liability in respect of any tax;

(J) Bringing suit by the United Sattes, or any officer on its behalf, in respect of any liability in respect of any tax; and

(K) Any other act required or permitted under the internal revenue laws specified in regulations prescribed under this section by the Secretary or his delegate;

(2) The amount of any credit or refund (including interest).

(b) EXCEPTIONS.—

(1) TAX IN JEOPARDY; BANKRUPTCY AND RECEIVERSHIP; AND TRANSFERRED ASSETS.—Notwithstanding the provisions of subsection (a), any action or proceeding authorized by section 6851 (regardless of the taxable year for which the tax arose), chapter 70, or 71, as well as any other action or proceeding authorized by law in connection therewith, may be taken, begun, or prosecuted. In any other case in which the Secretary or his delegate determines that collection of the amount of any assessment would be jeopardized by delay, the provisions of subsection (a) shall not operate to stay collection of such amount by levy or otherwise as authorized by law. There shall be excluded from any amount assessed or collected pursuant to this paragraph the amount of interest, penalty, additional amount, and addition to the tax, if any, in respect of the period disregarded under subsection (a). In any case to which this paragraph relates, if the Secretary or his delegate is required to give any notice or to make any demand upon any person, such requirement shall be deemed to be satisfied if the notice or demand is prepared and signed, in any case in which the address of such person last known to the Secretary or his delegate is in an area for which United States post offices under instructions of the Postmaster General are not, by reason of the combatant activties, accepting mail for delivery at the time the notice or demand is signed. In such case the notice or demand shall be deemed to have been given or made upon the date it is signed.

(2) ACTION TAKEN BEFORE ASCERTAINMENT OF RIGHT TO BENEFITS.—The assessment or collection of any internal revenue tax or of any liability to the United States in respect of any internal revenue tax, or any action or proceeding by or on behalf of the United States in connection therewith, may be made, taken, begun, or prosecuted in accordance with law, without regard to the provisions of subsection (a), unless prior to such assessment, collection, action, or proceeding it is ascertained that the person concerned is entitled to the benefits of subsection (a).

§ 301.7509 STATUTORY PROVISIONS; EXPENDITURES INCURRED BY THE POST OFFICE DEPARTMENT.

SEC. 7509. EXPENDITURES INCURRED BY THE POST OFFICE DEPARTMENT.

The Postmaster General or his delegate shall at least once a month transfer to the Treasury of the United States, together with the receipts required to be deposited under section 6803(a), a statement of the additional expenditures in the District of Columbia and elsewhere incurred by the Post Office Department in performing the duties, if any, imposed upon such Department with respect to chapter 21, relating to the tax under the Federal Insurance Contributions Act, and the Secretary or his delegate shall be authorized and directed to advance from time to time to the credit of the Post Office Department, from appropriations made for the collection of the taxes imposed by chapter 21, such sums as may be required for such additional expenditures incurred by the Post Office Department.

§ 301.7510 STATUTORY PROVISIONS; EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES.

SEC. 7510. EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES.

The privilege existing by provision of law on December 1, 1873, or thereafter of purchasing supplies of goods imported from foreign countries for the use of the United States, duty free, shall be extended, under such regulations as the Secretary or his delegate may prescribe, to all articles of domestic production which are subject to tax by the provisions of this title.

§ 301.7510–1 EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES.—For any regulations under section 7510, see the applicable regulations with respect to the various taxes.

§ 301.7511 STATUTORY PROVISIONS; EXEMPTION OF CONSULAR OFFICERS AND EMPLOYEES OF FOREIGN STATES FROM PAYMENT OF INTERNAL REVENUE TAXES ON IMPORTED ARTICLES.

SEC. 7511. EXEMPTION OF CONSULAR OFFICERS AND EMPLOYEES OF FOREIGN STATES FROM PAYMENT OF INTERNAL REVENUE TAXES ON IMPORTED ARTICLES.

(a) RULE OF EXEMPTION.—No internal revenue tax shall be imposed with respect to articles imported by a consular officer of a foreign state or by an employee of a consulate of a foreign state, whether such articles accompany the officer or employee to his post in the United States, its insular possessions, or the Panama Canal Zone, or are imported by him at any time during the exercise of his functions therein, if—

(1) Such officer or employee is a national of the state appointing him and not engaged in any profession, business, or trade within the territory specified in this subsection;

(2) the articles are imported by the officer or employee for his personal or official use; and

(3) the foreign state grants an equivalent exemption to corresponding officers or employees of the Government of the United States stationed in such foreign state.

(b) CERTIFICATE BY SECRETARY OF STATE.—The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign states which grant an equivalent exemption to the consular officers or employees of the Government of the United States stationed in such foreign states.

GENERAL RULES

Effective Date and Related Provisions

§ 301.7851 STATUTORY PROVISIONS; APPLICABILITY OF REVENUE LAWS.

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(a) GENERAL RULES.—Except as otherwise provided in any section of this title—

* * * * * * *

(6) SUBTITLE F.—

(A) GENERAL RULE.—The provisions of subtitle F [including chapter 77, relating to miscellaneous provisions] shall take effect on the day after the date of enactment of this title and shall be applicable with respect to any tax imposed by this title. * * *

(C) TAXES IMPOSED UNDER THE 1939 CODE.—After the date of enactment of this title, the following provisions of subtitle F shall apply to the taxes imposed by the Internal Revenue Code of 1939, notwithstanding any contrary provisions of such code:

* * * * * * *

(v) Chapter 77, relating to miscellaneous provisions, except that section 7502 shall apply only if the mailing occurs after the date of enactment of this title, and section 7503 shall apply only if the last date referred to therein occurs after the date of enactment of this title. * * *

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved April 30, 1957.

DAN THROOP SMITH,
Deputy to the Secretary.

(Filed by the Division of the Federal Register on May 2, 1957, 8:48 a. m., and published in the issue of the Federal Register for May 3, 1957, 22 F. R. 3143.)

SECTION 7502.—TIMELY MAILING TREATED AS TIMELY FILING

26 CFR 301.7502: Statutory provisions; timely mailing treated as timely filing.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7503.—TIME FOR PERFORMANCE OF ACTS WHERE LAST DAY FALLS ON SATURDAY, SUNDAY OR LEGAL HOLIDAY

26 CFR 301.7503: Statutory provisions; time for performance of acts where last day falls on Saturday, Sunday or legal holiday.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7504.—FRACTIONAL PARTS OF A DOLLAR

26 CFR 301.7504: Statutory provisions; fractional parts of a dollar.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7505.—SALE OF PERSONAL PROPERTY PURCHASED BY THE UNITED STATES

26 CFR 301.7505: Statutory provisions; sale of personal property purchased by the United States.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7506.—ADMINISTRATION OF REAL ESTATE ACQUIRED BY THE UNITED STATES

26 CFR 301.7506: Statutory provisions; administration of real estate acquired by the United States.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7507.—EXEMPTION OF INSOLVENT BANKS FROM TAX

26 CFR 301.7507: Statutory provisions; exemption of insolvent banks from tax.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7508.—TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF WAR

26 CFR 301.7508: Statutory provisions; time for performing certain acts postponed by reason of war.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7509.—EXPENDITURES INCURRED BY THE POST OFFICE DEPARTMENT

26 CFR 301.7509: Statutory provisions; expenditures incurred by the Post Office Department.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7510.—EXEMPTION FROM TAX OF DOMESTIC GOODS PURCHASED FOR THE UNITED STATES

26 CFR 301.7510: Statutory provisions; exemption from tax of domestic goods purchased for the United States.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

SECTION 7511.—EXEMPTION OF CONSULAR OFFICERS AND EMPLOYEES OF FOREIGN STATES FROM PAYMENT OF INTERNAL REVENUE TAXES ON IMPORTED ARTICLES

26 CFR 301.7511: Statutory provisions; exemption of consular officers and employees of foreign states from payment of internal revenue taxes on imported articles.

Regulations under the Internal Revenue Code of 1954. See T. D. 6232, page 469.

CHAPTER 79.—DEFINITIONS

SECTION 7701.—DEFINITIONS

Rev. Rul. 57-112

Where "mineral fee interests" are included in trust corpus and under the trust agreement the trustee does not have a right to exploit the mineral by developing the property but may only, with approval in writing of the particular contract by all the owners of beneficial interests, lease to an operating company for such purpose, the inclusion of the mineral fee interests in the trust corpus does not, in itself, result in the trust being treated as an association taxable as a corporation for Federal income tax purposes.

Advice has been requested whether the inclusion of "mineral fee interests" in the corpus of a trust renders the trust taxable as a corporation.

The corpus of the trust under consideration consists solely of "non-working interests" such as oil and gas royalties, oil payments, and similar participations in hydrocarbons. The powers granted to the trustees do not extend beyond those necessary to the incidental preservation of the trust property, the collection of the income therefrom, the payment of expenses, and the disbursement of the net proceeds of the trust to the beneficial owners. The trustees may sell or deal with assets of the trust only upon authorization in writing by all of the beneficial owners. Furthermore, the trustees have no discretion in the matter of investment, reinvestment, accumulation, or distribution of the trust net income. Trusts of the type described above are held to be strict investment trusts. See *Royalty Participation Trust, Commonwealth Trust Company, Trustee* v. *Commissioner*, 20 T. C. 466, acquiescence C. B. 1953–2, 6. It is now proposed to include in the trust corpus certain mineral fee interests, which will be acquired subject to an existing oil and gas lease, and other similar interests which will be leased by the trustees if and when the opportunity presents itself.

The so-called "mineral fee interests" represent fee simple title to the minerals in place. The owner of such an interest is privileged either to exploit the minerals himself or to lease the same to a company operating for that purpose. The owner of a "mineral fee interest" that has been leased for oil and gas purposes is not charged with any of the cost or burdens of developing or operating the property.

Where "mineral fee interests" are included in the trust corpus and under the trust agreement the trustees do not have authority to exploit the mineral by developing and operating the property but may only, with approval in writing of a particular contract by all the owners of beneficial interest, lease to an operating company for such purpose, and the income from such interest will constitute royalty, the inclusion of the "mineral fee interests" in the trust corpus will not, in itself, result in the trust being treated as an association taxable as a corporation.

Accordingly, it is held that the inclusion of "mineral fee interests" in the corpus of the trust herein considered will not result in the trust being treated as an association taxable as a corporation.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

Rev. Rul. 57–35

A special label has, for some time, been affixed to each package of tobacco products removed, without payment of tax, for the use of the Armed Forces of the United States beyond the jurisdiction of the internal revenue laws. This special label was used pursuant to specific request of the armed services and contained the legend "Free of Tax—For use only of U. S. military or naval forces, and other authorized personnel, outside the jurisdiction of the internal revenue laws of the United States. This product is admitted free of duty." Since the use of the special label was originally requested by the armed services during the National emergency, the question as to its discontinuance was referred to the Department of Defense for an opinion. The Department of Defense has advised that the use of the special label may now be discontinued. Accordingly, tobacco products manufacturers may discontinue the use of this special label on tobacco products removed free of tax for use of the Armed Forces of the United States beyond the jurisdiction of the internal revenue laws of the United States.

For the change in format of tobacco tax forms, see Rev. Proc. 57–2, page 723.

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26 CFR 270.153: Return of cigars and cigarettes to factory.

For procedure with respect to the receipt of taxpaid cigars and cigarettes from other factories and the return of such products to the factory where made, see Rev. Proc. 57–9, page 734.

For procedure with respect to receipt of taxpaid tobacco products of a kind other than produced at the receiving factory, see Rev. Proc. 57–20, page 749.

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26 CFR 275.142: Return of manufactured tobacco to factory.

For procedure with respect to the receipt of taxpaid manufactured tobacco from other factories and the return of such products to the factory where made, see Rev. Proc. 57–9, page 734.

For procedure with respect to receipt of taxpaid tobacco products of a kind other than produced at the receiving factory, see Rev. Proc. 57–20, page 749.

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. Rev. Rul. 57-286

(Also Section 22(b), Regulations 118; Section 39.22(b)(3)-1.)

(Also Part I, Section 117; 26 CFR 1.117-1.)

The Internal Revenue Code of 1939 contains no provision concerning the taxable status of scholarships and fellowship grants, but amounts received as fellowship grants of the type described in I. T. 4056 were included in the gross income of the recipients. In view of the Commissioner's acquiescence in the decision in *George Winchester Stone, Jr., et ux.* v. *Commissioner*, 23 T. C. 254, the Internal Revenue Service will not require the inclusion in gross income, for taxable years governed by the 1939 Code, of amounts received as fellowship grants similar to that received in the *Stone* case.

Advice has been requested regarding the treatment under the Internal Revenue Code of 1939 of certain scholarships and fellowship grants.

The Internal Revenue Code of 1939 contains no provisions concerning the taxable status of scholarships and fellowship grants. However, section 22(b)(3) thereof excludes from gross income amounts received as gifts. It was held in I. T. 4056, C. B. 1951-2, 8, that certain fellowship grants made by the *M* foundation were not exempt from Federal income tax as gifts under section 22(b)(3) of the 1939 Code, but that the amount of any such fellowship grant was includible in the recipient's gross income. In the case of *George Winchester Stone, Jr., et ux.* v. *Commissioner*, 23 T. C. 254, acquiescence page 9, this Bulletin, the Tax Court of the United States held that the amount of $1,000 received by the petitioner in 1950 from the John Simon Guggenheim Memorial Foundation as part of a fellowship grant was a gift and therefore excludable from gross income under section 22(b)(3).

In view of the Commissioner's acquiescence in the decision in the Stone case, *supra*, fellowship grants made by the John Simon Guggenheim Memorial Foundation and grants generally similar thereto will not be required by the Internal Revenue Service to be included in gross income for taxable years governed by the 1939 Code. Whether or not fellowship grants other than those from the John Simon Guggenheim Memorial Foundation paid during such taxable years constituted gross income or gifts excludable from gross income under section 22(b)(3) of the 1939 Code will depend upon consideration of all the facts in each case.

Fellowship grants made for taxable years governed by the internal Revenue Code of 1954 will be controlled by section 117 thereof which provides rules for determining the extent to which amounts received as scholarships or fellowship grants are to be excluded from the recipients' gross income.

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

Exclusion from gross income of amounts received through accident and health insurance as compensation for personal injuries or sickness. See Rev. Proc. 57-23, page 752.

REGULATIONS 118, SECTION 39.22(b): Exclusions from gross income.

Taxability of a Rockefeller Public Service Award for the year 1953. See Rev. Rul. 57-50, page 74.

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and requests.

Amounts received from the John Simon Guggenheim Memorial Foundation as a fellowship grant. See Rev. Rul. 57-286, page 497.

REGULATIONS 118 SECTION 39.22(b)(5): Statutory provisions; exclusions from gross income; compensation for injuries or sickness. Ct. D. 1805

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. EXCLUSIONS FROM GROSS INCOME—AMOUNTS RECEIVED UNDER UNINSURED SICK BENEFIT PLAN FOR EMPLOYEES.
An employee may exclude from his gross income as "health insurance" sickness disability benefits received during 1949 under his employer's plan even though the plan did not contain features present in normal commercial insurance. The payment of premiums in a fixed amount at regular intervals is not a necessary element of insurance, nor is there any necessity for a definite fund to be set aside to meet the insurer's obligations. The legislative history does not indicate that Congress intended to restrict the exemption to conventional modes of insurance and not to include employer disability plans.
2. JUDGMENT REVERSED.
3. JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT, 233 F. 2d 413, REVERSED.

SUPREME COURT OF THE UNITED STATES

Gordon P. Haynes and Essie M. Haynes, Petitioners, v. *United States of America*

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

[April 1, 1957]

OPINION

Mr. Justice Black delivered the opinion of the Court.

In 1949, the petitioner, Gordon P. Hayes, became sick and unable to work while employed by the Southern Bell Telephone and Telegraph Company. At that time the company had in effect a comprehensive "Plan for Employees' Pension, Disability Benefits and Death Benefits." This plan had been in force since 1913 when it was adopted by Southern Bell and other companies in the American Telephone and Telegraph Company system. A written copy of the plan, which was prepared much like an insurance policy, was given every person upon his initial employment by the company. Among other things, the plan provided that Southern Bell "undertakes in accordance with these Regulations, to provide for the payment of definite amounts to its employees when they are disabled by accident or sickness." Under the plan every employee was entitled after two years' service with Southern Bell, to receive "sickness disability benefits" when he missed work because of illness. These payments began on the eighth calendar day of absence due to illness. The amount and duration of payments were set out with specificity and varied with the length of service. For example, employees who had worked for Southern Bell from two to five years were entitled to full pay for four weeks and one-half pay for nine additional weeks; employees who had been with the company for more than twenty-five years were entitled to full pay for fifty-two weeks. The company reserved the right to change or terminate the plan but agreed that no changes would be made which affected "the rights of any employee, without his consent, to any benefit or pension to which he may have previously become entitled hereunder."

Under the plan petitioner was paid $2,100 in sickness disability benefits during 1949. Since he had been an employee of the company for more than twenty-five years this was the full equivalent of what he would have received had be been working. The Government collected $318.44 income tax on petitioner's sickness benefits. He brought this action for a refund contending that these receipts were not taxable because of section 22(b)(5) of the 1939 Internal Revenue Code which exempted from taxable income "amounts received, through accident or health insurance * * * as compensation for personal injuries or sickness."[1] The District Court held that the payments received by petitioner on account of sicknes were not taxable and directed a refund. The Court of

[1] 26 U. S. C. (1952 ed.) [illegible] 22(b)(5).

Appeals reversed, accepting the Government's contention that Southern Bell's Plan was not "health insurance" but a "wage continuation plan." 233 F. 2d 413. In *Epmeier* v. *United States*, 199 F. 2d 508, the Seventh Circuit held that disability payments under a plan similar to Southern Bell's were not taxable. Because of this conflict we granted certiorari, 352 U. S. 820.

The crucial question is whether the Southern Bell Plan should be treated as "health insurance" within the meaning of section 22(b)(5). Broadly speaking, health insurance is an undertaking by one person for reasons satisfactory to him to indemnify another for losses caused by illness. We believe that the Southern Bell Disability Plan comes within this meaning of health insurance.

If Southern Bell had purchased from a commercial insurance company health insurance that provided its employees with precisely the same kind of protection promised under its own plan, the Government concedes that the payments received by ailing employees from the commercial company would not have been taxable. Nevertheless it argues that Southern Bell's plan should not be treated as "health insurance" because the employees paid no fixed periodic premiums, there was no definite fund created to assure payment of the disability benefits, and the amount and duration of the benefits varied with the length of service.[2] We do not believe that these facts remove the plan from the general category of health insurance. The payment of premiums in a fixed amount at regular intervals is not a necessary element of insurance. Similarly there is no necessity for a definite fund set aside to meet the insurer's obligations. And the fact that the amount and duration of benefits increased with the length of time that an employee worked for Southern Bell reflected the added value to the company of extra years of experience and service. Apparently the Government relies on these facts primarily to show that Southern Bell's Plan did not contain features which would be present in the normal commercial insurance contract. The Government, however, offers no persuasive reason why the term "health insurance" in § 22(b)(5) should be limited to the particular forms of insurance conventionally made available by commercial companies. Certainly there is nothing in the language of § 22(b)(5) which compels this limitation.

There is no support in the legislative history for the Government's argument that Congress intended to restrict the exemption provided in § 22(b)(5) to "conventional modes of insurance" and not to include employer disability plans. For reasons deemed satisfactory, Congress, since 1918, has chosen not to tax receipts from health and accident insurance contracts.[3] The language of section 22(b)(5) appeared in the Revenue Act of 1918 and has reappeared without relevant change in all succeeding revenue acts up to 1954.[4] The term "health insurance" was not defined in any of these acts or in any of the committee reports. There has been no uniform administrative practice which can be drawn upon to support the narrow meaning of section 22(b)(5) now urged by the Government. Administrative rulings since 1918 appear to have regularly vacillated between holding receipts under company disability plans taxable and holding that they are not taxable.[5] Under these circumstances we see no reason why the term "health insurance" in section 22(b)(5) should not be given its broad general meaning. See *Helvering* v. *Le Gierse*, 312 U. S. 531.

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[2] The Government points to several other aspects of the Southern Bell Plan as demonstrating that it is not "health insurance." After consideration of the Government's contentions in this respect we find they are without merit.

[3] In *Epmeier* v. *United States*, 199 F. 2d 508, 511, the Seventh Circuit was of the opinion that: "The provisions of Section 22(b)(5) undoubtedly were intended to relieve a taxpayer who has the misfortune to become ill or injured, of the necessity of paying income tax upon insurance benefits received to combat the ravages of disease or accident."

[4] Section 22(b)(5) can be traced to section 213(b)(6) of the Revenue Act of 1918, 40 Stat. 1066. In sections 104, 105 and 106 of the 1954 Internal Revenue Code, 26 U. S. C. (Supp. III) sections 104–106, Congress again exempted amounts received through health insurance. However these new provisions limited the exclusion for receipts similar to those involved here to a maximum of $100 per week. We do not accept the Government's contention that the enactment of sections 104–106 shows that Congress in 1918, and in succeeding revenue measures, intended to distinguish between conventional commercial insurance and an employer's plan like that of Southern Bell's.

[5] T. D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918); G. C. M. 23511, Cumulative Bulletin 86 (1943); I. T. 4000, 1 Cumulative Bulletin 21 (1950); I. T. 4015, Cumulative Bulletin 23 (1950); I. T. 4107, 2 Cumulative Bulletin 73 (1952); Rev. Rul. 208, 1952–2 Cumulative Bulletin 102. For a discussion of the difficulties of the American Telephone and Telegram Company's system because of the shifting administrative practice see Hearings before House Committee on Ways and Means on Forty Topics Pertaining to the General Revision of the Internal Revenue Code, 83d Cong., 1st Sess. 363.

The judgment of the Court of Appeals is reversed and the judgment of the District Court which held that petitioner was entitled to a refund is affirmed. It is so ordered.

Mr. Justice Burton and Mr. Justice Harlan dissent for the reasons stated in the opinion of the Court of Appeals, 223 F. 2d 413. See also, *Moholy* v. *United States*, 235 F. 2d 562; I. R. C., 1954, sections 104–106, and the accompanying report, H. R. Rep. No. 1337, 83d Cong., 2d Sess. 15, A32–A35.

Mr. Justice Whittaker took no part in the consideration or decision of this case.

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

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

Penalty payments made by a taxpayer to his mortgagee for the privilege of prepaying his mortgage indebtedness. See Rev. Rul. 57–198, page 94.

SECTION 23(k).—BAD DEBTS

REGULATIONS 118, SECTION 39.23(k)-6: Nonbusiness bad debts. Ct. D. 1800

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. DEDUCTIONS FROM GROSS INCOME—NONBUSINESS BAD DEBTS—PAYMENT OF OBLIGATION AS GUARANTOR OF NOTES OF CORPORATION

Taxpayer, the controlling stockholder of a corporation, guaranteed payment of promissory notes which the corporation executed in obtaining bank loans. The corporation became insolvent and taxpayer, as guarantor, was required to pay the bank. The corporation being unable to repay him, upon his payment as guarantor, taxpayer, by subrogation, acquired a debt, the loss resulting from the worthlessness of which is deductible as a short-term capital loss for nonbusiness bad debt under section 23(k)(4) of the 1939 Code and not as an ordinary nonbusiness loss deduction under section 23(e)(2).

2. JUDGMENT AFFIRMED.

Decision of the United States Court of Appeals for the Eighth Circuit, 224 F. 2d 947, affirmed.

SUPREME COURT OF THE UNITED STATES

Max Putnam and Elizabeth Putnam, petitioners, v. *Commissioner of Internal Revenue*

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

[December 3, 1956]

OPINION

Mr. Justice Brennan delivered the opinion of the Court.

The petitioner, Max Putnam, in December 1948, paid $9,005.21 to a Des Moines, Iowa bank in discharge of his obligation as guarantor of the notes of Whitehouse Publishing Company. That corporation still had a corporate existence at the time of the payment but had ceased doing business and had disposed of its assets eighteen months earlier. The question for decision is whether in the joint income tax return filed by Putnam and his wife for 1948, Putnam's loss is fully deductible as a loss "incurred in [a] transactions . . . for profit, though not connected with [his] trade or business" within the meaning

of section 23(e)(2) of the Internal Revenue Code of 1939,[1] or whether it is deductible only as a short-term capital loss, because a nonbusiness bad debt within the meaning of section 23(k)(4) of the Code.[2]

The Commissioner determined that the loss was a nonbusiness bad debt to be given short-term capital loss treatment. The Tax Court[3] and the Court of Appeals[4] for the Eighth Circuit sustained his determination. Because of an alleged conflict with decisions of the Courts of Appeals of other Circuits[5] we granted certiorari.[6]

Putnam is a Des Moines lawyer who in 1945, in a venture not connected with his law practice,[7] organized Whitehouse Publishing Company with two others, a newspaperman and a labor leader, to publish a labor newspaper. Each incorporator received one-third of the issued capital stock but Putnam supplied the property and cash with which the company started business. He also financed its operations, for the short time it was in business, through advances and guarantees of payment of salaries and debts. Just before the venture was abandoned, Putnam acquired the shares held by his fellow stockholders and in July 1947, as sole stockholder, wound up its affairs, and liquidated its assets. The proceeds of sale were insufficient to pay the full amount due to the Des Moines bank on two notes given by the corporation and guaranteed by Putnam for moneys borrowed in August 1946 and March 1947.

The familiar rule is that *instanter* upon the payment by the guarantor of the debt, the debtor's obligation to the creditor becomes an obligation to the guarantor, not a new debt, but, by subrogation, the result of the shift of the original debt from the creditor to the guarantor who steps into the creditor's shoes.[8] Thus, the loss sustained by the guarantor unable to recover from the debtor is by its very nature a loss from the worthlessness of a debt. This has been consistently recognized in the administrative and the judicial construction of the Internal Revenue laws[9] which, until the decisions of the Courts of Appeals in conflict with the decision below, have always treated guarantors' losses as bad

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[1] "SEC. 23. DEDUCTIONS FROM GROSS INCOME.
"In computing net income there shall be allowed as deductions:
* * * * * * *
"(e) LOSSES BY INDIVIDUALS.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
* * * * * * *
"(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *." 53 Stat. 13, 26 U. S. C. section 23(e)(2).

[2] "SEC. 23. DEDUCTIONS FROM GROSS INCOME.
* * * * * * *
"(k) BAD DEBTS.—
* * * * * * *
"(4) NON-BUSINESS DEBTS.—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term 'non-business debt' means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business." 53 Stat. 13, 56 Stat. 820, 26 U. S. C section 23(k)(4).

[3] 13 CCH TC Mem. Dec. 458.

[4] 224 F. 2d 947.

[5] *Pollak* v. *Commissioner*, 209 F. 2d 57 (C. A. 3d Cir.); *Edwards* v. *Allen*, 216 F. 2d 794 (C. A 5th Cir.); *Cudlip* v. *Commissioner*, 220 F. 2d 565 (C. A. 6th Cir.).

[6] 350 U. S. 964.

[7] Petitioners abandoned in this Court the alternative contention made below that the loss was deductible in full as a business bad debt under section 23(k)(1).

[8] *United States* v. *Munsey Trust Co.*, 332 U. S. 234, 242; *Aetna Life Ins. Co.*, v. *Middleport*, 124 U. S. 534, 548; *Howell* v. *Commissioner*, 69 F. 2d 447, 450 [Ct. D. 872, C. B. XIII–2, 294 (1934)]; *Scott* v. *Norton Hardware Co.*, 54 F. 2d 1047; Brandt, Suretyship and Guaranty (3d ed.), section 324; 38 C. J. S. Guaranty section 111; 24 Am. Jur. Guaranty section 125. Iowa follows this rule. *Randell* v. *Fellers*, 218 Iowa 1005, 252 N. W. 787; *American Surety Co.* v. *State Trust & Sav. Bank*, 218 Iowa 1, 254 N. W. 338. There is not involved here a question of the effect of state law upon federal tax treatment of Putnam's loss. Cf. *Watson* v. *Commissioner*, 345 U. S. 544 [Ct. D. 1760, C. B. 1953–1, 179]; *Lyeth* v. *Hoey*, 305 U. S. 188 [Ct. D. 1370, C. B. 1938–2, 208]; *Burnet* v. *Harmel*, 287 U. S. 103 [Ct D. 611, C. B. XI–2, 210 (1932)].

[9] The bad debt deduction provisions of earlier Revenue Acts were enacted in section 214(a)(7) of the Revenue Act of 1921, 42 Stat. 239; section 214(a)(7) of the Revenue Act of 1924, 43 Stat. 269; section 214(a)(7) of the Revenue Act of 1926, 44 Stat. 26; section 23(j) of the Revenue Act of 1928, 45 Stat. 799; section 23(j) of the Revenue Act of 1932, 47 Stat. 179; section 23(k) of the Revenue Act of 1934, 48 Stat. 688; section 23(k) of the Revenue Act of 1936, 49 Stat. 1658; section 23(k) of the Revenue Act of 1938, 52 Stat. 460; and section 23(k) of the Internal Revenue Code of 1939, 53 Stat. 12.

debt losses.[10] The Congress recently confirmed this treatment in the Internal Revenue Code of 1954 by providing that a payment by a noncorporate taxpayer in discharge of his obligation as guarantor of certain noncorporate obligations "shall be treated as a debt." [11]

There is then no justification or basis for consideration of Putnam's loss under the general loss provisions of section 23(e)(2), i. e., as an ordinary nonbusiness loss sustained in a transaction entered into for profit. Congress has legislated specially in the matter of deductions of nonbusiness bad debt losses, i. e., such a loss is deductible only as a short-term capital loss by virtue of the special limitation provisions contained in section 23(k)(4). The decision of this Court in *Spring City Co.* v. *Commissioner*, 292 U. S. 182 [Ct. D. 829, C. B. XIII-1,281 (1934)], is apposite and controlling. There it was held that a debt excluded from deduction under section 234(a)(5) of the Revenue Act of 1918 was not to be regarded as a loss deductible under section 234(a)(4). Chief Justice Hughes said for the Court:

> "Petitioner also claims the right of deduction under section 234(a)(4) of the Act of 1918 providing for the deduction of 'Losses sustained during the taxable year and not compensated for by insurance or otherwise.' We agree with the decision below that this subdivision and the following subdivision (5) relating to debts are mutually exclusive. We so assumed, without deciding the point, in *Lewellyn* v. *Electric Reduction Co.*, 275 U. S. 243, 246. The making of the specific provision as to debts indicates that these were to be considered as a special class and that losses on debts were not to be regarded as falling under the preceding general provision. What was excluded from deduction under subdivision (5) cannot be regarded as allowed under subdivision (4). If subdivision (4) could be considered as ambiguous in this respect, the administrative construction which has been followed from the enactment of the statute—that subdivision (4) did not refer to debts—would be entitled to great weight. We see no reason for disurbing that construction." 292 U. S., at 189.

Here also the statutory scheme is to be understood as meaning that a loss attributable to the worthlessness of a debt shall be regarded as a bad debt loss, deductible as such or not at all.

The decisions of the Courts of Appeals in conflict with the decision below turn upon erroneous premises.[12] It is said that the guarantor taxpayer who involuntarily acquires a worthless debt is in a position no different from the taxpayer who voluntarily acquires a debt known by him to be worthless. The latter is treated as having acquired no valid debt at all.[13] The situations are not analogous or comparable. The taxpayer who voluntarily buys a debt with knowledge that he will not be paid is rightly considered not to have acquired a debt but to have made have made a gratuity. In contrast the guarantor

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[10] See *e. g.*, 2 Cum. Bull. 137; 5 Cum. Bull. 146; III-1 Cum. Bull. 158; III-1 Cum. Bull. 166; *Shiman* v. *Commissioner*, 60 F. 2d 65 (C. A. 2d Cir.); *Hamlen* v. *Welch*, 116 F. 2d 413 (C. A. 1st Cir.); *Gimbel* v. *Commissioner*, 36 B. T. A. 539; *Roberts* v. *Commissioner*, 36 B. T. A. 549; *Sharp* v. *Commissioner*, 38 B. T. A. 166; *Hovey* v. *Commissioner*, P-H 1939 B. T. A. Mem. Dec. ¶39.081; *Pierce* v. *Commissioner*, 41 B. T. A. 1261; *Whitcher* v. *Welch*, 22 F. Supp. 763.

Similar decisions rendered since the Revenue Act of 1942 include: *Ortiz* v. *Commissioner*, 42 B. T. A. 173, reversed on another ground, *sub nom. Helvering* v. *Wilmington Trust Co.*, 124 F. 2d 156, reversed (without discussion on this point), 316 U. S. 164 [Ct. D. 1555, C. B. 1942-1, 225]; *Burnett* v. *Commissioner*, P-H 1942 B. T. A. Mem. Dec. ¶42,528; *Ritter* v. *Commissioner*, P-H 1946 TC Mem. Dec. ¶46,237; *Greenhouse* v. *Commissioner*, P-H 1954 TC Mem. Dec. ¶54,250; *Estate of Rosset* v. *Commissioner*, P-H 1954 TC Mem. Dec. ¶54,346; *Watson* v. *Commissioner*, 8 T. C. 569; *Sherman* v. *Commissioner*, 18 T. C. 746; *Aftergood* v. *Commissioner*, 21 T. C. 60; *Stamos* v. *Commissioner*, 22 T. C. 885.

[11] "SEC. 166. BAD DEBTS.

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"(f) GUARANTOR OF CERTAIN NONCORPORATE OBLIGATIONS.—A payment by the taxpayer (other than a corporation) in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of a non-corporate obligation the proceeds of which were used in the trade or business of the borrower shall be treated as a debt becoming worthless within such taxable year for purposes of this section (except that subsection (d) shall not apply), but only if the obligation of the borrower to the person to whom such payment was made was worthless (without regard to such guaranty, endorsement, or indemnity) at the time of such payment." 68A Stat. 50, 26 U. S. C. section 166(f). And see 65 Yale L. J. 247.

[12] See N. 5, *supra*.

[13] *Reading Co.* v. *Commissioner*, 132 F. 2d 306; *W. F. Young, Inc.* v. *Commissioner*, 120 F. 2d 159; *American Cigar Co.* v. *Commissioner*, 66 F. 2d 425 [Ct. D. 824, C. B. XIII-1, 260 (1934)].

pays the creditor in compliance with the obligation raised by the law from his contract of guaranty. His loss arises not because he is making a gift to the debtor but because the latter is unable to reimburse him.

Next it is assumed, at least in the *Allen* case, that a new obligation arises in favor of the guarantor upon his payment to the creditor. From that premise it is argued that such a debt cannot "become" worthless but is worthless from its origin, and so outside he scope of section 23(k). This misconceives the basis of the doctrine of subrogation, apart from the fact that if it were true that the debt did not "become" worthless, the debt nevertheless would not be regarded as an ordinary loss under section 23(e). *Spring City Co.* v. *Commissioner, supra.* Under the doctrine of subrogation, payment by the guarantor, as we have seen, is treated not as creating a new debt and extinguishing the original debt, but as preserving the original debt and merely substituting the guarantor for the creditor. The reality of the situation is that the debt is an asset of full value in the creditor's hands because backed by the guaranty. The debtor is usually not able to reimburse the guarantor and in such cases that value is lost at the instant that the guarantor pays the creditor. But that this instant is also the instant when the guarantor acquires the debt cannot obscure the fact that the debt "becomes" worthless in his hands.

Finally, the Courts of Appeals found support for their view in the following language taken from the opinion of this Court in *Eckert* v. *Burnet*, 283 U. S. 140 [Ct. D. 325, C. B. X-I, 241 (1931)]:

> "The petitioner claims the right to deduct half that sum as a debt 'ascertained to be worthless and charged off within the taxable year,' under the Revenue Act of 1926, c. 27, § 214(a)(7); 44 Stat. 9, 27.
>
> "It seems to us that the Circuit Court of Appeals sufficiently answered this contention *by remarking that the debt was worthless when acquired. There was nothing to charge off.* The petitioner treats the case as one of an investment that later turns out to be bad. But in fact it was the satisfaction of an existing obligation of the petitioner, having, it may be, the consequence of a momentary transfer of the old notes to the petitioner in order that they might be destroyed. It is very plain we think that the words of the statute cannot be taken to include a case of that kind." 283 U. S., at 141. (Emphasis added.)

That statement did not imply a determination by this Court that the guarantor's loss was not to be treated as a bad debt.[14] This Court was not faced with the question in *Eckert*. The point decided by the case was that a guarantor reporting on a cash basis and discharging his guaranty, not by a cash payment, but by giving the creditor his promissory note payable in a subsequent year, was not entitled to a bad debt loss deduction in the year in which he gave the note. The true significance of the quoted language is that although "the debt was worthless when acquired" it could not "be charged off" within the taxable year as the promissory note given for its payment was not paid or payable within that year.[15]

The objectives sought to be achieved by the Congress in providing short-term capital loss treatment for nonbusiness bad debts are also persuasive that section

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[14] The basis for this statement came from the opinion of the Court of Appeals for the Second Circuit and was explained by that court in its later opinion in *Shiman* v. *Commissioner*, 60 F. 2d 65, 67, as follows:

"Though there was no debt until Shiman paid the brokers, it then became such at once and was known to be worthless as soon as it arose; verbally at any rate there is no difficulty. Nor is there any reason to impute a purpose to except such cases; the loss is as real and unavoidable as though the debt had had some value for a season. The analogy of section 204(b) is apt. We can see no ground therefore for question except some of the language used in *Eckert* v. *Burnet*, 283 U. S. 140, 51 S. Ct. 373, 75 L. Ed. 911 [Ct. D. 325, C. B. X-1, 241 (1931)], taken from our opinion in 42 F. (2d) 158. That was quite another situation. Eckert, the taxpayer, had been an accommodation endorser for a corporation which became insolvent. When called upon to pay he gave his note instead, not payable within the year. The Court refused to allow the deduction, because Eckert was keeping his books on a cash basis, but it intimated that when he paid he might succeed; until then he had done no more than change the form of the obligation. Yet, if it were enough to defeat him that the debt was 'worthless when acquired,' the same objection ought to be good after he had paid; contrary to what was suggested. We cannot therefore think that the language so thrown out was intended as an authoritative statement by which we must be bound."

[15] See *Helvering* v. *Price*, 309 U. S. 409 [Ct. D. 1451, C. B. 1940-1, 134]. The requirement that the debt "be ascertained to be worthless and be charged off within the taxable year" was superseded in the Revenue Act of 1942, § 124 (a), by the requirement that the debt be one which "becomes worthless within the taxable year."

23(k)(4) applies to a guarantor's nonbusiness debt losses. The section was part of the comprehensive tax program enacted by the Revenue Act of 1942 to increase the national revenue to further the prosecution of the great war in which we were then engaged.[16] It was also a means for minimizing the revenue losses attributable to the fraudulent practices of taxpayers who made gifts to relatives and friends disguised as loans.[17] Equally, however, the plan was suited to put nonbusiness investments in the form of loans on a footing with other nonbusiness investments. The proposal originated with the Treasury Department whose spokesman championed it as a means "to insure a fairer reflection of taxable income," [18] and the House Ways and Means Committee Report stated that the objective was "to remove existing inequities and to improve the procedure through which bad-debt deductions are taken." [19] We may consider Putnam's case in the light of these revealed purposes. His venture into the publishing field was an investment apart from his law practice. The loss he sustained when his stock became worthless as well as the losses from the worthlessness of the loans he made directly to the corporation would receive capital loss treatment; the 1939 Code so provides as to nonbusiness losses both from worthless stock investments and from loans to a corporation, whether or not the loans are evidenced by a security.[20] It is clearly a "fairer reflection" of Putnam's 1948 taxable income to treat the instant loss similarly. There is no real or economic difference between the loss of an investment made in the form of a direct loan to a corporation and one made indirectly in the form of a guaranteed bank loan. The tax consequences should in all reason be the same, and are accomplished by section 23(k)(4).[21] The judgment is affirmed.

Mr. Justice HARLAN dissenting in a separate opinion.

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[16] Chairman Doughton of the House Committee on Ways and Means opened the hearings on the bill which became the Revenue Act of 1942 with the statement: "* * * the meeting of the committee this morning is the first step in the consideration, preparation, and reporting of perhaps the largest tax bill that it has ever been the duty and responsibility of our committee to report.

"We are faced with revenue needs and a tax program of a magnitude unthought of in modern times, and we all realize it is necessary to raise every dollar of additional revenue that can be raised without seriously disturbing or shattering our national economy." Hearings before House Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d Sess. 1.

[17] Petitioners argue that this was its sole purpose and that the section should be construed as limited in application to such loans. The context of the segment of the House Ways and Means Committee Report discussing this objective does not support the petitioners' argument. H. R. Rep. No. 2333, 77th Cong., 2d Sess. 45:

"C. NONBUSINESS BAD DEBTS

"The present law gives the same tax treatment to bad debts incurred in nonbusiness transactions as it allows to business bad debts. *An example* of a nonbusiness bad debt would be an unrepaid loan to a friend or relative, while business bad debts arise in the course of the taxpayer's trade or business. This liberal allowance for nonbusiness bad debts has suffered considerable abuse through taxpayers making loans which they do not expect to be repaid. This practice is particularly prevalent in the case of loans to persons with respect to whom the taxpayer is not entitled to a credit for dependents. This situation has presented serious administrative difficulties because of the requirement of proof.

"The bill treats the loss from nonbusiness bad debts as a short-term capital loss. The effect of this provision is to take the loss fully into account, but to allow it to be used only to reduce capital gains. Like any other capital loss, however, the amount of such bad debt losses may be taken to the extent of $1,000 against ordinary income and the 5-year carry-over provision applies." (Emphasis added.)

[18] Hearings before House Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d Sess. 90.

[19] H. R. Rep. No. 2333, 77th Cong., 2d Sess. 44.

[20] Section 23(g)(2) and (3) as to worthless stock. Section 23(k)(2)(3) and (4) as to loans. As Judge Stewart pointed out in his dissenting opinion in the *Cudlip* case, 220 F. 2d, at 572.

"Had the petitioner made the necessary additional investment in the conventional form of subscribing for stock, his loss upon the failure of the corporation would have been a capital loss, section 23(g)(2), I. R. C. Had he made the investment in the form of a loan to the corporation evidenced by an instrument bearing interest coupons, his loss would likewise have been a capital loss, section 23(k)(2), I. R. C. Had he made the additional investment in the form of an ordinary loan to the corporation, his loss would likewise have been a capital loss, section 23(k)(4) I. R. C., Commissioner of Internal Revenue v. Smith, supra.

"Because the petitioner happened instead to risk his money by guaranteeing the corporation's bank loans, the court now holds that the petitioner may take an ordinary loss, deductible in full from his ordinary income. Yet from the petitioner's viewpoint, the situation would have been precisely the same had he himself borrowed the money and then lent it to the corporation. It therefore seems to me that the result reached by the court in this case is significantly unrealistic."

[21] Upon this ground, contrary to the holding in *Fox* v. *Commissioner*, 190 F. 2d 101, the guarantor's nonbusiness loss would receive short-term capital loss treatment despite the nonexistence of the debtor at the time of the guarantor's payment to the creditor.

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

REGULATIONS 118, SECTION 39.23(m)-5: Computation of depletion based on percentage of income in cases of certain mines or other natural deposits.

Deduction of stated rate of depletion with respect to dolomite. See Rev. Rul. 57-288, page 518.

SECTION 23(q).—CHARITABLE AND OTHER CONTRIBUTIONS BY CORPORATIONS

Rev. Rul. 57-228

Where, during the taxable year, a board of directors authorized a contribution and such contribution was paid after the close of the taxable year and on or before the fifteenth day of the third month following the close of the taxable year, an election may be made in the return to treat all, or only a portion, of the contribution as paid during the taxable year.

Advice has been requested whether an election, in accordance with the last paragraph of section 23(q) of the Internal Revenue Code of 1939, may be exercised in regard to a portion of a contribution paid after the close of the taxable year and on or before the 15th day of the third month following the close of the taxable year.

The *M* corporation, which reports net income on the accrual method, filed its return for 1952 disclosing a net income of $950,000. Contributions itemized on the return included a donation to the *X* hospital in the amount of $50,000; other contributions paid were listed which amounted to $5,000, for a total of all contributions of $55,000. The contribution to the *X* hospital was marked with an asterisk drawing attention to a footnote which advised of the *M* corporation's election, in accordance with the last paragraph of section 23(q) of the Code, to consider this amount as having been paid during the taxable year to the extent allowable as a deduction from taxable income, after deductions of all other contributions listed above. Also attached to the return was a certification by the president of *M* corporation that the board of directors had met during the taxable year and voted to contribute $50,000 to the *X* hospital, of which amount $40,000 was paid during the taxable year and $10,000 was paid, in a single payment, subsequent to the close of the taxable year and prior to March 15, 1953.

The total contributions of $55,000 itemized on the return exceeded the five percent limitation provided in section 23(q) of the Code and, consequently, a deduction for contributions was claimed on the return in the smaller amount of $50,000 (hospital, $45,000; other contributions, $5,000). The $5,000 amount in excess of the allowable five percent was reflected in the surplus analysis, designated as schedule M on the return, as "Accrued Contributions" under the caption "Other unallowable deductions," and not under the caption "Contributions in excess of five percent limitation".

The $5,000 amount in excess of the five percent limitation, which was reflected in schedule M of the return, is proposed as a deduction in the subsequent year, 1953, on the theory that the Code and regulations do

not bar the exercise of the election in accordance with section 23(q) in such a manner as to split a single contribution deduction.

Section 39.23(q)(1)(c) of Regulations 118 provides, in part, as follows:

> A corporation reporting its net income on the accrual basis may elect to have considered as paid during the taxable year any contribution or gift to organizations described in section 23(q), * * * payment of which contribution or gift is made after the close of the taxable year and on or before the fifteenth day of the third month following the close of such year if, during such year, the board of directors authorized such contribution or gift. * * *

A corporation is deemed to have made an election which complies with the requirements of the statutes where its board of directors authorized, by resolution during the taxable year, the payment of charitable contributions up to a maximum of five percent of such taxable income.

Accordingly, it is held that where a board of directors authorized a contribution or gift during a taxable year, and such contribution or gift was paid in a single payment subsequent to the close of the taxable year, and on or prior to the fifteenth day of the third month following the close of the taxable year, an election may be made in the return to treat all or only a portion of the contribution as paid during the taxable year.

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

REGULATIONS 118, SECTION 39.23(bb)-1: Circulation expenditures. Rev. Rul. 57-87

> Treatment, for Federal income tax purposes, of circulation expenditures by publishers who have consistently deferred both subscription income and subscription expense.
> I. T. 3369, C. B. 1940-1, 46, modified.

Advice has been requested regarding the treatment of circulation expenditures attributable to prepaid subscription income, in view of the provisions of I. T. 3369, C. B. 1940-1, 46, and section 23(bb) of the Internal Revenue Code of 1939.

The taxpayer in the instant case has consistently filed Federal income tax returns on the basis of reporting only the allocable part of prepaid subscription revenue relating to that portion of the subscriptions to be fulfilled in that year and of deferring the remaining allocable portions of such revenue to subsequent years in relation to the subscriptions to be fulfilled in those years. Likewise, in determining its income, the taxpayer deferred all subscription expenses to the year to which they relate in accordance with the provisions of I. T. 3369, *supra*.

I.T. 3369, *supra*, as far as it is pertinent here holds that where a publisher has consistently reported an aliquot part of the subscription income for each year of the subscription period, all applicable expenses incurred during the year in which the subscriptions are obtained shall be spread allocably over the subscription periods in the same manner as subscription income.

However, section 204 of the Revenue Act of 1950 amended section 23 of the 1939 Code by adding a new subsection (bb) to provide for the deduction of expenditures (with certain exceptions) to establish, maintain, or increase the circulation of a newspaper, magazine, or periodical. This new section of the 1939 Code, subject to the conditions provided by subsections (c)(1) and (2) of section 204 of the Act, was effective for the taxable years beginning subsequent to December 31, 1945. The provisions of section 23(bb) of the 1939 Code read as follows:

SECTION 23.—DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions: * * *

(bb) CIRCULATION EXPENDITURES.—Notwithstanding section 24(a), all expenditures (other than expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical) to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical; except that the deduction shall not be allowed with respect to the portion of such expenditures as, under regulations prescribed by the Secretary, is chargeable to capital account if the taxpayer elects, in accordance with such regulations, to treat such portion as so chargeable. Such election, if made, must be for the total amount of such portion of the expenditures which is so chargeable to capital account, and shall be binding for all subsequent taxable years unless, upon application by the taxpayer, the Secretary permits a revocation of such election subject to such conditions as he deems necessary.

In view of the provisions of section 23(bb) of the 1939 Code, it is held that for years beginning subsequent to December 31, 1945, such expenditures are currently deductible in the year paid or incurred. Accordingly, to the extent that it requires or permits any deferral of expenditures to establish, maintain, or increase the circulation of any newspaper, magazine or periodical, I. T. 3369, *supra*, is modified.

Pursuant to the authority contained in section 7805(b) of the Internal Revenue Code of 1954, this modification shall be effective only with respect to the first open year of such taxpayer at the time that this Revenue Ruling is published in the Internal Revenue Bulletin. Expenditures paid or incurred in a year prior to the effective date of this Revenue Ruling but which were deferred to a subsequent year under I. T. 3369, *supra*, will be deductible in the year in which they would have been deductible had no modification occurred.

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. 57-45, page 509.

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. 57-45

(Also Regulations 111, Section 29.26-5.)
(Also Part I, Section 247; 26 CFR 1.247-1.)

A public utility is not entitled to 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 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 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. *Philadelphia Electric Co.* v. *United States*, 117 Fed. Supp. 424, discussed.

In *Philadelphia Electric Co.* v. *United States*, 117 Fed. Supp. 424, the question presented was whether the plaintiff, a "public utility" as defined in section 26(h)(2)(A) of the Internal Revenue Code of 1939, was entitled to the credit allowed by section 26(h) of the 1939 Code in respect of dividends paid by it on its "$1.00 dividend preference common stock." The dividends in respect of such stock were cumulative and payable in preference to dividends on the common stock of the plaintiff, which was its only other class of stock outstanding. The dividend rate on such prefrence common stock was fixed and limited to the same amount. However, in the event of liquidation, the holders of such preference common stock were entitled to participate on an equal basis with the holders of the common stock in the assets of the corporation.

Section 26(h)(1) of the Code allows a public utility, as defined in section 26(h)(2)(A), a credit for dividends paid on its preferred stock. Section 26(h)(2)(A) of the Code defines a "public utility" as follows:

> (A) PUBLIC UTILITY.—The term "public utility" means a corporation engaged in the furnishing of telephone service or in the sale of electric energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

Section 26(h)(2)(B) of the Code defines the term "preferred stock" as follows:

> (B) PREFERRED STOCK.—The term "preferred stock" means stock issued prior to October 1, 1942, which during the whole of the taxable year (or the part of the taxable year after its issue) was stock the dividends in respect of which were cumulative, limited to the same amount, and issued on or after October 1, 1942, shall be deemed for the purposes payable in preference to the payment of dividends on other stock. Stock of this paragraph to have been issued prior to October 1, 1942, if it was issued (including issuance either by the same or another corporation in a transaction which is a reorganization, as defined in section 112(g)(1), or a transaction to which section 112(b)(10), or so much of section 112(d) or (e) as relates to section 112(b)(10), is applicable, or which is a transaction subject to Supplement R) to refund or replace

> bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock (including stock which is preferred stock by reason of this sentence), but only to the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds or debentures issued prior to October 1, 1942, or the other preferred stock, which such new stock is issued to refund or replace. The determination of whether stock was issued to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock, shall be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Prior to the amendment made by Treasury Decision 6195, approved August 8, 1956, C. B. 1956–2, 979, section 39.26(h)–1(c)(1) of Regulations 118 and section 29.26–5(a) of Regulations 111 contained the following provision:

> For the purposes of section 26(h) * * * preferred stock means stock which * * * was stock nonparticipating as to earnings or profits either currently or in liquidation, * * *.

Under these regulations prior to the amendment made by Treasury Decision 6195, *supra*, stock which is participating as to earnings or profits in liquidation could not qualify as "preferred stock" for the purposes of section 26(h) credit. However, in the Philadelphia Electric Company case, the court held that this provision of the regulations was invalid, being in addition to the requirements of the statute and unnecessary to effectuate the statutory conditions of the credit. Under the court's decision, the plaintiff was allowed the dividends paid credit in respect of the dividends paid by it during the calendar year 1947 on its outstanding preference common stock.

Treasury Decision 6195, *supra*, amended the provisions of Regulations 111 and 118 quoted above to omit the words "earnings or profits either currently or in liquidation" and inserted in lieu thereof the words "current distributions." This amendment was made to conform the regulations to the decision in the Philadelphia Electric Company case. However, in other cases involving facts similar to those in the Philadelphia Electric Company case, it will be the position of the Internal Revenue Service that the credit in respect of dividends paid on public utility preferred stock is not allowable for another reason discussed below.

The Philadelphia Electric Company issued its preference stock in 1943 in the reclassification of its common stock into new common stock and the preference stock. At the time of such reclassification, all the outstanding common stock of the company was held by its parent corporation, which was a "registered holding company" within the meaning of section 2 of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. 79b(a). After the company issued its new common stock and preference stock to its parent corporation in exchange for the company's old common stock, the parent corporation distributed the company's new preference stock plus cash to the holders of the parent's preferred stock in partial liquidation and redemption of such stock. The exchanges in respect of the company's new preference stock, both between the company and its parent corporation and between the parent corporation and the latter's preferred stockholders, were made in obedience to orders of the Securities and Exchange Commission to facilitate the parent corporation's compliance with section 11(b) of the Public Utility Holding Company Act of 1935. Such

exchanges were subject to the provisions of Supplement R of the 1939 Code. See section 371 (a) and (g) of the Code.

However, the parent corporation of the plaintiff company was not "engaged in the furnishing of telephone service or in the sale of electric energy, gas, or water * * *," and, thus, was not a "public utility" within the meaning of section 26(h)(2)(A) of the Code. See *In the Matter of United Gas Improvement Co.*, 12 S. E. C. 1080 (1943). Prior to the redemption of its preferred stock, the parent corporation was not entitled to the section 26(h) credit in respect of dividends paid by it on its own preferred stock. As provided in section 26(h)(2)(B), stock issued on or after October 1, 1942, under certain circumstances will be considered as having been issued before October 1, 1942, for purposes of the section 26(h) credit. However, in the case of new perferred stock issued on or after October 1, 1942, by a public utility to replace preferred stock of another company, as in the instant case, it is the position of the Service that the dividends paid credit is not allowable in respect of dividends paid on the new preferred stock if the other company whose preferred stock was replaced by the new preferred stock was not itself a "public utility" and entitled to the section 26(h) credit in respect of dividends paid by it on the preferred stock so replaced.

Under such circumstances, it is not believed that the allowance of the dividends paid credit in respect of dividends paid on the new preferred stock would be consistent with the intended meaning of the statute. It is the position of the Service that the purpose of the statutory provision 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 was 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 a credit not previously allowable to the former corporation.

Accordingly, it is held that a "public utility" as defined in section 26(h)(2)(A) of the Code is not entitled to the dividends paid credit in respect of dividends paid on preferred stock issued by such "public utility" on or after October 1, 1942, pursuant to an order of the Securities and Exchange Commission under section 11(b) of the Public Utility Holding Company Act of 1935, *supra*, to replace preferred stock issued prior to October 1, 1942, by another corporation, where at the time of such replacement such other corporation was not a "public utility" as defined in section 26(h)(2)(A) of the Code and had not been entitled to the section 26(h) credit in respect of any dividends paid by it on its own preferred stock so replaced.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SECTION 41.—GENERAL RULE

REGULATIONS 118, SECTION 39.41–1: Computation of net income.

Prepaid membership dues received by an accrual basis automobile club. See Ct. D. 1807, page 513.

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN

REGULATIONS 118, SECTION 39.43-2: When charges deductible.

Accrual of vacation pay by taxpayers using the accrual method of accounting. See Rev. Rul. 57-28, page 193.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 54.—RECORDS AND SPECIAL RETURNS

REGULATIONS 118, SECTION 39.54-1: Records and income tax forms.

Effect of filing information returns in determining period of limitation on assessment of deficiencies resulting from a retroactive determination that an automobile club is not exempt from tax. See Ct. D. 1807, page 513.

SECTION 55.—PUBLICITY OF RETURNS

Inspection of certain returns by the Senate Committee on Government Operations. See E. O. 10699, page 436.

Inspection of certain returns by the Committee on Un-American Activities, House of Representatives. See E. O. 10701, page 437.

Inspection of certain returns by the Select Committee of the Senate. See E. O. 10703, page 438.

Inspection of certain returns by the Senate Committee on the Judiciary. See E. O. 10706, page 438.

Inspection of certain returns by the Senate Committee on the Judiciary. See E. O. 10712, page 439.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS

REGULATIONS 118, SECTION 39.101(9)-1: Social clubs. Ct. D. 1807

(Also Sections 41, 54, 275, 3791(b); Regulations 118, Sections 39.41-1, 39.54-1, 39.275-1.)

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. EXEMPT CORPORATIONS—RETROACTIVE REVOCATION OF EXEMPTION.

The Commissioner was not estopped from revoking a ruling holding that an automobile club was exempt from income tax where such ruling was based on a mistake of law. The action of the Commissioner retroactively revoking taxpayer's exemption was not an abuse of discretion.

2. STATUTE OF LIMITATIONS ON ASSESSMENT OF DEFICIENCIES— RETURN NOT FILED BECAUSE OF EXEMPTION.

The statute of limitations on assessment of deficiencies did not begin to run from the date on which a return should have been filed by an organization which was retroactively declared not to be exempt from tax but from the date on which returns were actually filed. Returns on Form 990 did not start the running of the limitations period.

3. TAXABLE YEAR OF INCLUSION OF INCOME—PREPAID MEMBERSHIP DUES.

Membership dues received by an accrual basis automobile club one year in advance were includible in income in the year received since they were held under a claim of right without restriction on their disposition.

4. JUDGMENT AFFIRMED.

5. JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT, 230 FED. (2D) 585, AFFIRMED.

SUPREME COURT OF THE UNITED STATES

Automobile Club of Michigan, petitioner, v. *Commissioner of Internal Revenue*

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

[April 22, 1957]

OPINION

MR. JUSTICE BRENNAN delivered the opinion of the Court.

In 1945, the Commissioner of Internal Revenue revoked his 1934 and 1938 rulings exempting the petitioner from federal income taxes, and retroactively applied the revocation to 1943 and 1944. The Commissioner also determined that prepaid membership dues received by the petitioner should be taken into income in the year received, rejecting the petitioner's method of reporting as income only that part of the dues as were recorded on petitioner's books as earned in the tax year. The Tax Court sustained the Commissioner's determinations,[1] and the Court of Appeals for the Sixth Circuit affirmed.[2] This Court granted certiorari.[3]

The Commissioner had determined in 1934 that the petitioner was a "club" entitled to exemption under provisions of the internal revenue laws corresponding

[1] 20 T. C. 1033.
[2] 230 F. 2d 585.
[3] 352 U. S. 817.

to section 101(9) of the Internal Revenue Code of 1939,[4] notifying the petitioner that "* * * future returns, under the provisions of section 101(9) * * * will not be required so long as there is no change in your organization, your purposes or methods of doing business." In 1938, the Commissioner confirmed this ruling in a letter stating: "* * * as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed * * * *" Accordingly the petitioner did not pay federal taxes from 1933 to 1945. The Commissioner revoked these rulings in 1945, however, and directed the petitioner to file returns for 1943 and subsequent years.[5] Pursuant to this direction, the petitioner filed, under protest, corporate income and excess profits tax returns for 1943, 1944 and 1945.

The Commissioner's earlier rulings were grounded upon an erroneous interpretation of the term "club" in section 101(9) and thus were based upon a mistake of law. It is conceded that in 1943 and 1944 petitioner was not, in fact or in law, a "club" entitled to exemption within the meaning of section 101(9), and also that petitioner is subject to taxation for 1945 and subsequent years.[6] It is nevertheless contended that the Commissioner had no power to apply the revocation retroactively to 1943 and 1944, and that, in any event, the assessment of taxes against petitioner for 1943 and 1944 was barred by the statute of limitations.

The petitioner argues that, in light of the 1934 and 1938 rulings, the Commissioner was equitably estopped from applying the revocation retroactively. This argument is without merit. The doctrine of equitable estoppel is not a bar to the correction by the Commissioner of a mistake of law.[7] The decision in *Stockstrom* v. *Commissioner*, 190 F. 2d 283, to the entent that it holds to the contrary, is disapproved.

Petitioner's reliance on *H. S. D. Co.* v. *Kavanagh*, 191 F. 2d 831, and *Woodworth* v. *Kales*, 26 F. 2d 178, is misplaced because those cases did not involve correction of an erroneous ruling of law. Reliance on *Lesavoy Foundation* v. *Commissioner*, 238 F. 2d 589, is also misplaced because there the court recognized the power in the Commissioner to correct a mistake of law, but held that in the circumstances of the case the Commissioner had exceeded the bounds of the discretion vested in him under section 3791(b) of the 1939 Code.[8]

The Commissioner's action may not be disturbed unless, in the circumstances of this case, the Commissioner abused the discretion vested in him by section 3791(b) of the 1939 Code. That section provides:

> "RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

The petitioner contends that this section forbids the Commissioner taking retroactive action. On the contrary, it is clear from the language of the section and

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[4] Section 101(9) provided as follows:

"The following organizations shall be exempt from taxation under this chapter—

* * * * * * *

"(9) 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 * * *" 53 Stat 33, 26 U. S. C. (1934 ed., Supp. V) sec. 101(9).

The earlier statute sections were identical to the 1939 section. 52 Stat. 480 (1938); 49 Stat. 1673 (1936); 48 Stat. 700 (1934); 47 Stat. 193 (1932).

[5] The letter of revocation stated that in order to qualify as a club under sec. 101(9), the "* * * organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization * * *" It was then stated that the previous rulings were revoked because "[t]he evidence submitted shows that fellowship does not constitute a material part of the life of * * * [petitioner's] organization and that * * * [petitioner's] principal activity is the rendering of commercial services to * * * [its] members."

[6] Petitioner renders various services for its members. Among these are emergency road service when a car is disabled; furnishing maps, road and other travel information; and publishing a monthly magazine containing news of travel and of laws pertaining to the use of automobiles.

[7] *Keystone Auto. Club* v. *Commissioner*, 181 F. 2d 402; *Schafer* v. *Helvering*, 83 F. 2d 317, aff'd, 299 U. S. 171 [Ct. D. 1183, C. B. XV-2, 197]; *John M. Parker Co.* v. *Commissioner*, 49 F. 2d 254; *Southern Maryland Agricultural Fair Assn.* v. *Commissioner*, 40 B. T. A. 549; *Yokohama Ki-Ito Kwaisha*, 5 B. T. A. 1248; see also, *Chattanooga Auto. Club* v. *Commissioner*, 182 F. 2d 551 (by implication); *Warren Auto. Club* v. *Commissioner*, 182 F. 2d 551 (by implication); *Smyth* v. *California State Auto. Assn.*, 175 F. 2d 752 (by implication); *Automobile Club of St. Paul* v. *Commissioner*, 12 T. C. 1152 (by implication).

[8] 53 Stat. 467, 26 U. S. C. sec. 3791(b).

its legislative history [9] that Congress thereby confirmed the authority of the Commissioner to correct any ruling, regulation or Treasury decision retroactively, but empowered him, in his discretion, to limit retroactive application to the extent necessary to avoid inequitable results.

The Petitioner, citing *Helvering* v. *Reynolds*, 306 U. S. 110 [Ct. D. 1383, C. B. 1939-1 (Part 1), 225], argues that resort by the Commissioner to section 3791(b) was precluded in this case because the repeated re-enactments of section 101(9) gave the force of law to the provision of the Treasury regulations relating to that section. These regulations provided that when an organization had established its right to exemption it need not thereafter make a return of income or any further showing with respect to its status unless it changed the character of its operations or the purpose for which it was originally created.[10] *Helvering* v. *Reynolds* is inapplicable to this case. As stated by the Tax Court: "The regulations involved there [*Helvering* v. *Reynolds*] * * * purported to determine what did or did not constitute gain or loss. The regulations here . . . in no wise purported to determine whether any organization was or was not exempt." [11] These regulations did not provide the exemption or interpret section 101(9), but merely specified the necessary information required to be filed in order that the Commissioner might rule whether or not the taxpayer was entitled to exemption. This is thus not a case of ". . . administrative construction embodied in the regulation[s] . . ." which, by repeated re-enactment of section 101(9), ". . . Congress must be taken to have approved . . . and thereby to have given . . . the force of law." *Helvering* v. *Reynolds*, 306 U. S., at 114, 115.

We must, then, determine whether the retroactive action of the Commissioner was an abuse of discretion in the circumstances of this case. The action was the consequence of the reconsideration by the Commissioner, in 1943, of the correctness of the prior rulings exempting automobile clubs, initiated by a General Counsel Memorandum interpreting section 101(9) to be inapplicable to such organizations.[12] The Commissioner adopted the General Counsel's interpretation and proceeded to apply it, effective from 1943, indiscriminately to automobile clubs.[13] We thus find no basis for disagreeing with the conclusion, reached by both the Tax Court and the Court of Appeals, that the Commissioner, having dealt with petitioner upon the same basis as other automobile clubs, did not abuse his discretion. Nor did the two-year delay in proceeding with the petitioner's case, in these circumstances, vitiate the Commissioner's action.

The petitioner's contention that the statute of limitations barred the assessment of deficiencies for 1943 and 1944 is also without merit. Its returns for those years were not filed until October 22, 1945. Within three years, on August 25, 1948, the petitioner and the Commissioner signed consents extending the period to June 30, 1949. The period was later extended to June 20, 1950. Notice of deficiencies was mailed to petitioner on February 20, 1950. The assessments were therefore within time under sections 275(a) and 276(b)[14] unless, as the petitioner asserts, the statute of limitations began to run from the dates when, if there was a duty to file, the statute required filing.[15] The petitioner argues that because its omission to file on March 15, 1944, and March 15, 1945, was induced by the Commissioner's 1934 and 1938 rulings, it is only equitable to interpret the statute of limitations as running from those dates in the circumstances of this

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[9] H. R. Rep. No. 704, 73d Cong., 2d Sess. 38; S. Rep. No. 558, 73d Cong., 2d Sess. 48.

[10] Treas. Reg. 86, Art. 101-1 (1934); Treas. Reg. 94, Art. 101-1 (1936); Treas. Reg. 103, sec. 19.101-1 (1939).

[11] 20 T. C., at 1041.

[12] G. C. M. 23688, 1943 Cum. Bull. 283.

[13] See, *e. g.*, *Chattanooga Auto. Club* v. *Commissioner*, 182 F. 2d 551; *Warren Auto. Club* v. *Commissioner*, 182 F. 2d 551; *Keystone Auto. Club* v. *Commissioner*, 181 F. 2d 402; *Smyth* v. *California State Auto. Assn.*, 175 F. 2d 752; *Automobile Club of St. Paul* v. *Commissioner*, 12 T. C. 1152.

[14] Section 275 (a) provides as follows:

"Except as provided in section 276—

"(a) GENERA 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 collectiton of such taxes shall be begun after the expiration of such period." 53 Stat. 86, 26 U. S. C. sec. 275(a).

Section 276(b) provides as follows:

"(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 in writing made before the expiration of the period previously agreed upon." 53 Stat. 87, 26 U. S. C. sec. 276(b).

[15] The 1943 tax return was due on March 15, 1944. The 1944 tax return was due on March 15, 1945.

case. But the express condition prescribed by the Congress was that the statute was to run against the United States from the date of the actual filing of the return, and no action of the Commissioner can change or modify the conditions under which the United consents to the running of the statute of limitations against it. In *Lucas* v. *Pilliod Lumber Co.*, 281 U. S. 245, 249 [Ct. D. 266, C. B. IX–2, 396 (1930)], this Court held:

> "Under the established general rule a statute of limitations runs against the United States only when they assent and upon the conditions prescribed. Here assent that the statute might begin to run was conditioned upon the presentation of a return duly sworn to. No officer had power to substitute something else for the thing specified * * *." [16]

It is also argued that the Form 990 returns filed by the petitioner in compliance with section 54(f) of the 1939 Code, as amended,[17] constituted the filing of returns for the purposes of section 275(a). But the Form 990 returns are merely information returns in furtherance of a congressional program to secure information useful in a determination whether legislation should be enacted to subject to taxation certain tax-exempt corporations competing with taxable corporations.[18] Those returns lack the data necessary for the computation and assessment of deficiencies and are not therefore tax returns within the contemplation of section 275(a). Cf. *Commissioner* v. *Lane-Wells Co.*, 321 U. S. 219 [Ct. D. 1602, C. B. 1944, 539].

The final issue argued concerns the treatment of membership dues and arises because such dues are paid in advance for one year. The dues upon collection are deposited in a general bank account and are not segregated from general funds but are available and are used for general corporate purposes. For bookkeeping purposes, however, the dues upon receipt are credited to an account carried as a liability account and designated "Unearned Membership Dues." During the first month of membership and each of the following eleven months one twelfth of the amount paid is credited to an account designated "Membership Income." This method of accounting was followed by petitioner from 1934. The income from such dues reported by petitioner in each of its tax returns for 1943 through 1947 was the amount credited in the year to the "Membership Income" account. The Commissioner determined that the petitioner received the prepaid dues under a claim of right, without restriction as to their disposition, and therefore the entire amount received in each year should be reported as income. The Commissioner relies upon *North American Oil Co.* v. *Burnet*, 286 U. S. 417, 424 [Ct. D. 499, C. B. XI–1, 293 (1932)], where this Court said: "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition * * * [it] has received income which * * * [it] is required to return * * *"

The petitioner does not deny that it has the unrestricted use of the dues income in the year of receipt, but contends that its accrual method of accounting clearly reflects its income, and that the Commissioner is therefore bound to accept its method of reporting membership dues. We do not agree. Section 41 of the Internal Revenue Code of 1939 required that "[t]he net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books * * * but * * * if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income * * *" [19] The pro rata allocation of the membership dues in monthly amounts is purely artificial and bears no relation to the services which petitioner may in fact be called upon to render for the member.[20] Section 41 vests the Commissioner with discretion to determine whether the petitioner's method of accounting clearly reflects income. We cannot say, in the circumstances here, that the discretionary action of the Commissioner, sustained by both the

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[16] To the extent that the decision in *Balkan Nat. Ins. Co.* v. *Commissioner*, 101 F. 2d 75, is to the contrary, it is disapproved.

[17] 53 Stat. 28, as amended, 58 Stat. 36, 26 U. S. C. sec. 54(f).

[18] H. R. Rep. No. 871, 78th Cong., 1st Sess. 24–25; S. Rep. No. 627, 78th Cong., 1st Sess. 21.

[19] 53 Stat. 24, 26 U. S. C. sec. 41.

[20] *Beacon Publishing Co.* v. *Commissioner*, 218 F. 2d 697, and *Schuessler* v. *Commissioner*, 230 F. 2d 722, are distinguishable on their facts. In *Beacon*, performance of the subscription, in most instances, was, in part, necessarily deferred until the publication dates after the tax year. In *Schuessler*, performance of the service agreement required the taxpayer to furnish services at specified times in years subsequent to the tax year. In this case, substantially all services are performed only upon a member's demand and the taxpayer's performance was not related to fixed dates after the tax year. We express no opinion upon the correctness of the decisions in *Beacon* or *Schuessler*.

Tax Court and the Court of Appeals, exceeded permissible limits. See *Brown* v. *Helvering*, 291 U. S. 193, 204–205 [Ct. D. 786, C. B. XIII–1, 223 (1934)].

Affirmed.

MR. JUSTICE WHITTAKER took no part in the consideration or decision of this case.

MR. JUSTICE BURTON, whom Mr. Justice Clark joins, concurring in part and dissenting in part in a separate opinion.

MR. JUSTICE HARLAN, dissenting in a separate opinion.

SUPPLEMENT B.—COMPUTATION OF NET INCOME

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

REGULATIONS 118, SECTION 39.113(a)(5)-1: Basis of property acquired by bequest devise or inheritance. Rev. Rul 57–287

> Where a trust indenture provides that trust income is payable to the grantor during her lifetime and reserves to the grantor at all times up to her death the right to revoke the trust with the consent of named trustees, none of whom has any adverse interest in the trust, the trust comes within the meaning of secton 113(a)(5) of the Internal Revenue Code of 1939 and the basis of the property transferred to the trust is its fair market value at the date of the grantor's death (or optional valuation date).
>
> Revenue Ruling 55–502, C. B. 1955–2, 560, modified.

Advice has been requested whether the decision of the Tax Court of the United States in *Hazel B. Beckman Trust et al.* v. *Commissioner*, 26 T. C. 1172, acquiescence, page 9, this Bulletin, will affect the position taken by the Internal Revenue Service in Revenue Ruling 55–502, C. B. 1955–2, 560.

In Revenue Ruling 55–502, *supra*, the grantor created a trust with a portion of the trust income to be paid each year to her husband and the balance of the trust income to be paid to her during her lifetime. The trust instrument provided that the grantor with the consent of her husband could modify, alter, or revoke the trust instrument. The grantor died in 1954 with her husband surviving and the question was presented whether the trustee was entitled to a basis under section 113(a)(5) of the Internal Revenue Code of 1939.

It was stated in Revenue Ruling 55–502, *supra*, that, in order for section 113(a)(5) of the 1939 Code to be applicable, the right to revoke or change must be entirely in the grantor, for only in such circumstances is the corpus of the trust to be viewed in practical effect as belonging to the grantor. A right to revoke or change in conjunction with another party is not completely in the grantor, particularly where, as in that case, the right was at all times until the grantor's death, exercisable only in conjunction with one having an adverse interest. Revenue Ruling 55–502 held, accordingly, that the trust property sold would not take a basis under section 113(a)(5) but would be determined under section 113(a)(2) of the Code.

In the Beckman case, the grantor created a trust and transferred certain shares of stock to it. The trust indenture provided that the trust income was payable to the grantor during her lifetime and reserved to the grantor at all times up to her death the right to revoke

the trust with the consent of named trustees, none of whom had any adverse interest in the trust.

The Commissioner contended that the case came within the provisions of section 113(a)(2) of the Code on the theory that, before section 113(a)(5) can be applied, it must be shown that the grantor retained such complete control that the trust property should be considered as belonging to the grantor, and that this requirement is not met where the grantor possesses the right of revocation in conjunction with another person, even though such person is a trustee not having a substantial adverse interest in the trust. The court held in effect that section 113(a)(5) is applicable if the reserved right to revoke is held in conjunction with another or others not having an adverse interest.

It is accordingly held that where a trust indenture provides that trust income is payable to the grantor during her lifetime and reserves to the grantor at all times up to her death the right to revoke the trust with the consent of named trustees, none of whom has any adverse interest in the trust, the trust comes within the meaning of section 113(a)(5) of the Internal Revenue Code of 1939 so that the basis of the property transferred to the trust is its fair market value at the date of the grantor's death (or optional valuation date).

Revenue Ruling 55–502, *supra*, is modified insofar as it holds that section 113(a)(5) of the Code is applicable only if the right to revoke or change the trust is completely and unqualifiedly in the grantor.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion. (Also Section 23(m), Section 39.23(m)–5.) — Rev. Rul. 57–288

The stated rate of percentage depletion for dolomite contained in section 114(b)(4) of the Internal Revenue Code of 1939 precludes the application of the end-use test for determining the percentage rate allowable. Consequently, dolomite is entitled to a flat rate of ten percent, irrespective of its use.

Revenue Ruling 55–700, C. B. 1955–2, 569, and Revenue Ruling 56–582, C. B. 1956–2, 981, modified.

The Internal Revenue Service has been requested to reconsider its position with respect to the percentage depletion rate allowable for dolomite in the light of the decision of the Tax Court of the United States in the case of *Virginian Limestone Corporation* v. *Commissioner* 26 T. C. 553, acquiescence page 9, this Bulletin.

Heretofore, the Service has followed the position set forth in Revenue Ruling 55–700, C. B. 1955–2, 569, to the effect that, for purposes of the Internal Revenue Code of 1939, the application of the end-use test was proper in the determination of the percentage depletion rates allowable for dolomite used or sold for use as metallurgical grade and chemical grade limestone or as stone proper. That ruling was based on the theory that there is no clear line of distinction between dolomite and limestone, as one grades into the other in relation to the amount of magnesium it contains.

In the Virginian Limestone case, the Tax Court of the United States held that dolomite is entitled to a flat rate of ten percent, the depletion rate prescribed for dolomite by section 114(b)(4) of the Internal Revenue Code of 1939. The findings of fact in that case read in part as follows:

> All of the rock quarried and sold by petitioner was dolomite, within the commonly understood commercial meaning of that term. The term "dolomite," when used with reference to rock, is one of specific designation, and has reference to a particular class of sedimentary rock, commonly known by that name, which is rich in magnesium carbonate; whereas, "stone" and "limestone" are terms of more general classification, and may refer to rocks which contain little or no magnesium carbonate.
>
> All of petitioner's rock was of essentially the same chemical and mineral composition. It has a high magnesium carbonate content, ranging from about 35 to about 42 percent; and its average chemical composition, stated in terms of carbonates, was about 37 to 40 percent magnesium carbonate, and about 52 to 56 percent calcium carbonate.

The interpretation by the court in the Virginian Limestone case, that the percentage allowance for dolomite is specifically prescribed for in section 114(b) of the 1939 Code, obviates the necessity of applying the end-use test. Accordingly, it is now recognized by the Service that a calcium magnesium carbonate of the composition determined by the Tax Court of the United States to be dolomite is entitled to the rate specified in section 114(b)(4) of the 1939 Code, irrespective of its use.

In view of the above, Revenue Ruling 55–700, C. B. 1955–2, 569, is modified to the extent that any limestone rock which has a magnesium carbonate content of 35 percent or higher shall be designated as dolomite and entitled to percentage depletion at a flat rate of ten percent irrespective of its use. Any limestone rock which does not contain magnesium carbonates, in accordance with the foregoing specification, will continue to be classified on the basis of the end-use test as set forth in Revenue Ruling 55–700, *supra*. Revenue Ruling 56–582, C. B. 1956–2, 981, to the extent that it refers to dolomite is also modified.

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

REGULATIONS 118, SECTION 39.117(a)-1: Meaning of terms. — Rev. Rul. 57–29

I. T. 3721, C. B. 1945, 164, sets forth the treatment, for Federal income tax purposes, of transactions in connection with the purchase and sale, on a "when, as and if issued" basis, of securities of corporations. In explaining how the amount of a loss sustained by a taxpayer on the disposition of a contract to buy or sell securities on a "when, as and if issued" basis should be determined where such a contract did not cost him anything, the third, fourth, fifth, and last paragraphs beginning on page 171 of C. B. 1945, have been incorrectly construed to mean that such a contract may have a basis other than zero. In computing the cost basis of assets for any purpose, the Internal Revenue Service does not recognize an obligation of a tax-

payer reflected in an executory contract prior to the performance of the contract. Such an executory contract to buy or sell securities which has cost the taxpayer nothing has a basis of zero to him, for Federal income tax purposes, in computing his gain or loss on a subsequent sale or disposition thereof prior to performance on the contract.

In order to clarify the position of the Service on this matter I. T. 3721, *supra*, is hereby modified by eliminating therefrom the paragraphs referred to above.

SECTION 124.—AMORTIZATION DEDUCTION

REGULATIONS 111, SECTION 29.124–6: Adjusted basis of emergency facility. Ct. D. 1801

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT.

1. AMORTIZATION OF EMERGENCY FACILITIES—CERTIFICATION OF PORTION OF COST BY WAR PRODUCTION BOARD.

The War Production Board had the authority under section 124 of the Internal Revenue Code of 1939 to issue certificates certifying that only part of the cost of essential wartime improvements was necessary to the national defense. Accordingly, taxpayer was not entitled to accelerate amortization with respect to the entire cost of certain emergency facilities where only part of the cost of such facilities had been certified by the Board as necessary in the interest of national defense.

2. JUDGMENT REVERSED.

Judgment of the United States Court of Claims, 134 Ct. Cl. 800, reversed.

SUPREME COURT OF THE UNITED STATES

The United States, petitioner, v. *The Allen-Bradley Company*

On writ of certiorari to the United States Court of Claims

[January 22, 1957]

OPINION

Mr. Justice Black delivered the opinion of the Court.

In 1940 this country embarked on the greatest program of defense preparedness in its history. Such an undertaking called for a vast expansion of the nation's industrial capacity. New and improved facilities were desperately needed, not only for the production of guns, planes and the other obvious weapons of war, but also for the innumerable items that are essential to the prosecution of large scale conflict. This unprecedented program of expansion demanded the full and immediate cooperation of everyone who could lend assistance. While the Government attempted to secure the necessary facilities by building them itself or by extending emergency construction loans to private business, it soon appeared that these methods would not be adequate to meet the needs of defense. Private capital was called on for assistance in the task. However business exhibited a reluctance to build new war plants because of widespread fears that such facilities would become wholly useless when the emergency had passed. In response to these fears, Congress acted to lessen the financial risks involved in the private construction of emergency facilities. Among other things it amended the 1939 Internal Revenue Code by adding sections 23(t) and 124,[1] which allowed business to write off the cost of new facilities as a deduction against taxable income within a period of five years or less, regardless of the actual economic life of the facilities, provided they had been

[1] 54 Stat. 998–1003, as amended 26 U. S. C. sections 23(t), 124.

certified by the proper executive agency as "necessary in the interest of national defense." This accelerated amortization privilege generally enabled those businesses receiving it to reduce their federal income taxes with the net result that a large part of the construction costs was, at least temporarily, borne by the Federal Government through a reduction in its tax receipts.

This case involves a question of the proper interpretation of section 124(f), a vital part of these accelerated amortization provisions. The essential facts are not in dispute. During the Second World War the respondent Allen-Bradley Company produced radio parts and other materials needed by the Government to carry on the war. These products were in critically short supply and at the request of government procurement officers respondent repeatedly increased and improved its facilities in order to boost its output. In connecton with such expansions it applied to the War Production Board, which was then the certifying authority, for certificates that the improvements were necessary to the national defense. The Board issued nine different certificates of necessity to respondent but the dispute here involves only three of these certificates. Each of these three stated that the facilities covered by it were necessary in the interest of national defense but only up to a specified percentage of their total cost. This "partial certification" was made pursuant to a policy adopted by the Board in 1943 that it would certify essential facilities, which could reasonably be expected to have peacetime utility, only to the extent that their costs were attributable to the wartime increase in prices. Respondent accepted these partial certifications, proceeded with the expansion and in its tax returns for 1944 and 1945 deducted an amount based on the accelerated amortization of that part of the total cost which had been certified by the Board.

In 1953 respondent first raised the claim which is the basis of this suit that the Board had no authority to certify only part of the cost of a necessary emergency facility. Respondent concedes that the Board had discretion to refuse to issue any certificate at all, but contends that once it decided that a facility was necessary to the national defense its function was at an end and that any attempt by it to limit the certification to a part of the cost of such facility was a nullity. Therefore, respondent contends, it was entitled to accelerate the amortization of the full cost of those facilities covered by the three partial certificates and not just that part of the full cost which had been certified by the Board. On the basis of these contentions respondent filed the present action in the Court of Claims to recover an alleged overpayment of its 1944 and 1945 income taxes. The Court of Claims accepted respondent's arguments and rendered judgment for it. 134 Ct. Cl. 800. We granted certiorari because of the conflict between this decision and that of the Court of Appeals for the Second Circuit in *Commissioner* v. *National Lead Co.*, 230 F. 2d 161 [Ct. D. 1802, page 522, this Bulletin].

The language of the crucial section 124(f) is ambiguous. It specifies that in determining the amount of the wartime construction costs which are to be available for the special amortization privilege:

> "(1) There shall be included only so much of the amount * * * as is properly attributable to such construction * * * after December 31, 1939, as [the War Production Board] has certified as necessary in the interest of national defense during the emergency period * * *"

Respondent argues that the phrase "only so much of the amount" in this section refers simply to that part of the cost of facilities that is attributable to construction after 1939. On the other hand the Government contends that this qualifying phrase refers not only to those costs incurred after 1939, but also to that portion of those costs which the War Production Board has certified is necessary to the national defense. We believe that either interpretation is possible; that neither is compelled. But those who were responsible for the administration of the Act consistently interpreted section 124(f) as authorizing them to certify that only a part of the costs of construction after 1939 was necessary to the national defense.[2]

The legislative history shows that Congress intended that the administrators of the certification program were to have broad discretion in exercising their power. These administrators were faced with extremely complicated problems in attempting to accomplish the desired objective of Congress in the face of constant

[2] See War Department Regulations, Issuance of Necessity Certificate, 7 Fed. Reg. 4233 (1942); War Production Board Regulations, Issuance of Necessity Certificates, 8 Fed. Reg. 1694 (1943). And compare Treas. Reg. 111, § 29.124-6.

and drastic changes in conditions. And as the nation's industrial capacity became more adequate they carefully balanced the need for the proposed expansion against the loss of revenue to the Government caused by accelerated amortization before issuing a certificate. The power to certify only a portion of the cost gave them a more flexible instrument to balance these conflicting objectives.

It appears that Congress kept close supervision over the certification program and the special amortization privilege. For example, section 124 was amended five times during the war;[3] two of these amendments altered section 124(f) itself in a manner which did not affect the language decisive to the present controversy. But no attempt was made to restrain the administrators from issuing certificates covering only a part of the cost of necessary facilities, although it seems apparent that responsible committees of Congress were aware that section 124(f) had been consistently interpreted and applied by the certifying authorities as permitting them to issue such certifications. In fact a special Senate "watch-dog" committee was established to continually study and investigate the program for construction of war plants and facilities including the "* * * benefits accruing to contractors with respect to amortization for the purposes of taxation or otherwise * * *"[4]

Perhaps section 124(f) could have been construed differently. But it was not. Construed as it was, it served its purpose. It contributed materially to the phenomenal expansion of our industrial plant which was so necessary for successful prosecution of the war. Certificates issued for only a portion of the cost of necessary facilities were accepted by business in general, and respondent in particular—apparently without substantial objection. The technique employed in section 124(f) was a new one and those who drafted that section could not be certain how it would work in practice. They could not foresee the many problems that would arise in the administration of this sweeping power which could be used to encourage expansion of any industry producing materials useful in the all-out war effort. Therefore it is not strange that the provision was loosely drawn and, in some respects, imprecise. However it would have been strange in these circumstances if Congress had embarked on this new course without leaving wide discretion for flexible administration in the light of the day-to-day grind of experience. The language of section 124(f) lends itself to such flexibility.

We hold that the Board had authority under section 124(f) to issue certificates, as in this case, certifying that only a part of the cost of essential wartime improvements was necessary to the national defense. Therefore, the judgment of the Court of Claims must be reversed.

It is so ordered.

Mr. Justice Harlan concurring in a separate opinion.

Ct. D. 1802

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT.

1. AMORTIZATION OF EMERGENCY FACILITIES—CERTIFICATION OF PORTION OF COST BY WAR PRODUCTION BOARD.

The War Production Board was empowered under section 124 of the Internal Revenue Code of 1939 to issue certificates covering only a part of the cost of petitioner's wartime improvements. Accordingly, petitioner was not entitled to accelerate the amortization of the full cost of those facilities covered by the Board's "partial certifications."

2. DECISION FOLLOWED.

United States v. *Allen-Bradley Company* (U. S. Supreme Court Opinion dated January 22, 1957) followed.

3. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Second Circuit, 230 F. 2d 161, affirmed.

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[3] 55 Stat. 4, 55 Stat. 757, 56 Stat. 50, 56 Stat. 851 and 59 Stat. 525.
[4] S. Res. 71, 77th Cong., 2d Sess. (87 Cong. Rec. 1615), and S. Res. 6, 78th Cong., 1st Sess. (89 Cong. Rec. 331).

SUPREME COURT OF THE UNITED STATES

National Lead Company, petitioner, v. *Commissioner of Internal Revenue*

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

[January 22, 1957]

OPINION

Mr. Justice Black delivered the opinion of the Court.

This is a companion case to No. 78, *United States* v. *Allen-Bradley Company,* [Ct. D. 1801, page 17, this Bulletin] which was also decided today. During World War II petitioner manufactured engine bearings. In 1944 petitioner expanded its plant in an effort to increase the output of these essential war products. At the same time it applied to the War Production Board for certification that the various additions were necessary in the interest of national defense. However the Board, as in *Allen-Bradley,* granted certificates of necessity for only a part of the cost of petitioner's new facilities. In its income tax return for 1944 petitioner exercised the privilege such certification conferred by taking as a deduction a sum based on the accelerated amortization of that part of the costs which had been certified by the Board.

In 1951 the Commissioner of Internal Revenue asserted a deficiency against petitioner on grounds unrelated to the present controversy. Petitioner subsequently filed a petition for redetermination with the Tax Court claiming that it was entitled to a refund for overpayment of income taxes in 1944. The amount of this overpayment was calculated on the basis that petitioner was entitled to accelerate the amortization of the full cost of those facilities covered by the Board's "partial certifications." Petitioner contends that the Board was not authorized to certify only a part of the cost of a facility when the Board had determined that the facility as a whole was necessary to the national defense. The Tax Court granted petitioner's claim, but on appeal the Second Circuit reversed, holding that petitioner had forfeited its right to challenge the Board's action by waiting too long after accepting the tax benefits of the "partial certificates" to attack their validity. 230 F. 2d 161. The Court of Appeals did not reach the question whether the Board was authorized to issue such "partial certificates." For reasons stated in our opinion in No. 78, *United States* v. *Allen-Bradley Company,* we hold that the Board was empowered to issue certificates covering only a part of the cost of petitioner's improvements. Accordingly, we affirm the judgment of the Court of Appeals.

Affirmed.

Mr. Justice Harlan joins in the Court's decision for the reasons stated in his concurring opinion in *United States* v. *Allen-Bradley Company, ante.*

Ct. D. 1806

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. AMORTIZATION OF EMERGENCY FACILITIES—PROCEDURE—COURT RULES AS TO FINALITY.

The finality provisions of the Supreme Court rules do not bar the Court from vacating *sua sponte* its order denying Government's petition for writ of certiorari some sixteen months after such order and some six months after subsequent denial of two successive petitions for rehearing, where the interests of justice would make unfair the strict application of the rules. The tax question is resolved on the basis of companion cases of *United States* v. *Allen-Bradley* Co., 352 U. S. 306, and *National Lead Co.* v. *Commissioner,* 352 U. S. 313, in which the court held that the War Production Board had authority to certify part, as well as all, of new facility's cost for accelerated amortization.

2. JUDGMENT REVERSED.

3. JUDGMENT OF THE UNITED STATES COURT OF CLAIMS, 129 F. SUPP. 215, REVERSED PER CURIAM.

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner, v. *The Ohio Power Company*

On petition for rehearing

[April 1, 1957]

PER CURIAM: On June 11, 1956, we unanimously vacated *sua sponte* our order of December 5, 1955 (350 U. S. 919), denying the timely petition for rehearing in this case (351 U. S. 980), so that this case might be disposed of consistently with the companion cases of *United States* v. *Allen-Bradley Co.*, 352 U. S. 306, [Ct. D. 1801, page 520 of this Bulletin] and *National Lead Co.* v. *Commissioner*, 352 U. S. 313, Ct. D. 1802, [page 522 of this Bulletin] in which we had granted certiorari the same day, *viz.* June 11, 1956. 351 U. S. 981. If there is to be uniformity in the application of the principles announced in those two companion cases, the judgment below in the instant case cannot stand. Accordingly we now grant the petition for rehearing, vacate the order denying certiorari, grant the petition for certiorari, and reverse the judgment of the Court of Claims on the authority of *United States* v. *Allen-Bradley Co.*, *supra*, and *National Lead Co.* v. *Commissioner*, *supra*.

We have consistently ruled that the interest in finality of litigation must yield where the interests of justice would make unfair the strict application of our rules. This policy finds expression in the manner in which we have exercised our power over our own judgments, both in civil and criminal cases. *Clark* v. *Manufacturers Trust Co.*, 337 U. S. 953; *Goldbaum* v. *United States*, 347 U. S. 1007; *Banks* v. *United States*, 347 U. S. 1007; *McFee* v. *United States*, 347 U. S. 1007; *Remmer* v. *United States*, 348 U. S. 904; *Florida ex rel. Hawkins* v. *Board of Control*, 350 U. S. 413; *Boudoin* v. *Lykes Bros. S. S. Co.*, 350 U. S. 811; *Cahill* v. *New York, N. H. & H. R. Co.*, 351 U. S. 183; *Achilli* v. *United States*,—U. S.—.

Reversed.

Mr. Justice Brennan and Mr. Justice Whittaker took no part in the consideration or decision of this case.

Mr. Justice Harlan, whom Mr. Justice Frankfurter and Mr. Justice Burton join, dissenting in a separate opinion.

SUPPLEMENT C.—CREDITS AGAINST TAX

SECTION 131(a).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: ALLOWANCE OF CREDIT

REGULATIONS 118, SECTION 39.131(a)-2: Countries which do or do not satisfy similar credit requirement.

Evidence acceptable from an alien resident of the United States or Puerto Rico in a case where a determination as to his entitlement to credit against his United States income tax for taxes paid or accrued to a foreign country is required. See Rev. Rul. 57-153, page 243.

SECTION 131(h).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: CREDITS FOR TAXES IN LIEU OF INCOME, ETC., TAXES

REGULATIONS 118, SECTION 39.131(h)-1: Meaning Ct. D. 1808

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. FOREIGN TAX CREDIT—CUBAN PRODUCTION TAX

Production taxes, known as Speyer loan taxes, paid to Cuba for the years 1944 and 1945, qualify as taxes paid in lieu of income taxes within the meaning of section 131(h) of the 1939 Code, where the only thing that exempted payers of the production tax from paying the profits tax, which was admitted to be an income tax of general application, was the specific provision in the profits tax law that exempts payers of the production tax from paying the profits tax.

IN THE UNITED STATES COURT OF CLAIMS

No. 49070

Compania Embotelladora Coca-Cola, S. A., v. *the United States*

[Decided April 3, 1956]

OPINION

MESSRS. WILLIAM P. MCCLURE and JOHN E. MCCLURE for plaintiff. MESSRS. POPE F. BROCK and JOHN D. GOODLOE were on the briefs.

MR. DAVID R. FRAZER, with whom was MR. ASSISTANT ATTORNEY GENERAL H. BRIAN HOLLAND, for defendant. MR. ANDREW D. SHARPE was on the brief.

LITTLETON, Judge, delivered the opinion of the court:

The plaintiff sues to recover $45,894.46 representing Federal income taxes and interest paid for the calendar years 1944 and 1945, with interest thereon. The question presented is whether the Cuban production tax paid by plaintiff during 1944 and 1945 was a tax paid in lieu of a foreign income tax within the meaning of section 131(h) of the Internal Revenue Code of 1939, as amended, 26 U. S. C. section 131.

Section 131 provides:

> * * * (h) CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES.—For the purposes of this section and section 23(c)(1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States. * * *

If the Cuban production tax paid by plaintiff for 1944 and 1945 was paid in lieu of a foreign income tax within the meaning of section 131(h), plaintiff is entitled under section 131(a) to credit those taxes against the income taxes imposed by the United States. The pertinent part of section 131(a) provides:

> * * * ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, * * * shall be credited with:
>
> (1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * *

The plaintiff is a corporation organized on December 16, 1942, under the laws of the State of Delaware. Since its organization plaintiff's business has been that of manufacturing and selling a soft drink beverage in Cuba under the trade-mark "Coca-Cola."

In 1900, the provisional government of Cuba directed publication of Military Order No. 463, thereby establishing a general profits tax. This was a tax on the profits of corporations and was the first general income tax established in Cuba.

On February 27, 1903, a production tax was enacted which levied a tax on the manufacture, sale, or consumption of certain classes of articles such as alcoholic liquors, tobacco, playing cards, soft drinks and prepared water. This

tax was enacted to guarantee payment of a $35,000,000 loan and is known as the Speyer Loan production tax. As a result of the Cuban administrative interpretation, payers of the production tax were not required to pay the profits tax.

In 1927, the profits tax of 1900 was amended and, *inter alia*, payers of the production tax were specifically exempted from payment of the profits tax. In 1931, the profits tax was revised, the base was broadened to include the profits of individuals and unincorporated concerns, and the rate was made progressive. Also, those companies or persons paying the production tax of 1903 were continued to be specifically exempt from payment of the profits tax for the reason that "they are already taxed." On December 31, 1941, a surtax of 20 percent was imposed on the profits tax.

On December 31, 1941, the President of Cuba sanctioned Resolution Law No. 1 which imposed an income tax on the net profits of the natural or juridic persons who engaged in the manufacture of liquor, cider, table waters, soft drinks, tobacco and playing cards (payers of the production tax), and on salaries, wages, pensions, dividends, interest, proceeds, and any other kind of personal revenue. On April 5, 1943, the rates with respect to both the profits tax and the income tax were increased and a so-called tax on capital was imposed.

The plaintiff paid the Cuban production tax for the years 1944 and 1945. The plaintiff also paid for those years the Cuban income tax and the so-called tax on capital. In computing the Cuban income taxes for those years, deductions were allowed for the amount of the production taxes paid.

In its United States tax returns for the years 1944 and 1945, plaintiff claimed foreign tax credits under section 131(a) for the Cuban incomes taxes and so-called taxes on capital, as income taxes paid in a foreign country. Credits were also claimed under section 131(a) for those years for the production taxes, as taxes paid in lieu of foreign income taxes within the meaning of section 131(h).

The Commissioner of Internal Revenue allowed the credits for the Cuban income taxes and so-called taxes on capital,[1] but denied the credits for the production taxes. The Commissioner allowed deductions from income for the production taxes. The Commissioner assessed an income tax deficiency for 1944 in the amount of $26,548.72, plus interest of $3,880.10, or a total of $30,428.82, and for 1945 in the amount of $14,238.95, plus interest of $1,226.69, or a total of $15,465.64. The plaintiff paid these deficiencies and interest in the total amount of $45,894.46 on September 4, 1947. Timely claims for refund were filed, rejected, and this suit followed.

The defendant concedes that the Cuban profits tax was before and after 1941 an income tax of general application. The defendant further concedes that prior to the promulgation of the 1941 income tax law the payment of the production tax was the payment of a tax in lieu of an income tax within the meaning of section 131(h).

The plaintiff contends that the payment of the production tax continued to be in lieu of the profits tax after 1941. The defendant contends that the 1941 income tax was equivalent to the profits tax and was imposed as a substitute for the profits tax and, therefore, payers of the production tax, after 1941, were, in effect, paying the profits tax through the payment of the income tax. We agree with the plaintiff's contention for the reason that the only thing that exempted payers of the production tax from paying the profits tax, which is admitted to be an income tax of general application, is the specific provision in the profits tax law that exempts payers of the production tax from paying the profits tax. If the plaintiff had not paid the production tax, it would have been required to pay the profits tax under the terms of the profits tax law, regardless of whether it paid the income tax.

The defendant's contentions are not supported by the record. The record fails to show that the 1941 income tax was equivalent to the profits tax. The rates of the profits tax were considerably higher than the rates of the income tax. We see no reason in the record to label the income tax as a substitute for the profits tax—it was simply an additional tax imposed on the payers of the production tax and others who were not directly paying an income tax. If the income tax imposed on the payers of the production tax was equivalent to, and intended to be a substitute for, the profits tax, it would appear that in

[1] The Commissioner of Internal Revenue held this tax to be an income tax for purposes of allowing a foreign tax credit. Rev. Rul. 56-51, C. B. 1956-1, 320.

reality payment of the income tax was in lieu of the profits tax, although technically it was not.

The defendant states that since every Cuban taxpayer paid either the income tax or the profits tax and never both, the income tax is paid in lieu of the profits tax. The record does not sustain this contention for the reason that it fails to show that the income tax was paid in lieu of the profits tax. If the 1941 income tax had a specific provision stating that those persons who paid the income tax would not be required to pay the profits tax, it then could be said that payment of the income tax was in lieu of the profits tax because the profits tax would not be required to be paid regardless of whether the production tax was paid. However, there is no such provision in the 1941 Cuban income tax law. The only thing that relieves payers of the production tax from paying the profits tax is the specific exemption as to the profits tax contained in the profits tax law. If the production tax were repealed the payers of the production tax would be required to pay the profits tax under the language of the profits tax law regardless of whether they also paid the income tax, in the absence of some further statutory provision to the contrary. If the income tax were abolished the payers of the production tax would have to continue paying the production tax or they would be required to pay the profits tax.

The fact that plaintiff was allowed a deduction for its production taxes in computing its Cuban income tax does not, of course, affect the allowance of credits for the actual taxes paid. The deduction merely reduces the amount of Cuban income taxes and thus reduces the amount of the credit.

The plaintiff paid the income taxes and the so-called taxes on capital and has been allowed credits for them. The plaintiff paid the production taxes in lieu of the profits tax within the meaning of section 131(h) and should accordingly be allowed credits for those taxes under section 131(a).

The plaintiff is entitled to recover. Judgment is entered for plaintiff in the amount of $45,894.46, with interest as provided by law.

It is so ordered.

LARAMORE, Judge; MADDEN, Judge; WHITAKER, Judge; and JONES, Chief Judge, concur.

FINDINGS OF FACT

The court, having considered the evidence, the briefs and arguments of counsel, and the report of Commissioner George H. Foster, makes the following findings of fact:

1. Plaintiff is a corporation organized on December 16, 1942, under the laws of the State of Delaware. Since its organization, the plaintiff's business has been that of manufacturing and selling a soft drink beverage in Cuba under the trademark "Coca-Cola".

2. At all times material plaintiff kept its books and filed its Federal income and declared value excess profits tax returns on the calendar-year basis and in accordance with the accrual method of accounting.

3. Following the revolt of the people of Cuba against the Spanish Government and the ensuing Spanish-American War, a peace treaty was signed in Paris on December 10, 1898, wherein Spain relinquished all rights to Cuba. The treaty provided for temporary occupation of Cuba by American military forces. The American military occupation of Cuba lasted until May 20, 1902.

4. During the period of the American military occupation the governmental affairs of Cuba were administered by American military governors.

5. On November 13, 1900, the American military governor of Cuba, General Leonard Wood, directed the publication of Order No. 463, which provided for a "profits tax" of general application. It provided in part as follows:

> The Military Governor of Cuba, upon the recommendation of the Secretary of Finance, directs the publication of the following order in substitution of Civil Order No. 306, suspended by Civil Order No. 312, c. s., these Headquarters:
>
> I. From this date, Order No. 106 of July 11th, 1899, Headquarters Division of Cuba and all other provisions in force containing the form of State and Municipal Taxation of Banks and Companies, enumerated in sections 5, 6, 7 and 8 of Tariff Second of the Industrial Tax are hereby modified in accordance with the following articles:
>
> II. The following shall pay taxes to the State at the rate of 8 percent of their net profits:

(a) Banks of issue and discount transacting business either on real estate or on personal property.

(b) Stock Companies, except mining companies savings banks and such Government loan and pledge companies as may be officially recognized and included accordingly in the list of tax exemptions.

III. The following shall pay taxes to the State at the rate of 6 percent of their net profits:

(a) Railroads of general service, or namely, those destined to public exploitation of the transportation of passengers and the traffic of merchandise, either belonging to companies or to private parties conformably to legislation in force on the matter.

(b) Shipping Companies.

IV. Insurance Companies shall pay 2½ percent of the premiums annually collected from the insured. From said tax are exempted Mutual Insurance Corporations where no profits are distributed and whose operations may consist only in assessing the stockholders for the proportional amount of damages that any of them may have suffered.

The tax on the commission of the agents is hereby suppressed.

The administration, investigation and collection of the tax shall be in accordance with the provisions in force.

* * * * * * *

XI. Banks, Corporations and Companies exercising solely industries that are expressly comprised in the Tariff of Industrial Tax shall only pay the Municipalities the quotas corresponding to the kinds of industries that they exercise in each municipal district.

6. On May 5, 1902, the first Congress of Cuba convened in Havana. On May 20, 1902, Major General Leonard Wood formally surrendered his executive powers to Estrada Palma, President of Cuba.

7. Under the Cuban Constitution, laws are enacted by Congress and must be "sanctioned" or approved by the President before they are put into effect. If the President refuses to sanction a law, he must return it to Congress within ten days after it has been submitted to him, and the measure may still become a law if it is then approved by a special two-thirds majority of both Houses of Congress.

A presidential decree, on the other hand, is a measure enacted by the President of the Republic pursuant to the authority granted to him by Article 142 of the Constitution of the Republic of Cuba, which provides as follows:

> 142. It will be the function of the President, assisted by the Cabinet:
>
> (a) To sanction and promulgate the laws, to execute them and see to their execution; to issue, when Congress has not done so, regulations for their best execution; and to issue the decrees and orders which are advisable for this purpose and for whatever is pertinent to the government and administration of the Nation, without in any case contravening what is established by law.

Although it is sometimes difficult to determine whether a certain matter may be regulated by a presidential decree as being "pertinent to the government and administration of the Nation," there are certain matters in respect to which it is specifically provided that they must be governed solely by congressional laws, and not by presidential decrees or orders. Article 134 of the Constitution includes, among the faculties of Congress which may not be delegated, the following:

> (a) To draw up codes and laws of a general character; to determine the regimen of elections; to enact provisions relative to the national, the provincial and the municipal administrations, and all other laws and resolutions that it deems advisable on any other matters of public interest or that are necessary for the effectiveness of this Constitution.
>
> (b) To establish the taxes and imposts of a national character that are necessary for the needs of the Nation.
>
> (c) To discuss and approve the budget of expenditures and revenues of the Nation.

Presidential Decree 1117 of 1939 (referred to in finding 17) containing the "Regulations for the General Tax on Profits," is a typical instance of the exercise by the President of the regulatory powers given him under paragraph (a) of Article 142. In accordance with the cited constitutional provision, this de-

cree could not have been issued if Congress had reserved for itself the right to regulate the profits tax law, which was then the law of January 29, 1931 (still in effect as amended).

A presidential decree may in no sense contravene or modify a law of Congress. On the other hand, a law may repeal or modify a decree, in the same manner as it may repeal or modify a prior law.

Therefore, regulations for a certain tax enacted by a presidential decree in the absence of congressional action for this specific purpose, have full force and effect and may be legally vulnerable only insofar as they may result in actually broadening or limiting the scope of the tax, thus resulting in a modification of the law which such decree purports to regulate. For example, Presidential Decree 2008 of December 28, 1926 (referred to in finding 11) was intended as a measure "clarifying" or interpreting Article XI of Order No. 463 of 1900, in the sense that this provision should not be construed as establishing an exemption from the tax on profits in favor of stock companies paying an industrial tax to the municipalities. Decree 2008 met with strong opposition on the ground that in issuing a decree which under the guise of an interpretation really enacted a new tax, the executive had overstepped the constitutional bounds of its powers. To meet this opposition, the Government found it expedient to obtain a law of Congress (law of January 27, 1927, referred to in finding 12) confirming the provisions of Decree 2008.

8. On February 27, 1903, the Congress of Cuba duly enacted and the President of Cuba approved the so-called Speyer Loan production tax. This is the tax which plaintiff claims should be allowed as a credit under the provisions of section 131(h) of the Internal Revenue Code of 1939, and which, accordingly, presents the issue of this case. This law provided in part as follows:

> TOMAS ESTRADA PALMA, Constitutional President of the Republic of Cuba.
> HEREBY MAKES KNOWN: That Congress has enacted and he has approved the following
>
> LAW:
>
> ARTICLE 1.—The President of the Republic shall contract, in behalf of the Nation and as soon as possible, a loan of thirty-five million dollars in gold coin of the United States of America, at the minimum rate of issue of ninety per cent of its value and with interest at the maximum rate of five per cent per annum.
>
> * * * * * * *
>
> ARTICLE 3.—In order to secure and effect the payment of the amortization and interest of the Loan, a special permanent tax shall be created on the manufacture, sale or consumption of the articles hereafter mentioned:
>
> * * * * * * *
>
> *Section fourth:*
>
> A. Every case of twenty-four half bottles of artificial water manufactured in Cuba shall pay five cents.
>
> B. Every siphon of one liter capacity of artificial water manufactured in Cuba shall pay one-half cent.
>
> C. Every cylinder of artificial water manufactured in Cuba shall pay five cents.
>
> D. Every case of twenty-four half bottles of artificial cider (name of a refreshment) manufactured in Cuba shall pay five cents.
>
> E. Artificial waters or prepared refreshments which may be imported will pay, in addition to the Customs duties, the special tax in the same amount as those manufactured in the country.
>
> * * * * * * *
>
> *Section eleventh:*
>
> For the duration of the special tax established by this Law, all articles or objects subject thereto may not be the subject of new industrial taxes levied by the State, the Province or the Municipalities.

9. On January 25, 1904, the Congress of Cuba duly enacted and the President of Cuba approved a law supplementing and amending the law of February 27, 1903. Said law of January 25, 1904, provided in part as follows:

> TOMAS ESTRADA PALMA, Constitutional President of the Republic of Cuba.
> HEREBY MAKES KNOWN: That Congress has enacted and I have approved the following

LAW:

ARTICLE FIRST: The Law of February 27, 1903 regarding the thirty five million dollar loan shall be amended as follows:

* * * * * * *

Section four:

A. Every case of twenty-four half bottles of artificial water, manufactured in Cuba, will pay five cents.

B. Every siphon of one liter capacity of artificial water manufactured in Cuba will pay one-half cent.

C. Every cylinder of artificial water manufactured in Cuba will pay five cents.

D. Every case of twenty-four half bottles of artificial cider (refreshment known by that name), manufactured in Cuba, will pay five cents.

E. Artificial waters or prepared refreshments which may be imported will pay, in addition to the Custom duties, the special tax in the same amount as those manufactured in Cuba.

* * * * * * *

Section eleven:

For the duration of the special tax established by this Law, all articles or objects subject thereto may not be subjected to new industrial taxes by the State, the Province or the Municipalities.

10. On May 11, 1904, the 35 million-dollar loan was obtained and the Speyer Loan production taxes were pledged to service said loan.

11. In 1926 Presidential Decree No. 2008 was issued to require all stock companies theretofore exempt from the profits tax to file under the profits tax with respect to transactions taking place after July 21, 1925. This decree provided in part as follows:

FIRST: That all stock companies be required to file their balance sheets covering all transactions effected after July 21, 1925, for the purposes of the tax to which they are subject pursuant to Paragraph "b" of Article II of Order 463 of 1900, inasmuch as Article XI of the said Order contains no exemption from State profits taxes, which are established in a general way under the said Paragraph "b", indicating only, together with the following Article XII and applying to the entities mentioned therein, the sole municipal taxes that may be collected from the said companies: without prejudice to ruling in the future as to operations prior to the aforementioned date.

12. Since Decree No. 2008 construed Article (or section) XI of Military Order 463 of 1900 as not establishing an exemption from the profits tax for those companies paying an industrial tax to the municipalities, the decree met strong opposition on the grounds that the President, in issuing it, had really enacted a new tax and had thus overstepped the constitutional bounds of his powers. To meet this criticism, the Government found it expedient to obtain a law of Congress (law of January 27, 1927) confirming the provisions of Decree No. 2008. Article I of this law specifically exempted from payment of the profits tax those organizations or companies subject to the production tax of February 27, 1903. This law provided in part as follows:

I, GERARDO MACHADO Y MORALES, President of the Republic of Cuba,

MAKE KNOWN: That Congress has passed, and I have approved, the following

LAW:

ARTICLE I. Article XI of Order 463 of 1900 does not exempt the Banks, Organizations or Companies to which it refers, from the National taxes, fixed and regulated by Article II of this Order, limiting itself to indicating that they will pay the Municipality only the quota to which they are subject because of the industries in which they are engaged, that is, to the exclusion of all other Municipal taxes.

Organizations or companies which manufacture or sell the articles or objects subject to the Law of February 27, 1903, as well as corporations publishing newspapers, and companies engaged in the lease of city properties, which pay by way of Municipal tax a certain percentage of the revenues or profits which they receive, are excepted from the tax established in said Article II.

ARTICLE II. All taxes on account of the 8 per cent on profits imposed by section "b" of Article II of Order 463 of 1900, are remitted, up to July 20, 1925, the date of repeal of the 4 per cent tax, the conditions of that Order continuing in force from that date, and said companies in consequence being obligated to pay the tax fixed on profits.

In consequence, residential Decree 2008 of 1926 is confirmed, as respects all effects thereof. Nevertheless, the balances of corporate operations for the year which expired on December 31, 1926, shall pay 8 per cent on fifty per centum of the profits for that year. Previous and subsequent balances will be taxed in accordance with the provisions of Order 463 of 1900 and those established by this Law, and other current regulations.

13. On July 6, 1928, the Congress of Cuba duly enacted and the President of Cuba approved a law which made the aforesaid exemption set forth in Article I of the law of January 27, 1927 (i. e., the provision specifically exempting those companies paying the production tax from payment of the profits tax) retroactive to operations undertaken since July 21, 1925. This law provided in part as follows:

ARTICLE XLI. The exception established in the second paragraph of Article I of the Law of January 27, 1927, which clarifies the provisions of Article II in its relation to Article 2, paragraph (b) of Military Order 463 of 1900, shall be understood to extend to operations undertaken since July 21, 1925 by corporations or societies subject to the payment of the taxes created by Article 3 of the Law of February 27, 1903, and Law of January 25, 1904 on "Alcoholic Beverages, Domestic and Foreign," "Manufacture and Use of Playing Cards," since this has been the true spirit of the exemption contained in Article 1, paragraph 2, of the Law of January 27, 1927.

14. On September 25, 1928, Presidential Decree 1626, relating to the profits tax enacted as Military Order 463 of 1900, as amended by the law of January 27, 1927, and as further amended by the law of July 6, 1928, was enacted. This law specifically exempted certain persons and companies from payment of the profits tax, among which were the corporations and partnerships which paid the production tax and, also, foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports. Article 71 of said decree provided:

ARTICLE 71: The following shall be exempted from this tax:

(a) Official Savings and Loan Funds and Government Pawnshops. Unofficial Savings and Loan Funds shall be considered among those required to pay the tax under paragraph (b) of Article 68 of this Decree;

(b) Newspaper publishing corporations;

(c) Corporations or partnerships which manufacture or sell the articles or objects taxed by the Law of February 27, 1903, listed under Article 41 of the Law of July 6, 1928;

(d) Companies engaged in the leasing of urban properties and which pay to the Municipalities a percentage of the revenues or profits which they receive;

(e) Foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports;

(f) Persons or companies engaged in the sale of chattels or real estate on installments.

15. On January 29, 1931, the Congress of Cuba duly enacted and the President of Cuba approved a law which provided in part as follows:

I, GERARDO MACHADO Y MORALES, President of the Republic of Cuba,

MAKE KNOWN: That Congress has passed, and I have approved, the following

LAW:

CHAPTER FIRST

MODIFICATIONS OF THE TAX ON ALCOHOLIC LIQUORS, TOBACCO, PLAYING CARDS, SOFT DRINKS AND PREPARED WATERS

ARTICLE I. The first, second, fourth and sixth classes of the Law of February 27, 1903, as amended by the Law of January 25, 1904, covering the tax for the $35,000,000 loan, are modified and drawn to read as follows:

* * * * * * *

SECOND CLASS

DOMESTIC AND FOREIGN PREPARED WATERS AND SOFT DRINKS

A. Each case of 24 half bottles or smaller containers, of prepared waters, manufactured in Cuba shall pay 5c.

B. Each case of 24 half bottles or smaller containers of prepared soft drinks shall pay 5c.

C. Each siphon of one liter capacity of prepared water manufactured in Cuba shall pay ½ cent.

D. Each cylinder shall pay 5c.

E. Each liter of prepared water and prepared soft drings, imported, shall pay, in addition to Customs duties, 5c.

* * * * * * *

CHAPTER SIXTH

GENERAL TAX ON PROFITS

ARTICLE I. From the time this law becomes effective a contribution or tax is established on net profits or benefits according to the tariffs hereinafter copied.

ARTICLE II. The payment of this contribution or tax shall be made by: Every person, natural or juridic, Cuban or foreign, by reason of net profits or benefits obtained in Cuban territory, of which are paid, within or without the Republic, by natural or juridic persons domiciled or residing therein, or which are paid in Cuban territory even though the debtor is located outside thereof.

* * * * * * *

TARIFF THIRD

ON PROFITS OF MERCHANTS AND MANUFACTURERS

Individual merchants and manufacturers and all commercial and industrial companies or organizations, excepting those comprised in Tariff Fourth, shall pay in accordance with the following scale:

	Percent
From $1,200 to $3,000	2
More than $3,000 to $5,000	3
More than $5,000 to $10,000	4
More than $10,000 to $50,000	6
More than $50,000 to $100,000	8
More than $100,001 to $200,000	8½
More than $200,001 to $300,000	9
More than $300,001	10

TARIFF FOURTH

ON THE PROFITS OF BANKS AND ORGANIZATIONS

Payments shall be made by:

(1) Corporations, silent partnerships the investment in which is represented by shares of stock, and those of limited liability with respect to the profit on the shares, if any, and banks and bankers and all associations under the general law, whether industrial or mercantile, organized or which may be organized in Cuba and abroad, for the operation of the business of manufacture of sugar, and individuals who engage in that same industry, in accordance with the following scale:

	Percent
Up to $100,000	8
$100,001 to $200,000	8½
$200,001 to $300,000	9
$300,001 upward	10

(2) Railways and domestic navigation companies operating in coastwise service or on the high seas, located in the country, 6 percent on profits received.

Foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports shall be exempt from the tax on profits and shall pay, instead, 3 percent on the gross revenues obtained for freight and passengers taken aboard in domestic ports, without prejudice to their taxation under other forms, according to the legislation in force.

* * * * * * *

EXEMPTIONS

ARTICLE V. There are exemptions from this tax, in addition to those profits to which this law refers:

* * * * * * *

(8) Enterprises or individuals, on the profits derived from the publication of newspapers, magazines, booklets and books, as well as those others obtained by an establishment devoted to superior or elementary instruction in any matter, science, art or craft, and the persons or companies referred to in Article I of Chapter First of this Law, in connection with the Law of February 27, 1903, as it was modified by the Law of January 25, 1904, covering the tax for the $35,000,000 loan, since they are already taxed.

* * * * * * *

(16) Insurance companies, which shall continue to pay in the same manner as at present.

* * * * * * *

REPEALS

ARTICLE XXVII. Articles second and third of Military Order No. 463 of 1900, so far as they relate to the payment of the 8 percent and 6 percent taxes by certain companies and enterprises, are repealed; and likewise the exemption of the commissions of insurance agents referred to in Article VI of the Law of January 27, 1927, such agents paying in accord with section (9) of Article fourth of this Chapter of the present Law.

16. The first regulations promulgated under the law of January 29, 1931, were set forth in Decree No. 690, dated May 14, 1931. In accordance with the law, these regulations expressly exempted from the profits tax those companies or individuals registered to pay the production tax; foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports; and insurance companies. These regulations provided in part as follows:

DECREE No. 690.

In use of the faculties conferred on me by the Constitution of the Republic, by the Fifteenth of the General Provisions of Chapter Fourteenth of the Emergency Tax Law, of January 29 of this year, and by other laws in force, on proposal of the Secretary of the Treasury,

I RESOLVE:

To approve, for the administration and collection of the General Tax on Profits to which Chapter Sixth of the said Law of January 29, 1931, refers, the following:

REGULATIONS

* * * * * * *

CHAPTER III

TAX ON NET PROFITS

THOSE OBLIGATED TO PAY THIS TAX

ARTICLE 41st. The tax on net profits obtained in Cuba shall be paid by:

(a) Private parties or individuals who engage in any commerce or industry and commercial and industrial companies and organizations not comprised in those specified in subsequent paragraphs, payment being in accordance with the following tariff:

	Percent
From $1,200 to $3,000	2
More than $3,000 to $5,000	3
More than $5,000 to $10,000	4
More than $10,000 to $50,000	6
More than $50,000 to $100,000	8
More than $100,000 to $200,000	8½
More than $200,000 to $300,000	9
More than $300,000	10

(b) Corporations, silent partnerships the investment in which is represented by shares of stock, and those of limited liability with respect to the profit on the shares, if any, and banks and bankers and all associations under the general law, whether industrial or mercantile, organized or which may be organized in Cuba and abroad, for the operation of the business of manufacture of sugar, and individuals who engage in that same industry, and mining companies, in accordance with the following scale:

	Percent
Up to $100,000	8
From $100,001 to $200,000	8½
$200,001 to $300,000	9
$300,001 upward	10

(c) Railways and domestic navigation companies operating in coastwise service and on the high seas, located in the country, 6% on profits received.

* * * * * * *

EXEMPTIONS

ARTICLE 42d. The following are understood as exempt from the payment of this tax:

(a) Foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports, since they pay under another heading;

* * * * * * *

(f) Companies or individuals who are registered as tax taxpayers under the taxes of the Loan of $35,000,000, in accordance with the law of February 27, 1903, and subsequent concordant ones;

* * * * * * *

(l) Insurance companies, which shall continue to pay the tax in the same manner as at present;

* * * * * * *

17. On May 15, 1939, "Regulations for the General Tax on Profits," were duly promulgated by Presidential Decree No. 1117, replacing the aforesaid regulations promulgated under Decree No. 690. The regulations set forth in Decree No. 1117 were in effect during the taxable years herein involved. Like their predecessor regulations set forth in Decree No. 690, these regulations exempted, in accordance with the Law of January 29, 1931, those companies or individuals registered to pay the production tax; foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports; and insurance companies.

The regulations promulgated in Decree No. 1117 provided in part as follows:

NOW, THEREFORE: In use of the faculties conferred on me by the Constitution of the Republic, and other provisions, and on proposal of the Secretary of the Treasury,

I RESOLVE:

To issue the following Regulations for the General Tax on Profits, in substitution for Decree 690, of May 14, 1931, and all its modifications:

* * * * * * *

CHAPTER II

TAX ON NET PROFITS

THOSE OBLIGATED TO PAY THIS TAX

ARTICLE 11. The tax on net profits obtained in Cuba shall be paid by:

(a) Private parties or individuals who engage in any commerce or industry and commercial and industrial companies and organizations not com-

prised in those specified in subsequent paragraphs, payment being in accordance with the following tariff.

	Percent
Up to $25,000.00	6
On the excess over $25,000.00 up to $50,000.00	8
On the excess over $50,000.000 up to $100,000.00	10
On the excess over $100,000.00 up to $500,000.00	12
On the excess over $500,000.00 up to $1,000,000.00	15
On the excess over $1,000,000.00 upwards	20

(b) Corporations, silent partnerships the investment in which is represented by shares of stock, and those of limited liability with respect to the profit on the shares, if any, and banks and bankers and all associations under the general Law, whether industrial or mercantile, organized or which may be organized in Cuba and abroad, of the operation of the business of manufacture of sugar, and individuals who engage in the same industry, and mining companies, in accordance with the following scale:

	Percent
Up to $100,000.00	10
On the excess over $100,000.00 up to $500,000.00	12
On the excess over $500,000.00 up to $1,000,000.00	15
On the excess over $1,000,000.00 upwards	20

* * * * * * *

EXEMPTIONS

ARTICLE 12: The following are understood as exempt from the payment of this tax:

(a) Foreign navigation companies engaged in transporting freight and passengers between domestic and foreign ports, since they pay under another heading;

* * * * * * *

(e) Companies or individuals that are registered as taxpayers under the taxes of the Loan of $35,000,000, in accordance with the Law of February 27, 1903, and subsequent concordant ones; this exception being limited to the operations subject to those taxes;

* * * * * * *

(h) Mutual insurance organizations which are not of a commercial nature, in accordance with the provisions of the Code of Commerce;

* * * * * * *

(k) Insurance and bonding companies on their insurance and bonding operations properly speaking and without prejudice to paying the tax on items corresponding to other operations they effect subject to taxes, as well as of the tax of 4½ percent on premiums to which they are subject;

* * * * * * *

Given at the Presidential Palace, Havana, May 15, 1939.

FEDERICO LAREDO,
President.

OSCAR GARCIA MONTES,
Secretary of the Treasury.

18. On September 8, 1941, the Congress of Cuba duly enacted and the President of Cuba approved Law No. 28 which provided in part as follows:

ARTICLE FIRST: This Law is denominated "Emergency Tax Law" and shall govern according to the following sections:

Section 1. A surtax is established, up to twenty per centum (20%), exigible beginning from the effective date of this Law and until the new General Budgets of the Nation, approved by Congress, become effective, on all tariffs, scales and amounts of the taxes and contributions of the Nation now in force.

The President of the Republic is authorized to suppress or reduce the aforesaid surtax by Decree, in the proportion that he deems pertinent, taking into consideration the state of the revenues and the nature of each tax. Said Decree must be submitted for the ratification of Congress within the 5 days following its promulgation being understood to be in force until it is repealed by the President or Congress.

19. On September 17, 1941, the President of Cuba duly executed Decree No. 2597 which consisted of the regulations dealing with Law No. 28 enacted on September 8, 1941, establishing the surtax of 20 percent on the profits tax. This decree specifically applied the 20 percent surtax on the tax on profits referred to in Tariffs Third and Fourth of the law of January 29, 1931. This decree stated in part as follows:

First: The surtax authorized by Section 1 of Article First of the Emergency Tax Law No. 28, of September 8, 1941, published in the Official Gazette of the Republic on the 9th, will be applied to the following taxes and tariffs, in the form which is specified in each case.

* * * * * * *

(i) The tax on profits referred to in Tariffs Third and Fourth of said Emergency Tax Law of January 29, 1931, will be surtaxed 20 percent;

20. On November 22, 1941, Law No. 31 was duly enacted, and it provided in part as follows:

ARTICLE I. The President of the Republic is authorized to concert with the Export and Import Bank of Washington, in Spanish: Banco de Exportacion e Importacion de Washington, domiciled in the City of Washington, District of Columbia, United States of America, hereinafter called "the Bank", a credit operation whereby the Republic of Cuba will borrow from the Bank, all at one time or in successive partial amounts, until June 30, 1946, a sum of money that shall not exceed twenty-five million dollars ($25,000,000,000.00) in money of the United States of America, for the purposes prescribed in this law.

* * * * * * *

ARTICLE XXV. To guarantee the credit operation authorized by this Law, the following taxes are pledged:

* * * * * * *

II. The tax of 10 cents for each sack of sugar of 325 pounds, established by Article Second of the Law of July 31, 1917.

* * * * * * *

ARTICLE XXVI. To provide the General Budget of the Nation with the resources equivalent to the proceeds of the tax of 10 cents for each sack of sugar, that have been pledged by the preceding Article, the following taxes are created:

1. A surtax of 20 percent on the amount of the tariff now in force for contributions of banks and companies, created by Tariff Fourth of Chapter Sixth of the Emergency Tax Law of January 29, 1931.

21. On November 25, 1941, the President of Cuba duly issued Decree No. 3211, which provided in part as follows:

First: That the taxes and surcharges established in Law No. 31, of November 22, 1941, be exacted beginning with the date on which the Regulations are promulgated, that regulate the collection of said taxes.

Second: To maintain in its full force the surcharge established in Law No. 28, of September 8, 1941, in the same amount and extent that has been fixed heretofore.

22. On December 31, 1941, the President of Cuba duly issued Decree No. 3520 which provided in part as follows:

NOW THEREFORE; In use of the facilities conferred on me, with the advice of the Cabinet, and on proposal of the Minister of the Treasury,

I RESOLVE:

First: The surtaxes referred to in Decree No. 2597, of September 17, 1941, are extended from January 1, 1942, in the manner that they have been in force, and with the modifications of the present Decree.

* * * * * * *

Third: The surtax of 20% which, in accordance with paragraph (i) of Article First of Decree 2597, applies to the Tariff Fourth of the tax on profits, is eliminated, said surtax continuing in force with respect to the profits of the Tariff Third.

* * * * * * *

Fifth: On January 1, 1942, the suspension established by Decree 3211, of November 25, 1941 with respect to the taxes contained in Law No. 31,

of November 22, 1941, is set aside and in consequence, beginning with said January 1, 1942, all of the taxes and surtaxes specified in Article XXV and XXVI of the aforesaid Law No. 31 will be exactable.

23. Early in December of 1941, the Republic of Cuba declared war on the Japanese Empire, the German Reich, and the Kingdom of Italy. The Congress of the Republic of Cuba declared a state of national emergency by Special Law No. 34 of December 19, 1941, and in said law delegated to the Cuban Cabinet to be exercised by it during the term of 45 calendar days, certain functions proper to the Congress, among which was that of establishing certain taxes. Pursuant to the authority so granted, the Cabinet of Cuba on December 31, 1941, approved and the President of Cuba sanctioned Resolution Law No. 1. This law imposed taxes on luxuries, sugar production, incomes, and exportation of money. The income tax was imposed by Chapter Third. This chapter states in part as follows:

I, FULGENCIO BATISTA Y ZALDIVAR, President of the Republic of Cuba, MAKE KNOWN: That the Cabinet has approved, and I have sanctioned, the following:

* * * * * * *

CHAPTER THIRD

INCOME TAX

Section first

ARTICLE I. A tax is established on the net revenues of the natural or juridic persons who are engaged in the manufacture of alcohol, brandy and strong liquor, alcoholic ethers, alcoholates, alcoholic extracts, essences for liquors or any product not especially classified that contains ethylic alcohol; wines, sparkling wines, fruit wines and vermouths, cider, beer, table waters and soft drinks; cigars, cigarets, smoking tobacco, chewing tobacco and playing cards, in accordance with the following

Scale:	*Percent*
Up to $25,000.00	6
On the excess over $25,000.00 up to $50,000.00	8
On the excess over $50,000.00 up to $100,000.00	12
On the excess over $100,000.00 up to $500,000.00	15
On the excess over $500,000.00	20

ARTICLE II. Until the corresponding authority provides otherwise, the provisions, surtaxes and penalties contained in Chapter Second, et seq., of Decree No. 1117, of May 15, 1939, will be applied in the liquidation, supervision and collection of this tax.

Section second

ARTICLE III. A tax is established on the salaries, wages or compensations and pensions of all kinds, received in a continual or occasional manner, which will be collected in accordance with the following

Scale First	*Percent*
From $1,200.00 up to $2,400.00	1
On the excess over $2,400.00 up to $3,600.00	2
On the excess over $3,600.00 up to $6,000.00	3
On the excess over $6,000.00 up to $10,000.00	5
On the excess over $10,000.00 up to $18,000.00	7
On the excess over $18,000.00 up to $50,000.00	9
On the excess over $50,000.00	10

ARTICLE IV. A tax is established on the honorariums, fees or emoluments from the exercise of the liberal professions or from any other profession, art, or trade, or lucrative occupation, of a permanent or occasional character, in accordance with the following

Scale Second	*Percent*
From $2,400.00 up to $3,600.00	1.50
On the excess over $3,600.00 up to $6,000.00	3.75
On the excess over $6,000.00 up to $10,000.00	6.25
On the excess over $10,000.00 up to $18,000.00	8.75
On the excess over $18,000.00 up to $50,000.00	11.25
On the excess over $50,000.00	12.50

ARTICLE V. A tax is established on the income from all kinds of salaries, wages, compensation and pensions, honorariums, fees or emoluments, or from personal or real property, securities, stocks, bonds, obligations, "titulos" (another word for securities) of all kinds, dividends, interest, proceeds and any other kind of personal revenue coming from similar or analogous sources, in accordance with the following

Scale Third	*Percent*
From $5,000.00 up to $6,000.00	2
On the excess over $6,000.00 up to $8,000.00	2.50
On the excess over $8,000.00 up to $10,000.00	3.25
On the excess over $10,000.00 up to $12,000.00	4.25
On the excess over $12,000.00 up to $14,000.00	5.50
On the excess over $14,000.00 up to $16,000.00	7
On the excess over $16,000.00 up to $18,000.00	8.50
On the excess over $18,000.00	10

The remainder of the law dealing with the income tax merely set forth rules for applying Scales First, Second, and Third set forth in Section Second. Any portions of this law not herein quoted are incorporated by reference.

24. On April 5, 1943, the Congress of Cuba duly enacted and the President of Cuba approved a law which increased the rates with respect to both the profits tax and the income tax. This law states in part:

I, FULGENCIO BATISTA Y ZALDIVAR, President of the Republic of Cuba,

MAKE KNOWN: That Congress has passed and I have approved the following

LAW:

* * * * * * *

CHAPTER IV

TAX ON CAPITAL

ARTICLE 14. An annual tax of three pesos ($3.00) is established for each one thousand pesos or fraction of one thousand pesos, on the capital with which they are operating in Cuba, calculated at its real value, of the organizations or companies of all kinds, whether civil or mercantile, domestic or foreign.

ARTICLE 15. Without prejudice to the tax on profits, referred to in the Law of January 29, 1931, and its modifications, which will continue to be paid as heretofore, a tax is established of fifteen per centum (15%) additional on any profits in excess of ten per centum of the capital taxed in the manner specified in the preceding Article.

* * * * * * *

CHAPTER X

TAX ON PROFITS

ARTICLE 52. The following paragraph is added to Tariff Second of Article III of Chapter Sixth of the Law of January 29, 1931:

* * * * * * *

ARTICLE 53. The sale of Tariff Third, of Article III, Chapter Sixth, of the Emergency Tax Law of January 29, 1931, as modified by the Law of June 23, 1938, shall be worded as follows:

	Percent
Up to 25,000	9
The excess over $25,000 up to $50,000	12
The excess over $50,000 up to $100,000	15
The excess over $100,000 up to $500,000	18
The excess over $500,000 up to $1,000,000	22
The excess over $1,000,000	30

ARTICLE 54. The rate of tax established by the Law of June 23, 1938, for the taxpayers comprised in Section (1) of Tariff Fourth of Article III, Chapter Sixth, of the Emergency Tax Law of January 29, 1931, will be replaced by the following scale:

	Percent
Up to $100,000	15
The excess over $100,000 up to $500,000	18
The excess over $500,000 up to $1,000,000	22.5
The excess over $1,000,000	30

CHAPTER XVII

INCOME TAX

ARTICLE 75. Article I, Section First, Chapter Third, of Resolution-Law No. 1, of December 31, 1941, will be worded as follows:

> ARTICLE I. A tax is established on the net income of the natural or juridic persons who are engaged in the manufacture of alcohol, brandy, and strong liquor, alcoholic ethers, alcoholates, alcoholic extracts, essences for liquors or any product not especially classified that contains ethylic alcohol; wines, sparkling wines, fruit wines and vermouths, cider, beer, table waters and soft drinks; cigars, cigarets, smoking tobacco, chewing tobacco, matches and playing cards, in accordance with the following

Scale:	Percent
Up to $25,000.00	9
On the excess over $25,000.00 up to $50,000	12
On the excess over $50,000.00 up to $100,000	15
On the excess over $100,000.00 up to $500,000	18
On the excess over $500,000.00 up to $1,000,000	22.5
On the excess over $1,000,000.00	30

25. When Congress authorized an external fifty-million-dollar loan by the law of October 9, 1922, a provision was embodied (Article 8) authorizing the President of the Republic:

> * * * to destine, bind or obligate for these purposes (security and redemption of the Loan) the proceeds of all taxes or revenues in force at the present time which the Government may deem necessary or convenient to pledge, provided the said proceeds, though pledged to service other obligations, are sufficient to permit their application for the purposes set forth hereunder.

As a result of this authorization, in clause Ninth of the contract executed between Morgan & Company and the Cuban Government, covering the issuance of the fifty million-dollar loan, it was established, as a guarantee of the loan, that there was specifically and expressly effected:

> (b) The surplus of the proceeds of the taxes established in 1904 to secure the $35,000,000 Loan contracted with Speyer & Company * * *.

After total redemption of the Speyer Loan, all of the revenues obtained from the special taxes established by the laws of 1903 and 1904 and not just the "surplus" thereof, as theretofore, became part of the guarantee of the 1923 Morgan loan.

26. On April 2, 1948, the Second Civil and Contentious-Administrative Chamber of the Court of Appeals of the Havana District rendered its Decision No. 360. This case involved the question whether or not a taxpayer engaged in the business of manufacturing perfumes in Havana was exempt from the profits tax by reason of his being registered to pay the production tax. In this case the taxpayer had registered to pay the production tax but had not actually paid such tax. The law relating to the profits tax with which the court dealt was that set forth in Decree No. 1117 of 1939 (the regulations dealing with the law of January 29, 1931, and with which the United States Court of Claims is concerned in the instant case). The court held against the taxpayer, stating that registration to pay the production tax alone was not sufficient to exempt the taxpayer from paying the profits tax. The court held that in order to be exempt from the profits tax, the production tax must actually be paid. The court stated on this point:

> WHEREAS: that the exemption from the profits tax sought in the administrative proceeding and now in the contentious appeal, is based, fundamentally, on the interpretation and application of Article 12 section e

of Decree 1117 of 1939, which grants this benefit to companies and individuals registered as taxpayers under the Thirty-Five Million Loan Taxes; which exemption is to be granted or not, depending on whether the criterion of the appellant that the "registration" is sufficient for the exemption is accepted, or in turn the argument of the Government is accepted that the registration, in itself, does not entitle to exemption, but that it is necessary, in addition, to be effectively and actually a taxpayer, * * *

WHEREAS: such elementary rules preclude, as the appellant has done, that one should seek application of one single precept which is favorable to him, disregarding all the others contained in a single codified body of law and such others as bear a relation of compliance and addition thereto; hence: although under the letter (f) of Article 42 of Decree 690 of 1931, "companies and individuals registered as taxpayers under the Thirty-Five Million Loan Taxes, pursuant to the Law of February 27, 1903, and the subsequent complementary laws" are considered exempt from the tax on profits, it cannot be ignored that in reproducing this provision, Section (e) of Article 12 of Decree 1117 of 1939 added, "this exception being limited to the operations subject to these taxes" (thus giving the concept of taxation and not of mere registration) and especially, that the spirit and purpose of the said rule, the reason for the exemption, are clearly set forth in ordinal eight of Article 5 of the Law of Economic Emergency, as amended by the law of February 27, 1904, to the effect that the same is granted in connection with profits because the latter "are already subject to the thirty-five million loan tax"; which leads without ay doubt to the conclusion that it is the direct taxation under this latter tax and not the mere registration in the Registry of Taxpayers which determines the exemption, which having been denied by the Government, did not impair any preestablished administrative right in favor of the taxpayer.

27. This decision of the Court of Appeals was affirmed by Decision No. 775 of the Supreme Court of Cuba on December 22, 1949.

28. For the year 1944, the plaintiff accrued and paid to Cuba a Speyer Loan production tax in the amount of $164,563.14.

29. After the allowance of the Speyer Loan production tax of $164,563.14, less refund of the 1943 Speyer Loan production tax in the amount of $850.98, net amount of $163,712.16, as a deduction, plaintiff's net income for the year 1944, as computed under the laws of Cuba, was $537,303.29. Plaintiff accrued and paid to Cuba as a manufacturer of soft drinks a tax on this net income under the provisions of Resolution Law No. 1, enacted on December 31, 1941, as amended by the law of April 5, 1943, in the amount of $93,143.24, computed as follows:

Profit	*Rate (percent)*	*Tax*
Up to $25,000	9	$2,250.00
From $25,000 to $50,000	12	3,000.00
From $50,000 to $100,000	15	7,500.00
From $100,000 to $500,000	18	72,000.00
From $500,000 to $537,303.29	22½	8,393.24
Total		93,143.24

30. For the year 1944 plaintiff's capital which was subjected to the Cuban tax on capital amounted to $4,850,000. For the year 1944 plaintiff in accordance with Chapter IV entitled "Tax on Capital" of the law of April 5, 1943, accrued and paid to Cuba a 15 percent additional tax upon profits computed as follows:

Net income	$537,303.29
Less: 10% of capital subject to tax on capital	485,000.00
Balance subject to 15% additional	52,303.29
15% additional tax upon income	7,845.49

31. The total of the three tax liabilities for the year 1944, was $265,551.87, and consisted of the following:

Speyer Loan production tax (finding 28)	$164,563.14
Manufacturer of soft drink tax upon net income (finding 29)	93,143.24
15% additional tax upon income (finding 30)	7,845.49
Total	265,551.87

32. On or about March 15, 1945, plaintiff filed with the collector of internal revenue at Wilmington, Delaware, its Federal corporation income and declared value excess profits tax return for the calendar year 1944. In said return, plaintiff claimed no deduction for any of the three taxes accrued and paid to Cuba, as set out in finding 31. In said return, plaintiff claimed a foreign tax credit under section 131 of the Internal Revenue Code for said taxes on the grounds that:

(a) The Speyer Loan production tax was a tax paid or accrued during the year to a foreign country in lieu of a tax upon income, otherwise generally imposed, within the meaning of subparagraph (h) of Section 131;

(b) The tax on plaintiff as a manufacturer of a soft drink and the 15% additional tax were income taxes paid or accrued during the year to a foreign country, within the meaning of subparagraphs (a) (1) of Section 131.

Said return showed no United States corporation income or declared value excess profits tax after the foreign tax credit.

33. For the year 1945, the plaintiff accrued and paid to Cuba a Speyer Loan production tax in the amount of $212,389.65.

34. After the allowance of the Speyer Loan production tax of $212,389.65 as a deduction, plaintiffs net income for the year 1945 as computed under the laws of Cuba was $675,400.42. Plaintiff accrued and paid to Cuba as a manufacturer of a soft drink a tax on this net income under the provisions of Resolution Law No. 1 enacted on December 31, 1941, as amended by the law of April 5, 1943, in the amount of $124,215.09, computed as follows:

Profit	*Rate (percent)*	*Tax*
Up to $25,000	9	$2,250.00
From $25,000 to $50,000	12	3,000.00
From $50,000 to $100,000	15	7,500.00
From $100,000 to $500,000	18	72,000.00
From $500,000 to $675,400.42	22½	39,465.09
Total		124,215.09

35. For the year 1945 plaintiff's capital which was subjected to the Cuban tax on capital amounted to $5,000,000. For the year 1945 plaintiff in accordance with Chapter IV entitled "Tax on Capital" of the law of April 5, 1943, accrued and paid to Cuba a 15 percent additional tax upon profits in the amount of $26,310.06, computed as follows:

Net income	$675,400.42
Less: 10% of capital subject to tax on capital	500,000.00
Balance subject to 15% additional tax	175,400.42
15% additional tax upon income	26,310.06

36. The total of the three tax liabilities for the year 1945, was $362,914.80, and consisted of the following:

Speyer Loan production tax (finding 33)	$212,389.65
Manufacturer of soft drinks tax upon net income (finding 34)	124,215.09
15% additional tax upon income (finding 35)	26,310.06
Total	362,914.80

37. On or about March 15, 1946, plaintiff filed with the collector of internal revenue at Wilmington, Delaware, its Federal corporation income and declared value excess profits tax return for the calendar year 1945. In said return, plaintiff claimed no deduction for any of the three taxes accrued and paid to Cuba as set out in finding 36. In said return plaintiff claimed a foreign tax credit under section 131 of the Internal Revenue Code for said taxes on the ground that:

(a) The Speyer Loan production tax was a tax paid or accrued during the year to a foreign country in lieu of a tax upon income otherwise generally imposed within the meaning of subparagraph (h) of section 131.

(b) The tax on plaintiff as a manufacturer of a soft drink and the 15 percent additional tax were income taxes paid or accrued during the year to a foreign country within the meaning of subparagraph (a) (1) of Section 131.

Said return showed no United States income or declared value excess profits tax after the foreign tax credit.

38. On June 27, 1947, the Commissioner of Internal Revenue determined and allowed as follows:

(a) Determined that no part of the Speyer Loan production tax accrued and paid to Cuba by the plaintiff for the years 1944 and 1945 was a tax paid or accrued during said years to a foreign country in lieu of a tax upon income otherwise generally imposed within the meaning of subparagraph (h) of section 131.

(b) Allowed said Speyer Loan production tax as deductions for 1944 and 1945, respectively.

(c) Determined that plaintiff's net taxable income for the year 1944 was $531,406.04, and that its net taxable income for the year 1945 was $686,517.08.

(d) Determined that plaintiff's Federal income tax liability, prior to any credit for foreign taxes for the year 1944 was $127,537.45, and that its Federal income tax liability for the year 1945, prior to any credit for foreign taxes was $164,764.10.

(e) Allowed plaintiff a credit for foreign taxes for the year 1944, in the amount of $100,988.73, which consisted of the manufacturer of soft drinks tax of $93,143.24 and the 15% additional tax of $7,845.49 paid to Cuba for that year.

(f) Allowed plaintiff a credit for foreign taxes for the year 1945, in the amount of $150,525.15, which consisted of the manufacturer of soft drinks tax of $124,215.09 and the 15% additional tax of $26,310.06 paid to Cuba for that year.

(g) Determined a deficiency as the result of the foregoing adjustments, plus certain other minor adjustments not material herein, in plaintiff's Federal income tax liability for the year 1944 of $26,548.72 and a deficiency in plaintiff's Federal income tax liability for the year 1945 of $14,238.95.

39. Thereafter, the Commissioner of Internal Revenue made an assessment against plaintiff of said deficiency for the year 1944 of $26,548.72, plus interest thereon of $3,880.10, a total of $30,428.82, and made an assessment against the plaintiff of said deficiency for the year 1945 of $14,238.95, plus interest thereon of $1,226.69, a total of $15,465.64.

40. Plaintiff on September 4, 1947, paid said amounts of $30,428.82 and $15,465.64 to the collector of internal revenue at Wilmington, Delaware.

41. On February 25, 1948, plaintiff filed with the collector of internal revenue at Wilmington, Delaware:

(a) A claim on Treasury Department Form 843 for the refund of the $30,428.82 tax and interest so paid for the year 1944. A true and correct copy of said claim is attached to the petition, and is by reference made a part hereof.

(b) A claim on Treasury Department Form 843 for the refund of the $15,465.64 tax and interest so paid for the year 1945. A true and correct copy of said claim is attached to the petition, and is by reference made a part hereof.

42. On November 2, 1948, the Commissioner of Internal Revenue by registered mail and pursuant to the provisions of section 3772(a)(2) of the Internal Revenue Code of 1939, gave notice to plaintiff of the disallowance in full of said claims for refund.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is entitled to recover, and it is therefore adjudged and ordered that it recover of and from the United States forty-five thousand eight hundred ninety-four dollars and forty-six cents ($45,894.46), with interest as provided by law.

SUPPLEMENT F.—PARTNERSHIPS

SECTION 182.—TAX OF PARTNERS

REGULATIONS 118, SECTION 39.182-1: Distributive shares of partners. Rev. Rul. 57-138

For taxable years to which the Internal Revenue Code of 1939 applies, partners may, in accordance with the partnership agreement, allocate different items of partnership profit and loss in different ratios, provided such allocation is not for the purpose of avoidance of income taxes by a partner. Under such circumstances, only one partnership exists for Federal income tax purposes.

Revenue Ruling 56-134, C. B. 1956-1, 649, is revoked; O. D. 140, C. B. 1, 174 (1919), distinguished.

Reconsideration has been given to Revenue Ruling 56-134, C. B. 1956-1, 649, which holds that where a domestic partnership is engaged in business in the United States and a foreign country and the arrangement with respect to the drawing accounts of the partners results in different distributive shares of the partnership income with respect to the domestic and foreign branch, there are in each of such cases two common funds shared by the identical partners in different ratios and, therefore, two partnerships rather than one for Federal income tax purposes. This Revenue Ruling applies only to years governed by the Internal Revenue Code of 1939.

The question presented in Revenue Ruling 56-134, *supra*, is whether O. D. 140, C. B. 1, 174 (1919), has been overruled or modified by G. C. M. 13771, C. B. XIII-2, 229 (1934), as modified by G. C. M. 17255, C. B. XV-2, 243 (1936).

O. D. 140, *supra*, holds that "Income from a particular source cannot be allocated to one partner of a partnership for income tax purposes, but must be divided pro rata among the several partners."

G. C. M. 17255, *supra*, which modified G. C. M. 13771, *supra*, holds that where a nonresident alien member of a partnership operating in the United States and in a foreign country, devotes his time solely to the foreign branch, and the partnership agreement provides that he shall be paid a "salary" out of the profits of the foreign branch, the amount of the so-called salary is part of his distributive share of partnership profits and constitutes income from sources without the United States to the extent that income of the foreign branch is available to make such distribution.

The partnership agreement involved in O. D. 140, *supra*, unlike that involved in G. C. M. 17255, apparently contained no provision regarding the division of various items of partnership income. It follows, then, that O. D. 140, *supra*, stands only for the proposition that in the absence of such an agreement, partnership income must be divided pro rata among the several partners. Accordingly, since the cited rulings involve distinguishable factual situations, there is no apparent conflict between them.

Moreover, it is noteworthy that, while the 1939 Code is silent with respect to disproportionate sharing by partners of any item of partnership income, gain, loss, deduction or credit, the Internal Revenue Code of 1954 specifically recognizes that a partnership agreement may provide therefor.

It is stated in section 704(a) of the 1954 Code that a partner's distributive share of income, gain, loss, deduction or credit, except as otherwise provided in that section, is to be determined by the partnership agreement. Section 704(b) of the Code provides, in part, that, if the principal purpose of any provision in the partnership agreement determining a partner's distributive share of a particular item is to avoid or evade the Federal income tax, the provision of the partnership agreement is to be disregarded and the partners' distributive shares of that item are to be determined in accordance with the ratio in which the partners divide the general profits or losses, that is, the taxable income or loss of the partnership as described in section 702(a)(9) of the Code. See section 1.704–1 of the Income Tax Regulations. Although, with the exception of subsection (e) of section 704 of the Code, all the provisions thereof are new, it is stated in Senate Report No. 1622, 83d Congress, Second Session, at page 379, that such provisions are substantially in accord with existing practice.

Accordingly, for taxable years to which the 1939 Code applies, partners may, in accordance with the partnership agreement, share various items of partnership profit and loss in different ratios, provided such agreement is not for the purpose of avoidance of income taxes by a partner. In such a case, there is only one partnership for Federal income tax purposes.

Revenue Ruling 56–134, C. B. 1956–1, 649, is revoked and O. D. 140, C. B. 1, 174 (1919), is distinguished.

Rev. Rul. 57–203

A partner is required to report in his individual income tax return the full amount of his distributive share of a partnership loss occurring in a taxable year subject to the provisions of the Internal Revenue Code of 1939, notwithstanding the fact that his distributive share of such loss exceeds the adjusted basis of his investment in the partnership at the close of the partnership loss year.

Advice has been requested whether a deduction is allowable to an individual partner for his full distributive share of a partnership operating loss in a taxable year governed by the Internal Revenue Code of 1939 where his share of the partnership loss exceeds the adjusted basis of his investment in the partnership.

In the instant case, the taxpayer reports his income for Federal income tax purposes on the cash receipts and disbursements method. For the taxable year 1953, the partnership of which taxpayer is a partner sustained an operating loss. The taxpayer in his income tax return for 1953 claimed a deduction for his distributive share of the operating loss which exceeded the adjusted basis of his investment in the partnership. He also filed a claim for refund of income taxes paid for the taxable year 1952 attributable to a carryback of the net operating loss from 1953.

Section 182 of the Internal Revenue Code of 1939 provides that, in computing the net income of each partner, he shall include, whether or not distribution is made to him, his distributive shares of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months, and from sales or exchanges of capital assets held for more than six months, and his distributive

share of the ordinary net income or the ordinary net loss of the partnership.

Since the design of the 1939 Code and prior Revenue Acts is to tax the partners rather than the partnership upon the partnership income, the profits and losses realized by the partnership are the profits and losses of the individual partners. Thus, under the 1939 Code, a partner is required to report in his individual income tax return the full amount of his distributive share of the partnership loss, whether he makes good his share of such loss out of his pocket, by way of a charge against his partnership capital account or with borrowed funds which he is obligated to repay in a subsequent year. See *Fritz Hill* v. *Commissioner*, 22 B. T. A. 1079, asquiescence C. B. X–2, 31 (1931); *Augustine M. Lloyd et al.* v. *Commissioner*, 15 B. T. A. 82 acquiescence C. B. VIII–1, 27 (1929); *A. W. D. Weis* v. *Commissioner*, 13 B. T. A. 1284, acquiescence C. B. VIII–2, 55 (1929); *Laurence D. Miller* v. *Commissioner*, 7 B. T. A. 581.

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 204.—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL

REGULATIONS 111, SECTION 29.204–2: Gross income.

Portions of original premiums established and segregated as a reinsurance reserve by a title insurance company from June 1, 1938, to May 31, 1945, under section 434 1.a. of the New York State Insurance Law, may be treated as unearned premiums under 204(b)(5) of the 1939 Code. See Rev. Rul. 57–48, page 212.

REGULATIONS 118, SECTION 39.204–3: Deductions.

Deductibility of a dividend declared during a taxable year in an amount representing the entire or a specified portion of the net profits of the company at the end of the taxable year. See Rev. Rul. 57–134, page 210.

SECTION 207.—MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE

REGULATIONS 118, SECTION 39.207–3: Dividends to policyholders.

Deductibility of a dividend declared during a taxable year in an amount representing the entire or a specified portion of the net profits of the company at the end of the taxable year. See Rev. Rul. 57–134, page 210.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 275.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

REGULATIONS 118, SECTION 39.275–1: Period of limitation upon assessment of tax.

Period of limitation on assessment of deficiencies resulting from a retroactive determination that an automobile club is not exempt from tax. See Ct. D. 1807, page 513.

The Internal Revenue Service explains its policy and issues a guide for taxpayers and practitioners regarding the circumstances under which the securing of a waiver or consent, fixing the period of limitation upon assessment of income and profits tax, is appropriate. See Rev. Proc. 57–6, page 729.

SUBCHAPTER D.—EXCESS PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 453.—NONTAXABLE INCOME FROM CERTAIN MINING AND TIMBER OPERATIONS, AND FROM NATURAL GAS PROPERTIES

REGULATIONS 130, SECTION 40.453–1: General rule.

Application of Revenue Ruling 236 to other mineral enterprises. See Rev. Rul. 57–100, page 546.

SECTION 456.—ABNORMALITIES IN INCOME IN TAXABLE PERIOD

REGULATIONS 130, SECTION 40.456–7: Exploration discovery, prospecting. (Also Section 453; 40.453–1.) — Rev. Rul. 57–100

Although Revenue Ruling 236, C.B. 1953–2, 236, is directly concerned with the application of section 456 of the Internal Revenue Code of 1939 to the oil and gas extraction industry, the principles stated therein are equally applicable to corporations engaged in other mineral enterprises. Further, the provisions of section 453 of the Code do not prevent the application of section 456(a)(2)(B), except to the extent that the adjustment to the excess profits net income for "exempt excess output" includes a portion of the net abnormal income.

Rev. Rul. 236, C. B. 1953–2, 236, amplified.

Advice has been requested whether the general principles stated in Revenue Ruling 236, C.B. 1953–2, 236, which ruling is directly con-

cerned with the application of section 456 of the Internal Revenue Code of 1939 to the oil and gas extraction industry, are equally applicable to corporations engaged in other mineral enterprises, and, furthermore, whether Code sections 453 and 456 may both be applicable in the same taxable year.

Revenue Ruling 236, *supra*, states the position of the Internal Revenue Service with respect to the application of section 456 of the Internal Revenue Code of 1939, relating to excess profits tax, to taxpayers engaged in the extraction of petroleum and natural gas. It explains the allocation of abnormal income resulting from exploration, discovery or prospecting.

Section 453, a relief provision for excess output, provides the rules by which exempt excess output may be determined. Section 433(a)(1)(I) provides that normal tax net income will be adjusted in arriving at excess profits net income, by excluding from it the exempt excess output determined under section 453.

Section 456 is also a relief provision but it serves a different purpose. It provides an alternative method of computing the tax under subchapter D. Section 456 requires the elimination of "abnormal income" from the gross income of the taxable year. The excess profits net income, without this "abnormal income," is then determined; to this is added an amount equal to the tax which would have resulted if the net abnormal income attributable to prior years has been included in the gross income of the prior years. The tax under subchapter D of the Code, for the current taxable year, cannot exceed this amount.

Accordingly, it is the position of the Service that, although Revenue Ruling 236, C. B. 1953–2, 236, is directly concerned with the application of section 456 of the Internal Revenue Code of 1939 to the oil and gas extraction industry, the principles stated therein are equally applicable to corporations engaged in other mineral enterprises. It is further held that the provisions of section 453 of the Code do not prevent the application of section 456(a)(2)(B), except to the extent that the adjustment to the excess profits net income for "exempt excess output" includes a portion of the net abnormal income.

CHAPTER 5.—BOARD OF TAX APPEALS

SUBCHAPTER B.—COURT REVIEW OF BOARD DECISIONS

SECTION 1140.—DATE WHEN BOARD DECISION BECOMES FINAL

(Also Section 1142.) Ct. D. 1804

INCOME TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. JURISDICTION OF TAX COURT—POWER TO VACATE FINAL DECISION.

A Tax Court decision becomes final upon expiration of the time for filing a petition for review, that is, three months after the decision is rendered. After a decision has become final, the Tax Court has no jurisdiction to vacate, modify, or reconsider it. Accordingly, when, some four months after decision, taxpayers moved the Tax

Court to vacate its decision on ground of "excusable neglect" the decision had become final, the Tax Court was beyond its power when it granted the motion and rendered a second decision, and the Court of Appeals has no jurisdiction to review such second decision. The Tax Court is an administrative agency and cannot assume the equity powers of a court.

2. Petition for review dismissed, 235 F. (2d) 97.

3. Opinion affirmed *per curiam* by United States Supreme Court Order of March 11, 1957.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Bessie Lasky and Jesse L. Lasky, petitioners, v. *Commissioner of Internal Revenue, respondent*

Petitions for review of the decisions of The Tax Court of the United States

Before: DENMAN, Chief Judge, LEMMON, Circuit Judge, and SOLOMON, District Judge

[June 13, 1956]

OPINION

DENMAN, Chief Judge: Lasky and his wife seek to petition this court for review of decisions of the Tax Court, "an independent agency in the Executive Branch of the Government".[1] That agency held that over $800,000.00 received by Lasky in connection with the motion picture "Sergeant York" was ordinary income rather than capital gain, and consequently that Lasky and his wife each owe tax deficiencies of over $224,500.00.

The Commissioner challenges the jurisdiction of this Court of Appeals to consider the merits of the claimed right of review and moved to dismiss the petitions, contending that they were not filed within three months after the decision of the Tax Court as was required by 26 U. S. C. § 1142 which provided:[2]

> "The decisions of the Tax Court * * * may be reviewed by a court of appeals * * * if a petition for such review is filed by either the Commissioner or the taxpayer within three months after the decision was rendered * * *"

and by 26 U. S. C. § 1140 making the agency's decision final, reading:

> "§ 1140. Date when Tax Court decision becomes final
>
> The Decision of the Tax Court shall become final—(a) Petition for review not filed on time. Upon the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time;"

Clearly here the conditions precedent to the Court of Appeals' jurisdiction to review Tax Court action is the filing of the petition within three months of the Tax Court's first decision which was entered on April 8, 1954. No such petition was filed. Some four months after the decision, on August 23, 1954, the petitioners moved the Tax Court to vacate the decision of April 8, 1954, on the ground of excusable neglect,[3] a power formerly in the federal courts' equity jurisdiction, Cf. *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.*, 300 U. S. 131 (1937), and now contained in Rule 60 (b) F. R. C. P. which by Rule 1 is confined to the United States District Courts and not applicable to executive agencies.[4]

Though not a court at all but merely an administrative agency it assumed the power of a district court and in December, 1954, it granted petitioners' motion to vacate its decision of April 8, 1954, and for the taking of additional evidence. After additional evidence was taken, the Tax Court rendered a second decision reaching the same result as in the first. The petition for review of the second decision was filed well within three months of the date it was entered.

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[1] 26 U. S. C. § 1100 [now 26 U. S. C. § 7441], reading:
§ 7441. STATUS.
The Board of Tax Appeals shall be continued as an independent agency in the Executive Branch of the Government, and shall be known as the Tax Court of the United States. The members thereof shall be known as the chief judge and the judges of the Tax Court. Aug. 16, 1954, 9:45 E. D. T. c. 736, 68A Stat. 879.

[2] Now 26 U. S. C. § 7482.

[3] The failure to act in the statutory period was caused by the misfiling of the Tax Court's decisions in the office of petitioners' former attorney by a member of his staff.

[4] Katz v. Commissioner of Int. Rev., 188 F. 2d 957 (Cir. 2, 1951).

In *Swall* v. *Commissioner of Internal Revenue*, 122 F. 2d 324 (Cir. 9), cert. denied, 314 U. S. 697 (1941), this Court held that a decision of this administrative agency [then called the Board of Tax Appeals] becomes final three months after it was entered and that thereafter the Tax Court has no power to modify it or reconsider it. The decision was based on the precedent statutes applicable to the agency when it was called the Board of Tax Appeals identical with those cited supra by the Commissioner as the basis of his motion to dismiss.

Our decision in the Swall case was preceded by similar decisions of the First Circuit, *Sweet* v. *Commissioner*, 120 F. 2d 77, succeeded by a second decision, *Denholm & McKay* v. *Commissioner*, 132 F. 2d 243; the Second Circuit in *Monjar* v. *Commissioner*, 140 F. 2d 263; and the Third Circuit in White's *Will* v. *Commissioner*, 142 F. 2d 746.

Our Swall case and these cases are based on our construction of the word "final" in the § 1140 cited supra as the Supreme Court in *Helvering* v. *Northern Coal Co.*, 293 U. S. 191 (1934) construed the word "final" as used with reference to that court's decisions in the Revenue Act of 1926. There the Supreme Court had rendered its judgment affirming several judgments of the Board of Tax Appeals and issued its mandates. During the term of the court motions for petitions for rehearing were filed which in ordinary cases the court had the jurisdiction to entertain. It held that:

> "Section 1005(a) (4) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 110, 111, U. S. C., Tit. 26, § 640, with respect to decisions of the Board of Tax Appeals, provides:
>
> Sec. 1005(a). The decision of the Board shall become final—* * * (4) Upon the expiration of 30 days from the date of issuance of the mandate of the Supreme Court, if such Court directs that the decision of the Board be affirmed or the petition for review dismissed.
>
> In view of the authoritative and explicit requirement of the statute and of its application to these cases, the petitions for rehearing are severally denied."

Some nine years later the Supreme Court again held that the finality provided in the legislation gave it no jurisdiction to afford relief thereafter. *R. Simpson & Co.* v. *Commissioner*, 321 U. S. 225, 228 et seq. [Ct. D. 1601, C. B. 1944, 477.]

Obviously if the Supreme Court lacks the power to reconsider because the decision of the Board has become "final", a fortiori such an agency as the Tax Court likewise lacks the power by the words of Section 1140 that "The decision of the Tax Court shall become final * * * upon the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within that time"

Counsel for the Laskys, ignoring the Congressional definition of it as an executive agency, contend that the Tax Court is "like other *courts*" and hence as a *court* has the "*inherent* power to control, amend, open and vacate its decisions."

Extraordinary as it is that counsel, without mention of the statutory definition, seek to have us act as if it did not exist, we find that the Sixth Circuit, in *Reo Motors* v. *Commissioner*, 219 F. 2d 610, similarly ignores the statute and, without mentioning it, treats the Tax Court not as a mere executive agency but as having the inherent power of a United States Court.

In that case the Tax Court, more than three months after its final decision, ordered it set aside on the ground of mutual mistake of fact of both the parties in presenting the case to the agency. The Sixth Circuit holds of this executive agency that it has the jurisdiction so to act since "as a practical matter, it is a court exercising *inherently* judicial functions and having the necessary judicial powers to carry out such functions." It treats the agency as having the powers of a court to grant a writ of error coram nobis.

That court relies on the case of *Goldsmith* v. *United States Board of Tax Appeals*, 270 U. S. 117 (1925). There the sole question was whether the Board of Tax Appeals had the power to make rules governing the right to practice before it. The Supreme Court held the agency had this power because of its "quasi judicial" character, quoting the words of the statute that "The Board shall be an independent agency in the executive branch of the government." Nothing in that opinion remotely suggests that the agency is a court having the inherent power to issue writs coram nobis. Its quasi judicial powers of making rules, summoning witnesses, etc., are no more than are given other executive agencies such as the National Labor Relations Board.

Further, the Sixth Circuit opinion fails to mention the Supreme Court decision in *Helvering* v. *Northern Coal Co.*, supra, nine years after the Goldsmith decision was rendered. Nor does it consider our decision in the Swall case or the four other Circuit Court decisions cited above. That is to say, it ignores both the governing statute and the precedent opinions on it.

Both the Sixth Circuit and counsel here cite the case of *La Floridienne J. Buttgenbach & Co.* v. *Commissioner*, 63 F. 2d 630 (Cir. 5, 1933), where the court held *solely* that *on the stipulation of the parties* the Board of Tax Appeals could set aside its final order more than three months after its rendition. Here there is no such stipulation. More important still, the *La Floridienne* case was decided in 1933, the year before the Supreme Court rendered its Northern Coal Co. decision in 1934, determining that where the statutes make final the action of the taxing agency, no jurisdiction exists after such finality to set the decision aside. The *Buttgenback* case was specifically criticized in our opinion in the *Swall* case, supra. Though parties may stipulate to the jurisdiction of the *person*, they may not do so as to the *subject matter*.

Finally the Laskys stress the decision of the Supreme Court in *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.*, 300 U. S. 131 (1937). In effect they claim this case overrules the Northern Coal decision of 1934, though it does not mention it. In that case the matter in question was the power not of a mere executive agency but of the bankruptcy court to vacate its own order dismissing a petition for reorganization under 77B of the bankruptcy act, after the time for appeal had expired and after the term of the court had ended. The district court held it had such power. The Court of Appeals held it had not and reversed. The Supreme Court reversed, holding the District Court sitting in bankruptcy, had no term and that it could exercise its equitable powers as a bankruptcy *court* to set aside its decision after the time for appeal had expired.

Here was no overruling of the Northern Coal case for the bankruptcy laws made no such provision for finality of the court's decisions considered in that case, nor is there any such Congressional intent regarding the bankruptcy court as was expressed concerning the Tax Court agency by the Senate Committee Report on the identical predecessor section 1005 of the Revenue Act of 1926 now section 1140, which report stated.

> "DATE ON WHICH DECISION BECOMES FINAL.—Section 1005 prescribes the date on which a decision of the Board (whether or not review thereof is had) is to become final. Inasmuch as the statute of limitations upon assessments and suits for collection, both of which are suspended during review of the Commissioner's determination, commences to run upon the day upon which the Board's decision becomes final, it is of utmost importance that this time be specified as accurately as possible. In some instances in order to achieve this result the usual rules of law applicable in court procedure must be changed. For example, the power of the court of review to recall its mandate is made to expire 30 days from the date of issuance of the mandate." [C. B. 1939–1 (Part 2), 332, at 360.]

And as a final answer to the contention that the *Wayne Gas Co.* case overruled the *Northern Coal* case, is the decision affirming the *Northern Coal* case in *Simpson Co.* case, decided seven years after the *Wayne Gas* case.

We hold the Tax Court was without jurisdiction to set aside its first decision and that this court has no jurisdiction to consider a petition for review of its second decision. The petition for review is ordered dismissed.

SECTION 1142.—PETITION FOR REVIEW

Jurisdiction of the Tax Court to vacate a decision after it has become final. See Ct. D. 1804, page 547.

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS

PART III.—GENERAL PROVISIONS

SECTION 1426(1).—DEFINITIONS: EXEMPTIONS OF RELIGIOUS, CHARITABLE, ETC., ORGANIZATIONS

REGULATIONS 128, SECTION 408.216: Religious, charitable, educational, or other organizations exempt from income tax under section 101(6) of the Internal Revenue Code.

Interim instructions for applying the provisions of section 3121(k) of the Federal Insurance Contributions Act, as amended by the Social Security Amendments of 1956. See Rev. Rul. 57–11, page 344.

CHAPTER 15.—TOBACCO, SNUFF, CIGARS, AND CIGARETTES

SUBCHAPTER F.—MISCELLANEOUS PROVISIONS

SECTION 2198.—REDEMPTION OF STAMPS ON PACKAGES WITHDRAWN FROM MARKET

For the filing of claims by a successor to the manufacturer of taxpaid tobacco products, see Rev. Rul. 57–121, page 429.

CHAPTER 30.—TRANSPORTATION AND COMMUNICATION

SUBCHAPTER E.—TRANSPORTATION OF PROPERTY

SECTION 3475.—TRANSPORTATION OF PROPERTY

REGULATIONS 113, SECTION 143.1: Meaning of terms. Rev. Rul. 57–36

(Also Part I, Section 4271.)

Section 143.1(d) of Regulations 113, relating to the tax on the transportation of property, provides that the term "transportation" includes accessorial services furnished in connection with a transportation movement, such as loading, unloading, blocking and staking, elevation, transfer in transit, ventilation, refrigeration, icing, storage, demurrage, lighterage, trimming of cargo in vessels, wharfage, handling, feeding and watering livestock, and similar services and facilities. In *Swift & Company* v. *United States*, 144 Fed. Supp. 956, the United States Court of Claims did not sustain the position of the Government that the term "transportation" includes the services

of icing and salting furnished by a carrier in connection with a transportation movement and held that the amounts paid for such services are not subject to the tax imposed by section 3475 of the Internal Revenue Code of 1939. Although a petition for certiorari to the Supreme Court of the United States will not be filed in this case, the decision of the Court of Claims will not be considered by the Internal Revenue Service as a precedent in the disposition of other cases involving a similar factual situation. This will apply whether the situation arises under the provisions of section 3475 of the 1939 Code or under the similar provisions of section 4271 of the Internal Revenue Code of 1954.

CHAPTER 37.—ABATEMENTS, CREDITS, AND REFUNDS

SECTION 3771.—INTEREST ON OVERPAYMENTS

Statutory period in which a claim must be filed or action taken for interest on a refund of tax overpayment. See Rev. Rul. 57-242, page 452.

CHAPTER 38.—MISCELLANEOUS PROVISIONS

SECTION 3791(b).—RULES AND REGULATIONS: RETROACTIVITY OF REGULATIONS OR RULINGS

Retroactive revocation of exemption of automobile club. See Ct. D. 1807, page 513.

SECTION 3801(b).—MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES: CIRCUMSTANCES OF ADJUSTMENT

REGULATIONS 118, SECTION 39.3801(b)-9: Disallowed deductions or credits. Rev. Rul. 57-13

Taxpayer, a corporation employing the accrual method of accounting, has, for 1953 and prior calendar years, erroneously deducted New Jersey property taxes in the year of payment instead of the year of assessment, as required by G. C. M. 15305, C. B. XIV-2, 80 (1935). During the year 1953, the taxpayer paid and deducted the taxes for 1952 (a year now barred by the statute of limitation). Under authority of G. C. M. 15305, *supra*, the taxpayer also deducted the taxes assessed and therefore accruable in the year 1953. *Held*, the deduction for the New Jersey property tax which accrued in 1952, is not a proper deduction for 1953, when paid and, therefore, is not allowable. However, since a credit or refund attributable to the deduction for such tax for 1952 was not barred by the statute of limitations, at the time such deduction was originally claimed in 1953, the wrong year, and since 1953 is not barred by the statute of limitation, an adjustment for 1952 is permissible under section 3801(b)(6) of the Internal Revenue Code of 1939, provided the provisions of section 3801 are otherwise complied with.

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 1

26 CFR 315.27: Firearm.

For the classification of an extension barrel for use on industrial guns, see Rev. Rul. 57–34, page 434.

For classification of "DEWATS" and "unserviceable firearms" see Rev. Rul. 57–227, page 433.

PART III

ALCOHOL TAX RULINGS AND DECISIONS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNATIONAL 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 15.—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 251.40: Distilled spirits. Rev. Rul. 57–186
(Also Sections 5041 and 5051; Sections 251.42 and 251.45.)

It is held in Revenue Ruling 54–417, C. B. 1954–2, 475, that the internal revenue tax paid on imported vermouth received in the United States and subsequently returned to the foreign country from which shipped is not refundable. This ruling also applies in the case of tax paid on imported wines other than vermouth and in the case of tax paid on imported distilled spirits and beer. The tax, imposed by sections 5001, 5041, and 5051 of the Internal Revenue Code of 1954, on distilled spirits, wine, and beer, respectively, brought into the United States from a foreign country and paid at the time such products were withdrawn from customs custody, can not be refunded, even though the products are subsequently returned to the shipper in the foreign country. Revenue Ruling 54–417, *supra*, is hereby supplemented accordingly.

For the liberalization in requirements with respect to the listing of various tax rates on liquors imported from Puerto Rico and the distilled spirits, see Rev. Rul. 57–122 below.

SECTION 5008.—STRIP STAMPS FOR DISTILLED SPIRITS

26 CFR 250.127: Report of red strip stamps used. T. D. 6224[1]

(Also Section 5001; 251.40.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 250 and 251

Records and reports

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

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

On September 28, 1956, a notice of proposed rulemaking with respect to amendments of 26 CFR Parts 250 and 251 was published in the Federal Register (21 FR 7452). The purposes of the proposed amendments as set forth in the notice are (a) to simplify record-keeping and reporting requirements, and (*b*) to delete the detailed listing of various tax rates.

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 30-day period prescribed. Accordingly, the amendments so published are hereby adopted as set forth below:

PARAGRAPH 1. 26 CFR Part 250, "Liquors and Articles from Puerto Rico and the Virgin Islands," is amended as follows:

(A) Section 250.127 is amended to read:

The insular internal revenue agent will record and report the use of red strip stamps on taxpaid spirits bottled for sale to tourists in Puerto Rico as provided in § 250.146.

(B) Section 250.146, and the headnote thereto, is amended to read as follows:

§ 250.146 RECORD AND REPORT OF RED STRIP STAMPS.—Insular internal revenue agents having custody of red strip stamps will keep a daily record, by denomination, of red strip stamps received, used, mutilated, unaccounted for, destroyed, and on hand at the beginning and end of the day. No form is prescribed for the daily records but such records shall be retained to support the monthly report. At the close of the month, or within 10 days thereafter, the insular internal revenue agent will prepare a report, in quadruplicate, of the strip stamps received and used during the month on Form 2260, properly modified. The agent will retain one copy and forward three copies to the treasurer; the treasurer will retain one copy, forward one copy to the United States Internal Revenue Service office, and one copy to the assistant regional commissioner. (68A Stat. 602; 26 U. S. C. 5008)

(C) Subpart H is amended to read as follows:

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[1] 22 F. R. 657.

SUBPART H.—RECORDS AND REPORTS OF LIQUORS FROM PUERTO RICO

§ 250.163 GENERAL REQUIREMENTS.—Except as provided in § 250.164, every person, other than a tourist, bringing liquors into the United States from Puerto Rico shall keep records and render reports of the physical receipt and disposition of such liquors in accordance with Part 194 ("Liquor Dealers") of this chapter: *Provided*, That regardless of who takes actual physical possession of the liquors at the time of their release from customs custody, the records and reports of the person actually responsible for such release shall reflect the transaction. Records and reports will not be required under this part with respect of liquors while in customs custody. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

§ 250.164 PROPRIETORS OF TAXPAID PREMISES.—Transactions involving the bringing of liquors into the United States from Puerto Rico by proprietors of industrial alcohol plants or bonded warehouses, registered distilleries, fruit distilleries, and internal revenue bonded warehouses operating taxpaid premises, and proprietors of taxpaid bottling houses and rectifying plants shall be recorded and reported in accordance with the regulations governing the operations of each such premises. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

PROCUREMENT OF FORMS

§ 250.165 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 52A, 52B, and 338 shall be purchased by users from commercial printers and must be in the form prescribed: *Provided*, That, with the approval of the Director, Alcohol and Tobacco Tax Division, they may be modified to adapt their use to tabulating or other mechanical equipment. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

(D) The title of Subpart N is amended to read, "RECORDS AND REPORTS OF LIQUORS FROM THE VIRGIN ISLANDS".

(E) Section 250.274, and the headnote thereto, is amended to read as follows:

§ 250.274 GENERAL REQUIREMENTS.—Except as provided in § 250.275, every person, other than a tourist, bringing liquors into the United States from the Virgin Islands shall keep records and render reports of the physical receipt and disposition of such liquors in accordance with Part 194 ("Liquor Dealers") of this chapter: *Provided*, That regardless of who takes actual physical possession of the liquors at the time of their release from customs custody, the records and reports of the person actually responsible for such release shall reflect the transaction. Records and reports will not be required under this part with respect of liquors while in customs custody. (68A Stat. 619; 26 U. S. C. 5114.)

(F) Section 250.275 and the headnote thereto is amended to read as follows:

§ 250.275 PROPRIETORS OF TAXPAID PREMISES.—Transactions involving the bringing of liquors into the United States from the Virgin Islands by proprietors of industrial alcohol plants or bonded warehouses, registered distilleries, fruit distilleries, and internal revenue bonded warehouses operating taxpaid premises, and proprietors of taxpaid bottling houses and rectifying plants shall be recorded and reported in accordance with the regulations governing the operations of each such premises. (68A Stat. 618, 619, 681; 26 U. S. C. 5112, 5114, 5555.)

(G) Section 250.276 is revoked.

(H) Section 250.277 is revoked.

(I) Section 250.278 is revoked.

(J) Section 250.279 is revoked.

(K) Section 250.280 is revoked.

(L) Section 250.281 and the undesignated centerhead immediately preceding that section are revoked.

(M) Section 250.282 is revoked.

(N) Section 250.283 is revoked.

(O) Section 250.284 is amended as follows:

(1) By striking from the first sentence the phrase "Form 52 F, Record 52, and".

(2) By striking from the first sentence the phrase

": *Provided, further,* That where the form is printed in book form (including loose-leaf books), the instructions may be printed on the cover or the fly leaf of the book instead of on the individual form.".

PAR. 2. 26 CFR Part 251, "Importation of Distilled Spirits, Wines, and Beer," is amended as follows:

(A) Section 251.40 is amended as follows:

(1) By striking from the first sentence the phrase "of $10.50 per" and inserting in lieu thereof the phrase "prescribed by law on each".

(2) By striking the last sentence.

(B) Section 251.41 is amended as follows:

(1) By striking from the first sentence the phrase "of $10.50 per wine gallon" and inserting in lieu thereof the phrase "prescribed by law on each wine gallon,".

(2) By striking the last sentence.

(C) Section 251.42 is amended as follows:

(1) By placing the phrase "including imitation, substandard, or artificial wine, and compounds sold as wine, having not in excess of 24 percent of alcohol by volume" in the first sentence within parenthesis.

(2) By striking from the first sentence the phrase "rates shown below, such taxes to be" and inserting in lieu thereof the phrase "rates prescribed by law; such tax to be".

(3) By inserting in the third sentence, which begins "Fractions of less", immediately after the phrase "converted to the next", the word "full".

(4) By striking paragraphs (a), (b), (c), (d), and (e).

(5) By striking the paragraph designation only from paragraph (f).

(D) Section 251.45 is amended as follows:

(1) By striking from the first sentence the phrase "an internal revenue tax of $9.00" and inserting in lieu thereof the phrase "the internal revenue tax prescribed by section 5051, I. R. C.,".

(2) By striking the second sentence, which begins "on and after".

(E) Subpart I is amended to read as follows:

SUBPART I.—IMPORTER'S RECORDS AND REPORTS

RECORD AND REPORT OF RED STRIP STAMPS

§ 251.130 DAILY RECORD, PART I, FORM 96.—Importers shall keep a daily record on part I of Form 96 of red strip stamps procured and used. A separate page in a single copy is required for each denomination of stamps. (68A Stat. 612, 619; 26 U. S. C. 5008, 5114.)

§ 251.131 MONTHY REPORT, PARTS II AND III, FORM 96.—At the close of the month, importers shall prepare parts II and III of Form 96, in triplicate, reporting on part II the red strip stamps procured and used during the month, and on part III the stamps shipped abroad to importer's agents. On or before the 10th day of the succeeding month, one copy shall be forwarded to the assistant regional commissioner of the region in which the business of the importer is con-

ducted, and one copy shall be forwarded to the collector of customs who approved the importer's requisitions. The remaining copy shall be retained for filing in accordance with § 251.136. (68A Stat. 602; 26 U. S. C. 5008.)

§ 251.132 SEPARATE RECORD FOR EACH PLACE OF BUSINESS.—Where an importer has more than one place of business, a separate record on part I of Form 96 shall be maintained on the premises of each place of business. A separate monthly report (parts II and III) shall also be rendered for each place of business. Where an agent procures stamps for several importers, the agent shall keep a separate record for each importer on part I of Form 96 of all stamps sent abroad or retained on his premises for the account of the importer. Separate monthly reports (parts II and III) shall be rendered by the agent in the name of each importer to the assistant regional commissioner of the region in which the stamps are procured. (68A Stat. 602, 681; 26 U. S. C. 5008, 5555.)

RECORD AND REPORT OF IMPORTED LIQUORS

§ 251.133 GENERAL REQUIREMENTS.—Except as provided in § 251.134, every importer who imports distilled spirits, wines, or beer shall keep records and render reports of the physical receipt and disposition of such liquors in accordance with Part 194 ("Liquor Dealers") of this chapter: *Provided*, That regardless of who takes actual physical possession of the liquors at the time of their release from customs custody, the records and reports of the person actually responsible for such release shall reflect the transaction. Records and reports will not be required under this part with respect of liquors while in customs custody. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

§ 251.134 PROPRIETORS OF TAXPAID PREMISES.—Importing operations conducted by proprietors of industrial alcohol plants or bonded warehouses, registered distilleries, fruit distilleries, and internal revenue bonded warehouses operating taxpaid premises, and proprietors of taxpaid bottling houses and rectifying plants shall be recorded and reported in accordance with the regulations governing the operations of each such premises. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

§ 251.135 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 52A, 52B, and 338 shall be provided by importers at their own expense, but must be in the form prescribed: *Provided*, That with the approval of the Director, Alcohol and Tobacco Tax Division, they may be modified to adapt their use to tabulating or other mechanical equipment. (68A Stat. 618, 619, 681; 26 U. S. C. 5112, 5114, 5555.)

FILING AND RETENTION OF RECORDS AND REPORTS

§ 251.136 FILING.—If the importer maintains loose-leaf records of receipt or disposition, one legible copy of each such record shall be marked or stamped "Government File Copy", and shall be filed not later than the close of the business day next succeeding that on which the transaction occurred. All records required by this part, and legible copies of all reports submitted to the assistant regional commissioner shall be filed separately, chronologically, and in numerical sequence within each date, at the importer's place of business to which they relate: *Provided*, That upon application, the assistant regional commissioner may authorize the files, or any individual file, to be maintained at other premises under control of the importer, if he finds that such maintenance will not delay the timely filing of any document, or cause undue inconvenience to internal revenue officers desiring to examine such files. Supporting documents, such as consignors' invoices, delivery receipts, bills of lading, etc., or exact copies thereof, may be filed in accordance with the importer's customary practice. Documents supporting records of disposition shall have noted thereon the serial numbers of the records of disposition to which they refer. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

§ 251.137 RETENTION.—All records prescribed by this part, documents or copies of documents supporting such records, and file copies of reports submitted to the assistant regional commissioner shall be preserved for a period of not less than two years, and during such period shall be available, during business hours, for inspection and the taking of abstracts therefrom by internal revenue officers. Any records, or copies thereof, containing any of the information required by this part to be prepared, wherever kept, shall also be made available

for such inspection and the taking of abstracts therefrom. (68A Stat. 619, 681; 26 U. S. C. 5114, 5555.)

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

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

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

RALPH KELLY,
Commissioner of Customs.

Approved January 29, 1957.

W. RANDOLPH BURGESS,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on January 31, 1957, at 8:50 a. m., and published in the issue of the Federal Register for February 1, 1957, 22 F. R. 657.)

SUBPART B.—RECTIFICATION

SECTION 5021.—IMPOSITION AND RATE OF TAX

26 CFR 230.189: Reduction of spirits.

For use of partially demineralized water in reducing the proof of distilled spirits, see Rev. Rul. 57–122 below.

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26 CFR 235.345: Form 27–B Supplemental. Rev. Rul. 57–122
(Also Section 230.189.)

The Internal Revenue Services discusses the extent to which partially demineralized water may be used in reducing the proof of distilled spirits without such use constituting taxable rectification. Rev. Rul. 54–619, C. B. 1954–2, 461, supplemented.

Advice has been requested whether partially demineralized water may be used in reducing the proof of spirits without such use constituting taxable rectification.

Revenue Ruling 54–619, C. B. 1954–2, 461, holds that the use of demineralized (deionized) water treated with a small quantity of citric acid or hydrochloric acid (approximately one-half pound of acid per 1,000 gallons of water) in the reduction in proof of spirits constitutes taxable rectification. Since publication of the ruling, it has been brought to the attention of the Internal Revenue Service that partially demineralized water may be similar to completely deionized water treated as provided therein.

The use of partially demineralized water will be permitted in reducing the proof of spirits only as follows:

(1) The use of water, treated by a demineralization process in which the pH is not reduced below 5, after boiling to remove carbondioxide, will be allowed for reducing the proof of distilled spirits without incurring the rectification tax and without

the necessity of submitting a statement of the demineralization process.

(2) When a process of partial demineralization, in which the pH is reduced below 5 but not below 3.2, is to be used in preparing water for use in reducing the proof of distilled spirits, water samples representative of the process must be submitted, by each distiller or rectifier, to the appropriate field office laboratory for examination. The rectification tax will not be incurred by the use of demineralized water in this pH range.

(3) Water treated by demineralization or other process, in which the pH is reduced below pH 3.2, may not be used for reducing the proof of distilled spirits unless it can be shown that such use would not present a health hazard. The use of water having an acidity below pH 3.2 would constitute rectification, and any questions concerning its use for reducing the proof of distilled spirits must be referred to the Director, Alcohol and Tobacco Tax Division, Washington 25, D. C.

Revenue Ruling 54–619, C. B. 1954–2, 461, is hereby supplemented.

SUBPART C.—WINES

SECTION 5041.—IMPOSITION AND RATE OF TAX

26 CFR 235.465: Additional wine tax.

For the revision in the listing of various tax rates applicable to liqueurs, cordials, and wines, see T. D. 6221, page 566.

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26 CFR 251.42: Wines.

For information with respect to tax paid on wine imported into the United States and subsequently returned to the shipper, see Rev. Rul. 57–186, page 555.

SECTION 5042.—EXEMPTION FROM TAX

26 CFR 240.544: General. Rev. Rul. 57–158

Unfermented cider, or natural cider containing not more than one-half of one percent alcohol by volume is not subject to the wine provisions of the Internal Revenue Code. Fermented cider is the non-effervescent product of the normal alcoholic fermentation of apple juice only. For fermented cider to be exempt from tax and the wine provisions of the Code, it must be produced on other than bonded wine cellar or bonded winery premises, without the use of preservative methods or materials, and must be sold or offered for sale as cider and not as wine or as a substitute for wine.

Advice has been requested regarding the production, labeling, and sale of fermented cider, otherwise than on bonded wine cellar or bonded winery premises, and the application thereto of section 5042(a)(1) of the Internal Revenue Code of 1954 and section 240.544 of the Wine Regulations.

Unfermented cider, or natural cider containing not more than one-half of one percent of alcohol by volume, whether or not made with the use of preservative methods or materials, is not subject to the provisions of chapter 51 of the Internal Revenue Code.

The fermented cider which is exempt from the wine tax and the provisions of subchapter F of chapter 51 of the Code is the non-effervescent product of the normal alcoholic fermentation of apple juice only. To be within the statutory exemption, such cider must be produced on other than bonded wine cellar or bonded winery premises without the use of preservative methods or materials and must be sold or offered for sale as cider and not as wine or as a substitute for wine, as provided by section 5042(a)(1) of the Code and section 240.544 of the Wine Regulations.

The pasteurization of fermented cider has the effect of preserving or stabilizing the product and, therefore, makes the product subject to the provisions of internal revenue law relating to wine, including the wine tax. Other processes or materials which have the effect of preserving such cider or changing its character from that prescribed by the law likewise make the product subject to the provisions of internal revenue law relating to wine, including the wine tax. Accordingly, sweetening fermented cider with sugar or syrup removes such cider from the statutory exemption. Ordinary methods of filtration, with or without the use of a filter aid, or refrigeration, would not effectively preserve or stabilize fermented cider for commercial distribution, and therefore, the use of such methods would not, in the absence of any specific findings to the contrary, constitute the use of preservative methods or materials prohibited by the Code for the production of tax-free cider.

It is also held that compliance with the requirements of state law providing that a producer of fermented cider must obtain a license and that the product may be sold only by the producer or by beer and liquor dealers would not necessitate a determination that the product must be made on bonded wine cellar premises subject to the wine tax, provided the product is labeled clearly as cider and the label does not indicate or infer that the product is wine or a substitute for wine.

SUBPART D.—BEER

SECTION 5051.—IMPOSITION AND RATE OF TAX

26 CFR 251.45: Rate of tax.

For information with respect to tax paid on beer imported into the United States and subsequently returned to the shipper, see Rev. Rul. 57–186, page 555.

SECTION 5057.—REFUND AND CREDIT OF TAX, OR RELIEF FROM LIABILITY

26 CFR 245.160: Beer returned for reconditioning, use as material or destruction. Rev. Rul. 57–272

Section 5057 of the Internal Revenue Code of 1954 provides in part that any tax paid by any brewer on beer produced in the United States may be refunded or credited to him, or, if the tax has not been paid, the brewer may be relieved of liability therefor, if such beer is removed from the market before transfer of title thereto to any person, and such beer is returned to the brewery for reconditioning, for use as materials, or is destroyed under the supervision required by the regulations. *Held*, where beer is removed from the brewery to adjacent premises for package testing purposes and subsequently destroyed under Government supervision, such beer was not placed on the market for sale and removed therefrom within the meaning of section 5057 of the Code, but was removed for package testing only and was not intended for sale. Accordingly, the tax on such beer cannot be refunded or credited to the brewer. For a ruling with respect to the removal of beer free of tax for such testing purposes, see Revenue Ruling 56–236, C. B. 1956–1, 705.

26 CFR 245.163: Beer lost or destroyed by fire, casualty, or act of God. Rev. Rul. 57–83

The tax or beer lost through breakage after removal from the brewery and upon or after receipt of the beer on the premises of a brewer's wholesale branch is subject to the refund provisions of section 245.163 of the Beer Regulations, provided the branch is wholly owned and operated by the producing brewer and that title to the beer remains with the brewer at the time of the loss. No official forms or records have been prescribed solely for the purpose of supporting claims for refund of taxes on such losses. However, if the records of receipts, sales, inventories, and breakage are kept accurately at the branch pursuant to section 245.225 of the regulations, such records will, in most cases, adequately support a claim for refund. See also Revenue Ruling 55–343, C. B. 1955–1, 568, which relates to the monthly filing of claims for losses due to breakage, etc., before title to the beer is transferred to another person.

SUBPART E.—GENERAL PROVISIONS

SECTION 5062.—REFUND AND DRAWBACK IN CASE OF EXPORTATION

26 CFR 252.54: Gauging of spirits and wines. Rev. Rul. 57–159

Section 5062(b) of the Internal Revenue Code of 1954 provides in part for the allowance, under regulations, of drawback equal in amount to the tax found to have been paid on domestic distilled spirits,

upon the exportation thereof. *Held*, in calculating the proof gallons per case of distilled spirits bottled especially for export with benefit of drawback, the result may be carried to more than one decimal, depending upon the size of the bottles, number of bottles per case, and the proof of the spirits, since the claimant is entitled to drawback of the tax paid on the total proof gallons involved. Ordinarily the computation of proof gallons is carried out to two decimal places, but, in cases where the claimant would lose an appreciable amount of tax, the calculation may be extended to three decimal places. For example, 1,000 cases of distilled spirits bottled at 87 degrees of proof in four-fifths quart bottles contain 2,088.0 proof gallons on which the tax was paid, or 2.088 proof gallons per case. If the tax per case is computed to only one decimal, the claimant would lose the tax on 88 proof gallons. Should only two decimal points be used, the bottler would still lose the tax on eight proof gallons.

PART II.—OCCUPATIONAL TAX

SUBPART A.—RECTIFIER

SECTION 5082.—DEFINITION OF RECTIFIER

26 CFR 235.35 : General. Rev. Rul. 57-84

Section 5082 of the Internal Revenue Code of 1954 defines a rectifier as a person who "rectifies, purifies, or refines distilled spirits or wines by any process * * *, and every wholesale or retail liquor dealer who has in his possession any still or leach tub, or who keeps any other apparatus for the purpose of refining in any manner distilled spirits, * * *." *Held*, in order to subject a wholesale or retail liquor dealer who possesses rectifying equipment other than a still or leach tub to liability for the rectifier's special tax, it must appear that the equipment is kept by him for the purpose of refining distilled spirits.

SUBPART C.—MANUFACTURERS OF STILLS

SECTION 5104.—METHOD OF PAYMENT OF TAX ON STILLS

26 CFR 196.34 : Special tax return. Rev. Rul. 57-98
(Also Section 6651.)

A manufacturer of stills intended for distilling failed to pay the special (commodity) tax on a still and condenser removed from the place of manufacture. Section 5104 of the Internal Revenue Code of 1954 provides that the tax on stills or worms shall be paid by stamp, denoting the tax, under such regulations as the Secretary of the Treasury or his delegate may prescribe. Section 196.34 of the Regulations relating to Stills provides that the tax shall be paid by the manufacturer pursuant to the filing of Form 11, Special Tax Return. Section 196.38 of the regulations contains a specific requirement that

the special (commodity) tax be paid before the still, worm, or condenser is removed from the place of manufacture. Section 6651 of the Code provides for the assertion of a delinquency penalty for failure to file a return unless such failure is due to reasonable cause. *Held*, because of the failure of a manufacturer to file a return and make payment of the tax before removal of the still and condenser, the delinquency penalty is due, computed from the time the still and condenser were removed from the place of manufacture, unless reasonable cause for the delinquency exists.

SUBPART D.—WHOLESALE DEALERS

SECTION 5113.—EXEMPTIONS

26 CFR 194.169: Persons having right of succession. Rev. Rul. 57–172

A receiver for a solvent partnership may succeed to the special tax stamp as a retail liquor dealer provided a return on Form 11, showing the basis of the succession, is timely filed. The partnership would not incur a new special tax liability in the event business operations were resumed by it during the period covered by the existing special tax stamp provided an amended return is timely filed showing resumption of activities.

Advice has been requested whether a reciver for a solvent partnership, who has been appointed for a limited period of time, may succeed to the retail liquor dealer special tax stamp issued to the partnership and also whether the original partnership would incur a new liability from the date business operations were again resumed by it.

Section 194.168 of the Regulations relating to Liquor Dealers provides in part that certain persons other than the special taxpayer may, without incurring additional special tax liability, carry on the same business at the same address for the remainder of the taxable period for which the special tax was paid. To secure such right, the person or persons continuing the business must file with the District Director of Internal Revenue, within 30 days after the date upon which the successor begins to carry on the business, Form 11, Special Tax Return, showing the basis of the succession. Section 194.169 of the regulations lists the persons having such right of succession and includes a receiver or trustee in bankruptcy, or an assignee for the benefit of creditors.

It is held that a receiver for a solvent partnership, as in the case of an insolvent taxpayer, may succeed to a special tax stamp, provided a return on Form 11 is filed in accordance with the provisions of section 194.168 of the regulations. It is further held that the partnership would not incur a new special tax liability in the event business operations were resumed by it during the period covered by the special tax stamp if a timely return on Form 11 showing resumption of operations by the partnership were filed with the appropriate District Director of Internal Revenue.

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SECTION 5114.—RECORDS

26 CFR 194.215: Proprietors. T. D. 6221[1]

(Also Sections 5041, 5197; 235.465, 221.728.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 194, 195, 216, 220, 221, 225, 230, 235, AND 240

Records and reports

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

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

On September 20, 1956, a notice of proposed rulemaking with respect to amendments of 26 CFR Parts 194, 195, 216, 220, 221, 225, 230, 235, and 240 was published in the Federal Register (21 FR 7148). The purposes of the proposed amendments as set forth in the notice are (a) to simplify recordkeeping and reporting requirements, (b) to delete detailed listing of various tax rates, and (c) to eliminate requirements for submission of reports on Form 1686 by storekeeper-gaugers.

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 30-day period prescribed. The amendments as so published have been modified and are hereby adopted as set forth below:

PARAGRAPH 1. 26 CFR Part 194, "Liquor Dealers," is amended as follows:

(A) Section 194.215, and the headnote thereto, is amended to read:

§ 194.215 PROPRIETORS.—Wholesale liquor dealer operations conducted by proprietors of industrial alcohol plants or bonded warehouses, registered distilleries, fruit distilleries, internal revenue bonded warehouses, taxpaid bottling houses, and rectifying plants shall be recorded and reported in accordance with the regulations governing the operations of each such premises. (68A Stat. 619, 637, 652; 26 U. S. C. 5114, 5197, 5285.)

(B) Section 194.260, and the headnote thereto, is amended to read:

§ 194.260 REQUIREMENTS AND PROCEDURE.—Wholesale dealers in liquors may package alcohol for industrial purposes in containers in excess of 1 wine gallon and less than 5 wine gallons and shall be governed as to such operations by those provisions of Part 230 of this chapter which are applicable. Form 27 E, properly modified, must be submitted to, and be approved by, the assistant regional commissioner before any packaging operations may be conducted. The provisions of Part 230 relating to procuring, accounting for, overprinting as to denomination, and attaching red strip stamps must be followed, except that requisitions on Form 428 for red strip stamps will be submitted to the assistant regional commissioner for approval. The wholesale dealer shall keep records, daily, showing the bulk alcohol received, dumped, packaged, and disposed of, and the name and address of each consignor and consignee. Packaging operations will be carried on without the supervision of a storekeeper-gauger, and the preparation of Forms 230 will not be required. A monthly report of strip stamp transactions on Form 2260, and of alcohol transactions on Form

[1] The publication of this Treasury Decision in 22 F. R. 111 dated January 4, 1957, contains (1) a series of instructions for modifying the notice of proposed rulemaking published in 21 F. R. 7148, dated September 20, 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.

52 D properly modified, shall be submitted to the assistant regional commissioner, as prescribed in Part 230. Records, documents or copies of documents supporting such records, and copies of reports submitted to the assistant regional commissioner shall be filed on the wholesale dealer's premises, and shall be retained as prescribed in § 194.234. (68A Stat. 602, 639; 26 U. S. C. 5008, 5214.)

Par. 2. 26 CFR 195, "Production of Vinegar by the Vaporizing Process," is amended as follows:

(A) Section 195.152 is amended by striking the second and third sentences and inserting in lieu thereof the sentence, "The quantities of fermenting and distilling materials received and used must be determined and recorded at the time of receipt and use as provided in § 195.175.".

(B) Section 195.153, and the headnote thereto, is amended to read:

§ 195.153 REMOVAL OF FERMENTING MATERIAL FROM PREMISES.—The removal of fermenting material from the premises shall be recorded in the records required by § 195.175, and reported on the monthly report, Form 1623. The reasons for such removal shall be stated in the record.

(C) Section 195.155 is amended by striking the phrase "Form 1623." and inserting in lieu thereof the phrase "the record required by § 195.175.".

(D) Section 195.159 is amended by striking from the second sentence, which begins, "The receiving tanks", the phrase "on Form 1623, as indicated by the headings of the columns and the instructions printed on the form" and inserting in lieu thereof the phrase "by the proprietor on the records required by § 195.175".

(E) Section 195.160 is amended by striking the words "manufacture of vinegar: *Provided,* That the quantity thus removed or used is first accurately ascertained, and recorded on Form 1623" and inserting in lieu thereof, "manufacture of vinegar. The quantity thus removed or used must be determined and recorded by the proprietor on the records required by § 195.175.".

(F) Section 195.161 is amended as follows:

(1) By striking the phrase "reported monthly" and inserting in lieu thereof the phrase "reported in the proprietor's monthly report, Form 1623".

(2) By striking the second and third sentences. (G) Subpart L is amended to read as follows:

SUBPART L.—PROPRIETOR'S RECORDS AND REPORTS

§ 195.175 DAILY RECORDS.—The proprietor of every vinegar factory shall keep daily records of operations which shall contain all data necessary (1) to enable internal revenue officers to verify and trace each lot of low wines from receipt of material to production of finished vinegar, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating thereto, and (2) to provide the proprietor with records for compiling the monthly report on Form 1623. Such records shall clearly and accurately reflect the following:

(a) The receipt and disposition of each lot of fermenting or distilling material.

(b) The kind and quantity of fermenting material used, the quantity of mash set, and the quantity of distilling material produced (serial numbers of fermenters shall be shown on such records).

(c) The quantity of distilling material used, and the quantity of low wines produced.

(d) The quantity of vinegar produced.

(e) The quantity of vinegar removed (including losses).

In addition to any other information shown therein, the records shall show the date of each transaction or operation and, where applicable, the indentity of each consignor and consignee. Quantities of fermenting materials shall be given in terms of pounds of dry measure and wine gallons of liquid measure. Quantities of low wines shall be given in terms of proof gallons. Quantities of vinegar shall be given in terms of gallons of 100-grain strength. All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, by the close of the business day next succeeding the day on which the transaction occurs. The assistant regional commissioner may require additional information which he considers necessary.

§ 195.176 MONTHLY REPORT, FORM 1623.—At the end of each month the proprietor shall prepare a report on Form 1623, in duplicate, showing a monthly summary account of fermenting and distilling materials, low wines, and vinegar. On or before the 10th day of the succeeding month, the proprietor shall forward the original to the assistant regional commissioner and retain the duplicate.

§ 195.177 FILING AND RETENTION OF RECORDS AND REPORTS.—All records required to be maintained by this part, and legible copies of all reports submitted to the assistant regional commissioner, shall be filed and maintained by the proprietor for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. Records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers.

(H) Section 195.202 is amended by changing the first sentence to read, "The predecessor shall report on his Form 1623 all fermenting or distilling materials, materials in process, and low wines transferred to his successor, who shall in turn report such items on his Form 1623 as received from his predecessor.".

(I) Section 195.203 is amended by striking the last sentence and inserting in lieu thereof the following new sentence, "The fiduciary will make appropriate notation on Form 1623, and the records required by § 195.175, of his succession and the date thereof.".

(J) Section 195.210 is amended by striking the last sentence and inserting in lieu thereof the following new sentence, "All fermenting and distilling materials, low wines, and vinegar must be accounted for on Form 1623, the original of which must be marked 'Final report, permanent discontinuance of business,' and must be submitted to the assistant regional commissioner.".

PAR. 3. 26 CFR Part 216, "Denaturation of Rum," is amended as follows:

(A) Section 216.211 is amended by placing a period after the phrase "will not be required" and striking the remainder of the section.

(B) Section 216.214 is amended to read:

All samples of denatured rum furnished by the proprietor shall be recorded in the records required by § 216.315.

(C) Section 216.243 is amended by striking the fifth and sixth sentences, which begin, "Upon removal" and "The foreign", respectively, and inserting in lieu thereof the following new sentence, "The proprietor shall record the removal of the denatured rum from the warehouse on the records required by § 216.315.".

(D) Section 216.285 is amended by striking all sentences except the first.

(E) Section 216.297 is revoked.

(F) Subpart X is amended to read as follows:

SUBPART X.—PROPRIETOR'S RECORDS AND REPORTS

§ 216.315 DAILY RECORDS.—The proprietor shall keep daily records of denaturing operations which shall contain all data necessary (1) to enable internal revenue officers to identify and trace the movement of each lot of rum from receipt to disposition, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such rum, and (2) to provide the proprietor with records for compiling his monthly report on Form 575. Such records shall clearly and accurately reflect the following:

(a) The receipt of each lot of rum.
(b) The quantities of rum and denaturant used.
(c) The quantity of denatured rum produced.
(d) The quantity of denatured rum packaged.
(e) The quantity of denatured rum removed from the premisis (including samples and losses).

In addition to any other information shown thereon, the records shall show the date of the transaction or operation, the number of packages and their serial numbers (identifying pipeline receipts as such), the identity of each consignor and consignee, and, where available, the serial numbers of applications and basic permits. In the case of exportations, the number of the car and the route, or the name of the vessel by which, and the port through which, the denatured rum is to be exported, will be shown. Quantities shall be recorded in wine gallons except that the quantity of rum received shall be recorded in proof gallons, and the quantity of rum used for denaturation shall be shown in wine and proof gallons. All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, by the close of the business day next succeeding the day on which the transaction occurs. The assistant regional commissioner may require additional information which he considers necessary. (68A Stat. 681; 26 U. S. C. 5555.)

§ 216.316 MONTHLY REPORT, FORM 575.—At the end of each month the proprietor shall prepare a report on Form 575, in duplicate, showing a monthly summary account of all rum, denaturants, and denatured rum. Form 575 shall be prepared and executed in accordance with the instructions on the form, and as required by this part. The quantities of rum, denaturant, and denatured rum reported as on hand at the end of the month shall be determined by actual inventory: *Provided*, That in the absence of any evidence of casualty or theft, the transfer gauge of packages of rum, and the filling gauge of packages of denatured rum may be used as the inventory of such packages. The actual quantities of rum, denaturant, and denatured rum held in tanks must be ascertained. On or before the 10th day of the succeeding month, the proprietor shall submit both copies of the report to the storekeeper-gauger.

§ 216.317 FILING AND RETENTION OF RECORDS AND REPORTS.—All records required to be maintained by this part, and legible copies of all reports submitted to the assistant regional commissioner shall be filed and maintained by the proprietor for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. Records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers.

(G) Section 216.325 is amended to read:

Where denatured rum is for any reason returned to the denaturing bonded warehouse by a bonded dealer or manufacturer or by the carrier, as provided in Part 182 of this chapter, the proprietor will maintain a record of the return as required by § 216.315. The total quantity of such rum, identified as "Denatured rum returned," will be entered as a debit on the monthly report, Form 575. Shipments of such rum will be included in the total of removals for the month.

(H) Section 216.331 is amended to read:

Separate records will not be required for operations under a new individual or corporate name, or under each trade name or style, but the proprietor must note on each record, and on the monthly report, Form 575, the individual or corporate name or the trade names or styles under which operations were conducted during the month, and the dates of operation under each.

(I) Section 216.341 is amended as follows:

(1) By striking the word "enter" in two places in the first sentence and inserting in lieu thereof the word "report".

(2) By striking from the last sentence the phrase "on Form 575 of his succession" and inserting in lieu thereof the phrase "of his succession, and the date thereof, on Form 575 on the records required by § 216.315".

PAR. 4. 26 CFR Part 220, "Production of Distilled Spirits," is amended as follows:

(A) Section 220.367 is amended as follows:

(1) By striking from the first sentence the word "distilling".

(2) By inserting in the first sentence, immediately after the phrase "distillery premises", the phrase "for use in the production of distilled spirits,".

(3) By striking from the second sentence the phrase "or bills of lading" and inserting in lieu thereof the phrase ", bills of lading, or prescribed forms".

(4) By inserting a comma after the phrase "commercial invoices" in the third sentence.

(B) Section 220.369, and the headnote thereto, is amended to read:

§ 220.369 DETERMINING QUANTITIES OF MATERIALS USED.—The distiller shall determine daily the quantity of (a) each lot of materials used in the production of each type of spirits, and (b) each lot of materials capable of producing spirits used in preparing yeast mash. He shall prepare dated, signed quantity reports, in duplicate, and shall furnish the original thereof to the storekeeper-gauger not later than the morning of the business day next succeeding the day on which the materials were weighed or measured. The quantities determined by the distiller shall be reflected in the records of production prescribed by § 220.755. Where materials are to be used for producing spirits, the quantity reports shall show the type of mash being set ("molasses," "wheat," "corn in excess," "rye in excess," etc.) and the serial number of each fermenter being filled. (68A Stat. 637; 26 U. S. C. 5197.)

(C) Section 220.370 is revoked.

(D) Section 220.371 is revoked.

(E) Section 220.373 is revoked.

(F) Section 220.374 is amended by changing the first sentence to read, "The distiller will not be required to prepare weight or quantity slips of materials used in preparing pure yeast cultures or jug yeast which is added to the yeast mash, or to record the same on his records of production.".

(G) Section 220.379 is amended as follows:

(1) By changing the headnote to read "Measurement of fermenters".

(2) By striking the phrase "Form 1598" in the first sentence, and inserting in lieu thereof the phrase "the record of production required by § 220.755".

(3) By striking the remaining sentences of the section.

(H) Section 220.381 is revoked.

(I) Section 220.389 is amended by changing the last sentence to read, "The quantity of finished spirits produced will be determined and recorded daily on the record of production required by § 220.755.".

(J) Section 220.409 is amended as follows:

(1) By striking from the second sentence the word "immediate".

(2) By striking the last sentence.

(K) Section 220.416 is revoked.

(L) Section 220.417 is amended as follows:

(1) By inserting a period after the phrase "removed for denaturation or destroyed" and striking the remainder of the sentence.

(2) By adding at the end of the section the following new sentence, "The distiller shall maintain records of the removal or destruction of such distillates, as required by § 220.756.".

(M) Section 220.420 is amended as follows:

(1) By striking the second sentence, which begins, "Such gauge".

(2) By striking from the fourth sentence, which begins, "The destruction must", the word "immediate".

(3) By striking the last sentence and inserting in lieu thereof the following new sentence, "The destruction will be reported by the distiller on Form 1598.".

(N) Section 220.424 is amended by striking the last sentence and inserting in lieu thereof the following new sentence, "The distiller shall maintain a record of all removals of distilled water, showing the date of removal, the name and address of the consignee, and the quantity removed.".

(O) Section 220.433 is amended as follows:

(1) By striking the second sentence, which begins, "Such removals".

(2) By adding at the end of the section the following new sentence, "The distiller shall maintain records showing the date of removal, the name and address of the consignee, and the quantity removed.".

(P) Section 220.434 is amended as follows

(1) By striking from the second sentence, which begins, "If the washwater", the phrase "Form 1598 or 1686" and inserting in lieu thereof the phrase "the distiller's records".

(2) By striking the last sentence and inserting in lieu thereof the following new sentence, "The distiller shall maintain records showing the date of destruction and the quantity (proof gallons) destroyed.".

(Q) Section 220.435 is amended as follows:

(1) By striking from the first sentence the phrase "thoroughly washed or scrubbed and purified" and inserting in lieu thereof the phrase "so treated as".

(2) By striking the last sentence and inserting in lieu thereof the following new sentence, "No record need be made of such disposition.".

(R) Section 220.449 is amended as follows:

(1) By striking from the first sentence the phrase "quantity of spirits received will be ascertained by appropriate gauge and immediately transferred" and inserting in lieu thereof the phrase "quantity will be determined and the spirits will be promptly transferred".

(2) By striking from the last sentence the phrase "making or verification of entries in monthly records and reports," and inserting in lieu thereof the phrase "verification of records and reports".

(S) Section 220.451 is amended by changing the third sentence, which begins, "The spirits introduced", to read, "The spirits introduced into the distilling system shall be recorded as materials used (in proof gallons and by class and type) on the proprietor's records of production required by § 220.755.".

(T) Section 220.452 is amended as follows:

(1) By changing the second sentence to read "In any case where the deficiency in redistillation of any particular lot or lots of spirits exceeds that which may be attributed to normal redistillation deficiencies, the distiller will make explanatory statements relative to such deficiencies in the production record required by § 220.755.".

(2) By inserting the following new sentence at the end of the section, "The storekeeper-gauger will make proper inquiry and appropriate investigation to determine the cause of the deficiency, and will make a full report thereof to the assistant regional commissioner.".

(U) Section 220.455 is amended to read, "Spirits removed from a registered distillery to another distillery for redistillation shall be recorded by the distiller on the record of removals required by § 220.756, and shall be reported on Form 1598.".

(V) Section 220.487 is amended to read, "Taxable samples shall be recorded by the distiller on the record of removals required by § 220.756, and shall be included in the report on Form 1598.".

(W) Section 220.541 is amended by striking the last sentence.

(X) Section 220.580 is amended as follows:

(1) By striking from the first sentence the phrase "properly filled out".

(2) By striking the second and third sentences, which begin, "The district director" and "The remaining", respectively.

(Y) Section 220.582 is amended by striking from the last sentence "1697" and inserting in lieu thereof "2260".

(Z) Section 220.585 is amended by striking from the last sentence "1697" and inserting in lieu thereof "2260".

(AA) Section 220.586, and the headnote thereto, is amended to read as follows:

§ 220.586 MONTHLY REPORT OF DISTILLED SPIRITS STAMPS.—At the end of each month the distiller shall prepare a report on Form 2260, in duplicate, showing a summary monthly account of distilled spirits excise tax stamps. The original copy shall be submitted to the assistant regional commissioner on or before the 10th day of the succeeding month. The duplicate copy shall be retained on the premises for a period of not less than two years, and during such period shall be available during business hours for examination by internal revenue officers. (68A Stat. 614; 26 U. S. C. 5061)

(BB) Section 220.624 is amended to read, "The distiller shall maintain records of removals of distilled spirits from the distillery in accordance with the provisions of § 220.756.".

(CC) Section 220.649 is amended to read, "The distiller shall maintain a record showing the nature and extent of any loss of distilled spirits, the date the loss was discovered, and the proof gallons lost, and shall report such losses on Form 1598.".

(DD) Section 220.662 is amended as follows:

(1) By striking from the headnote the word "returns" and inserting in lieu thereof the phrase "Form 1598".

(2) By striking from the first sentence the phrase, "Upon receipt of the distiller's monthly return, Form 1598, Part 3," and inserting in lieu thereof the phrase, "On receipt of Form 1598 from the distiller,".

(EE) Section 220.697 is amended by striking the last two sentences and inserting in lieu thereof the following new sentence, "The removal of finished spirits shall be recorded in the records of the distiller by the trade name or style under which the spirits were finished.".

(FF) Section 220.698 is amended as follows:

(1) By striking from the first sentence the phrase, "Separate record" and inserting in lieu thereof the phrase, "Separate records, and separate reports".

(2) By striking from the first sentence the phrase, "such record" and inserting in lieu thereof the phrase, "his records of operation, and his report on Form 1598,".

(3) By striking the second sentence, which begins, "The storekeeper-gauger".

(GG) Section 220.712 is amended as follows:

(1) By striking from the first sentence the phrase "will complete his record, Form 1598, and the storekeeper-gauger his record, Form 1686, as to" and inserting in lieu thereof the phrase, "shall show on the record of production required by § 220.755 and on Form 1598".

(2) By striking from the second sentence, which begins, "If the distillates", the phrase "Form 1598" and inserting in lieu thereof the phrase "the distiller's records and on Form 1598".

(3) By striking the third sentence, which begins, "The storekeeper-gauger".

(4) By striking from the fourth sentence, which begins "The distiller", the phrase", and the storekeeper-gauger will continue to maintain a record on Form 1686".

(5) By changing the fifth sentence to read, "Where the plant is operated as a registered distillery in two or more periods during the same month by the same proprietor, the operations of such proprietor will be recorded on one record of production and reported on one Form 1598.".

(6) By adding the following new sentence at the end of the section, "Appropriate notations will be made to show the dates the distillery was operated as a fruit distillery or an industrial alcohol plant and the names under which it was so operated.".

(HH) Section 220.713 is amended as follows:

(1) By changing the first sentence to read, "The succeeding proprietor will record all materials in process received from his predecessor on the appropriate records and reports prescribed by Part 182 of this chapter if the distillery is to be operated as an industrial alcohol plant, or on the appropriate records and reports prescribed by Part 221 of this chapter if the distillery is to be operated as a fruit distillery.".

(2) By striking from the last sentence the phrase ", and the storekeeper-gauger".

(II) Section 220.723 is amended as follows:

(1) By changing the first sentence to read, "The outgoing distiller shall show on his record of production, and report on Form

1598, all materials in process and all unfinished spirits outside the cistern room which are transferred to his successor, who shall in turn show such items on his record, and report on Form 1598, as received from his predecessor.".

(2) By striking from the fourth sentence, which begins "Where the distillery", the phrase "keep a separate Form 1598" and inserting in lieu thereof the phrase "maintain separate records and submit separate monthly reports on Form 1598".

(3) By striking from the fifth sentence, which begins "When operations", the phrase "entered on the same" and inserting in lieu thereof the phrase "recorded on the same set of records, and reported on the same".

(4) By striking from the fifth sentence the phrase "on the separating lines".

(5) By striking the sixth sentence, which begins "The storekeeper-gauger".

(6) By striking from the last sentence the figures "220.756" and inserting in lieu thereof the figures "220.757".

(JJ) Section 220.724 is amended by changing the last sentence to read, "In the case of such change, the fiduciary shall make appropriate notation on his records, and on Form 1598, of his succession and the date thereof.".

(KK) Section 220.745 is revoked.

(LL) Section 220.746 is revoked.

(MM) Subpart FF is amended to read as follows:

SUBPART FF.—DISTILLER'S RECORDS AND REPORTS

Records and Reports of Distillery Operations

§ 220.755 Record of Production.—The distiller shall maintain at his distillery daily records of production which shall include all data necessary (1) to enable internal revenue officers to identify and trace the movement of all materials and spirits through the various processes from the use of materials to the deposit of the finished spirits in receiving cisterns, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such materials and spirits, and (2) to enable the distiller to properly mark and brand packages of distilled spirits, and to provide him with records for compiling the monthly report, Form 1598. Such records shall accurately and clearly reflect the following:

(a) The kind and quantity of materials used, in terms of pounds of dry measure and gallons of liquid measure (giving the sugar content for molasses).

(b) The type and quality of mash set in each fermenter.

(c) The type and quantity of beer distilled.

(d) The type and quantity of spirits produced.

Where distillates from two or more types of mash are produced, the distiller shall maintain a separate record for each type of distillate, and each such record shall show, by kind, proof, and proof gallons, the deposits in unfinished spirits tanks, charges to the various stills for redistillation, redeposits in unfinished spirits tanks, and other movement of the distillate. Each such record of the movement of distillates shall also show the fermenter number and the date set, or a symbol or lot number which will enable ready identification of the mash from which the spirits were produced. In addition to any other information shown therein, the records required by this section shall show the date of the transaction or operation, and, as applicable, the serial numbers of fermenters, unfinished spirits tanks, and receiving cisterns. The date of production shall be the date of gauge and removal from the receiving cisterns, and the quantity produced shall be the quantity reported on Form 1520 covering such removal. (68A Stat. 637; 26 U. S. C. 5197.)

§ 220.756. RECORDS OF REMOVALS.—The distiller shall maintain at his distillery daily records of removals which shall include all data necessary (1) to enable internal revenue officers to identify each lot of distilled spirits destroyed or removed from the premises, and to verify such destruction or removal, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such spirits, and (2) to provide the distiller with records for compiling the monthly report, Form 1598. Such records shall accurately and clearly reflect the following:

(a) The date of the transaction.

(b) The serial number of the cistern (or unfinished spirits tank) from which the spirits are drawn for destruction or removal from the premises.

(c) The name, address, and registry number of the consignee.

(d) The kind, number, and serial numbers of containers.

(e) The kind of spirits.

(f) The tax gallons removed.

(g) The purpose of the removal, such as taxpayment, transfer to internal revenue bonded warehouse (distinguishing between transfers to warehouses on or contiguous to the distillery premises and all others), transfer to denaturing bonded warehouse or denaturing plant, redistillation, destruction, etc.

All information required to be shown in the daily records required by this section and by § 220.755 shall be assembled or entered, as the case may be, before the close of the business day next succeeding the day on which the operation or transaction occurs. (68 A Stat. 637; 26 U. S. C. 5197.)

§ 220.757 MONTHLY REPORT, FORM 1598.—At the end of each month the distiller shall prepare a monthly report on Form 1598, in duplicate, and deliver both copies to the storekeeper-gauger on or before the 5th day of the month succeeding that for which the report is rendered. Form 1598 shall be prepared and executed in accordance with the instructions on the form and as required by this part. (68 A Stat. 637; 26 U. S. C. 5197.)

TAXPAID PREMISES

§ 220.758 RECORDS AT TAXPAID PREMISES.—Every distiller who maintains taxpaid premises in connection with his distillery shall keep daily records of the receipt and disposition of distilled spirits at such premises. By taxpaid premises is meant the "taxpaid" or "free" warehouse or room maintained in conjunction with the distillery, or premises maintained at other locations, for the receipt, storage, and disposition of taxpaid distilled spirits. Separate records must be kept for each such premises. The records shall contain all data necessary (1) to enable internal revenue officers to identify and trace such receipts and dispositions, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating thereto, and (2) to provide the distiller with records from which the monthly report on Form 338 may be compiled. Such records, in addition to any other information shown therein, must clearly and accurately reflect the following:

(a) The date of the transaction (or date of discovery in the case of casualty or theft).

(b) The name and address of each consignor and consignee.

(c) The actual quantity of distilled spirits involved (proof gallons if in packages, wine gallons if in bottles).

(d) The serial numbers of packages or cases.

(e) The name of the producer.

(f) The country of origin, if imported.

All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, before the close of the business day next succeeding that on which the transaction occurs. (68A Stat. 619; 26 U. S. C. 5114.)

§ 220.759 REPORTS FROM TAXPAID PREMISES.—At the end of each month the distiller shall, for each taxpaid premises, prepare a report (or reports) on Form 338 showing, separately as to bulk and bottled spirits, the total quantities of taxpaid distilled spirits received and disposed of during the month and on hand at the beginning and end of the month. The report shall be prepared in duplicate. The original shall be submitted to the assistant regional commissioner not later than the 10th day of the month next succeeding that for which rendered, and the duplicate shall be retained by the distiller. Distilled spirits in bulk containers

shall be reported in proof gallons, and distilled spirits in bottles shall be reported in wine gallons. When reporting bulk spirits Form 338 should be modified to show that bulk containers are involved, and that quantities are being reported in terms of proof gallons. Form 338 will be provided by users at their own expense, and, except for modification as above, must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division.

FILING AND RETENTION OF RECORDS AND REPORTS

§ 220.760 FILING AND RETENTION OF RECORDS AND REPORTS.—All records required by this part, all auxiliary or supplemental records of individual operations and transactions from which such records are compiled, and copies of all reports submitted to the assistant regional commissioner shall be filed and maintained by the distiller for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. Records and reports of noncontiguous taxpaid premises shall be filed at such premises unless the assistant regional commissioner authorizes their filing at some other location. The files of records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers.

PAR. 5. 26 CFR Part 221, "Production of Brandy," is amended as follows:

(A) Section 221.355 is amended as follows:

(1) By striking from the first sentence the phrase "distilling materials" and inserting in lieu thereof the phrase "materials (fermented or unfermented)".

(2) By inserting in the first sentence, immediately following the phrase "distillery premises", the phrase "for use in the production of brandy".

(3) By striking from the second sentence, which begins "Where commercial invoices", the word "or" and inserting in lieu thereof a comma.

(4) By inserting in the second sentence, immediately following the phrase "bills of lading", a comma and the phrase "or prescribed forms,".

(B) Section 221.357 is amended as follows:

(1) By striking from the first sentence the phrase "on Form 15".

(2) By changing the last sentence to read, "Where wine, or brandy for redistillation, is received the alcohol content thereof will also be entered on the record required by § 221.355.".

(C) Section 221.358 is amended as follows:

(1) By striking from the third sentence, which begins "Where water", the phrase "so entered on Form 15" and inserting in lieu thereof the phrase "will be recorded in the record required by § 221.355".

(2) By striking from the last sentence the phrase "alcoholic strength" and inserting in lieu thereof the phrase "alcohol content".

(D) Section 221.360 is amended as follows:

(1) By striking from the first sentence the phrase "Form 15" and inserting in lieu thereof the phrase "the production record required by § 221.770".

(2) By striking from the last sentence the word "form" and inserting in lieu thereof the word "record".

(E) Section 221.361 is amended as follows:

(1) By changing the word "alcoholic" in the headnote and in the first sentence to "alcohol".

(2) By striking from the last sentence the phrase "entries on Form 15" and inserting in lieu thereof the word "records".

(F) Section 221.362 is amended as follows:

(1) By changing the word "alcoholic" to "alcohol" in the first, fourth, eighth, and ninth sentences.

(2) By striking from the ninth sentence, which begins "The kind", the phrase "Form 15" and inserting in lieu thereof the phrase "the production record required by § 221.770".

(3) By striking the tenth and eleventh sentences, which begin "Where two" and "Each page", respectively.

(G) Section 221.363 is amended as follows:

(1) By striking from the first sentence the phrase "Form 15" and inserting in lieu thereof the phrase "the distiller's records".

(2) By striking from the last sentence the word "reporting" and inserting in lieu thereof the word "recording".

(H) Section 221.366 is amended by striking from the last sentence the phrase "recording on Form 15 prior to" and inserting in lieu thereof the phrase "recording on the distiller's records prior to".

(I) Section 221.370 is amended by striking the phrase "such quantity entered" and inserting in lieu thereof the phrase "included in the total of unfinished spirits reported".

(J) Section 221.386 is amended by striking the second and third sentences and inserting in lieu thereof the following new sentence, "The distiller shall maintain records showing the date of removal, kind of material, quantity, and the name and address of each consignee if the material has been disposed of to other persons.".

(K) Section 221.388 is amended by striking from the last sentence the word "entered" and inserting in lieu thereof the word "reported".

(L) Section 221.414 is amended by striking from the second sentence, which begins "The destruction", the word "immediate".

(M) Section 221.420 is amended as follows:

(1) By inserting a period after the phrase "removed for denaturation" in the first sentence and striking the remainder of the sentence.

(2) By inserting, immediately after the first sentence the following new sentence, "The distiller shall maintain records of the removal or destruction of such distillates as required by § 221.771.".

(N) Section 221.423 is amended as follows:

(1) By striking the second sentence, which begins "Such gauge".

(2) By striking from the fourth sentence, which begins "The destruction", the word "immediate".

(3) By striking the last sentence and inserting in lieu thereof the following new sentence, "The destruction will be reported by the distiller on his monthly report, Form 15.".

(O) Section 221.425 is amended as follows:

(1) By changing the second sentence, which begins "Distilled water", to read "Under no circumstances may distilled water be drawn off or removed through the receiving room, brandy deposit room, or bonded warehouse.".

(2) By changing the third sentence to read, "Barrels which have been used to package distilled spirits may not be used for the removal of distilled water.".

(3) By adding after the last sentence the following new sentence, "The distiller shall maintain a record of all removals of distilled water, showing the date of removal, the name and address of the consignee, and the quantity removed.".

(P) Section 221.437 is amended as follows:

(1) By striking the first sentence.

(2) By inserting at the end of the section the following new sentence, "The distiller shall maintain records showing the date of removal, the name and address of the consignee, and the quantity removed.".

(Q) Section 221.438 is amended as follows:

(1) By striking from the second sentence, which begins "If the washwater", the phrase "Form 15" and inserting in lieu thereof the phrase "the distiller's records".

(2) By changing the word "alcoholic" in the last sentence to "alcohol".

(3) By inserting a period after the phrase "on Form 1520" in the last sentence and striking the remainder of the sentence.

(4) By adding at the end of the section the following new sentence, "The distiller shall maintain records showing the date of destruction and the quantity (proof gallons) destroyed.".

(R) Section 221.439 is amended as follows:

(1) By striking from the first sentence the phrase "thoroughly washed or scrubbed and purified to" and inserting in lieu thereof the phrase "so treated as to".

(2) By striking the third, fourth, and fifth sentences, which begin "Where the washwater", "Where the washwater", and "An approved", respectively.

(3) By striking the last sentence and inserting in lieu thereof the following new sentence, "No record need be made of such disposition.".

(S) Section 221.467 is amended as follows:

(1) By striking from the second sentence, which begins "In any case", the phrase "submit explanatory statements relative to such deficiencies with Form 15" and inserting in lieu thereof the phrase "make explanatory statements relative to such deficiencies in the production record required by § 221.770".

(2) By striking from the last sentence the word "thereof" and inserting in lieu thereof the phrase "of the deficiency and will make a full report thereof to the assistant regional commissioner".

(T) Section 221.470, and the headnote thereto, is amended to read as follows:

§ 221.470. RECORD OF REMOVALS FOR REDISTILLATION.—Brandy removed from a fruit distillery to another distillery for redistillation shall be recorded by the consignor distiller on the record of removals required by § 221.771 and shall be reported by him on Form 15. (68A Stat. 634, 637; 26 U. S. C. 5194, 5197.)

(U) Section 221.580 is amended as follows:

(1) By striking from the first sentence the phrase "properly filled out".

(2) By striking the second and third sentences, which begin "The district director" and "The remaining copy", respectively.

(V) Section 221.582 is amended by changing the phrase "Form 1697" in the last sentence to read "Form 2260".

(W) Section 221.585 is amended by changing the phrase "Form 1697" in the last sentence to read "Form 2260".

(X) Section 221.586, and the headnote thereto, is amended to read as follows:

§ 221.586 MONTHLY REPORT OF DISTILLED SPIRITS EXCISE TAX STAMPS.—At the end of each month the distiller shall prepare a report on Form 2260, in duplicate, showing a summary monthly account of distilled spirits excise tax stamps. The original shall be submitted to the assistant regional commissioner on or before the 10th day of the succeeding month. The copy shall be retained on the premises for a period of not less than two years, and during such period shall be available during business hours for examination by internal revenue officers. (68A Stat. 614; 26 U. S. C. 5061.)

(Y) Section 221.598 is amended by changing the figures "221.173" in the last sentence to read "221.541".

(Z) Section 221.654 is amended to read, "Where brandy is lost or destroyed, after it has been gauged for removal or for deposit in the brandy deposit room, appropriate notation shall be made by the distiller in the record of removal required by § 221.771, and on Form 15. The loss or destruction of brandy before it has been gauged shall be recorded and explained in the record of production required by § 221.770, and on Form 15.".

(AA) Section 221.667 is amended as follows:

(1) By striking from the headnote the word "returns" and inserting in lieu thereof the phrase "Form 15".

(2) By striking from the first sentence the phrase "Upon receipt of the distiller's return, Form 15, Part 3," and inserting in lieu thereof the phrase "On receipt of Form 15 from the distiller,".

(BB) Section 221.713 is amended as follows:

(1) By inserting in the first sentence, immediately after the phrase "Separate records", the phrase ", and separate reports".

(2) By striking from the first sentence the phrase "such record" and inserting in lieu thereof the phrase "his records of operations and his report on Form 15".

(CC) Section 221.727 is amended as follows:

(1) By changing the first sentence to read, "The outgoing distiller shall show on the record of production required by § 221.770, and on Form 15, the transfer to the successor of materials in process, and the removal from the distillery of all brandy produced by the outgoing distiller.".

(2) By inserting in the second sentence, immediately following the phrase "will be made on", the phrase "the distiller's records and on"

(3) By changing the last sentence to read, "Where the plant is operated as a fruit distillery in two or more periods during the same month by the same proprietor, the operations of such proprietor will be recorded on one record of production, and reported on one Form 15".

(4) By adding at the end of the section the following new sentence, "Appropriate notations will be made to show the dates the distillery was operated as a registered distillery or an industrial

alcohol plant and the names under which it was so operated.".

(DD) Section 221.728 is amended by striking the first and second sentences and inserting in lieu thereof the following new sentence, "The succeeding proprietor will record all materials in process received from his predecessor on the appropriate records and reports prescribed by Part 182 of this chapter if the distillery is to be operated as an industrial alcohol plant, or on the appropriate records and reports prescribed by Part 220 of this chapter if the distillery is to be operated as a registered distillery.".

(EE) Section 221.743 is amended as follows:

(1) By striking from the first sentence the phrase "enter on his Form 15" and inserting in lieu thereof the phrase "show on his record of production, and report on Form 15,".

(2) By striking from the first sentence the phrase "enter such items on his Form 15" and inserting in lieu thereof the phrase "show such items on his records, and report on Form 15,".

(3) By striking from the fourth sentence, which begins "Where the", the phrase "keep a separate Form 15" and inserting in lieu thereof the phrase "maintain separate records and submit separate monthly reports on Form 15".

(4) By striking from the fifth sentence, which begins "When operations", the phrase "entered on the same Form 15, appropriate notations being made on the separating lines", and inserting in lieu thereof the phrase "recorded on the same set of records and reported on the same Form 15, appropriate notations being made".

(5) By changing the last sentence to read, "At the end of the month, the distiller will submit his report on Form 15 to the assistant regional commissioner in acordance with subpart HH.".

(FF) Section 221.744 is amended by inserting in the last sentence, immediately following the phrase "notation on" the phrase "the records and on".

(GG) Subpart HH is amended to read as follows:

SUBPART HH.—DISTILLER'S RECORDS AND REPORTS

Records and Reports of Distillery Operations

§ 221.770 Record of Production.—The distiller shall maintain at his distillery daily records of production which shall include all data necessary (1) to enable internal revenue officers to identify and trace the movement of all materials and brandy through the various processes from the use of materials to the deposit of finished brandy in receiving tanks, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such material and brandy, and (2) to enable the distiller to properly mark and brand packages of brandy, and to provide him with records from which the monthly report, Form 15, may be compiled. Such records shall accurately and clearly reflect the following:

(a) The kind and quantity of fermenting material in each fermenter.
(b) The kind and quantity of distilling material produced.
(c) The kind and quantity of distilling material distilled.
(d) The type and quantity of brandy produced.

Where distillates from two or more types of materials are produced, the distiller shall maintain a separate record for each type of distillate, and each such record shall show, by kind, proof, and proof gallons, the deposits in unfinished brandy tanks, charges to the various stills for redistillation, redeposits in unfinished brandy tanks, and other movement of the distillate. Each such record of the movement of distillates shall also show the fermenter number and the date set,

or a symbol or lot number which will enable ready identification of the material from which the brandy was produced. In addition to any other information shown therein, the records required by this section shall show the date of the transaction or operation, and, as applicable, the serial numbers of fermenters, unfinished brandy tanks, and receiving tanks. The date of production shall be the date of gauge and removal from the receiving tanks, and the quantity produced shall be the quantity reported on Form 1520 covering such removal. (68A Stat. 637; 26 U. S. C. 5197.)

§ 221.771 RECORD OF REMOVALS.—The distiller shall maintain at his distillery daily records of removals which shall include all data necessary (1) to enable internal revenue officers to identify each lot of brandy destroyed or removed from the premises, and to verify such removal or destruction, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such brandy, and (2) to provide the distiller with records for compiling the monthly report, Form 15. Such records shall accurately and clearly reflect the following:

(a) The date of the transaction.

(b) The serial number of the receiving tank (or unfinished brandy tank) from which the brandy is drawn for removal from the premises or for destruction.

(c) The name, address, and registry number of the consignee.

(d) The kind, number, and serial numbers of containers.

(e) The kind of brandy.

(f) The tax gallons removed.

(g) The purpose of the removal, such as taxpayment, transfer to internal revenue bonded warehouse (distinguishing between transfers to warehouses on or contiguous to the distillery premises and all others), transfer to bonded wine cellar, redistillation, destruction, etc.

Removals to and from the brandy deposit room shall be recorded in such manner as to provide data necessary to complete the brandy deposit room account on the monthly report, Form 15. All information required to be shown in the daily records required by this section and by § 221.770 shall be assembled or entered, as the case may be, before the close of the business day next succeeding the day on which the operation or transaction occurs. (68A Stat. 637; 26 U. S. C. 5197.)

§ 221.772 MONTHLY REPORT, FORM 15.—Immediately after the close of the month the distiller shall prepare a report on Form 15, in duplicate. Form 15 shall be prepared and executed in accordance with the instructions on the form and as required by this part. The original shall be submitted to the assistant regional commissioner on or before the 10th day of the succeeding month, and the copy shall be retained by the distiller. (68A Stat. 637, 640; 26 U. S. C. 5197, 5215.)

TAXPAID PREMISES

§ 221.773 RECORDS AT TAXPAID PREMISES.—Every distiller who maintains taxpaid premises in connection with his fruit distillery shall keep records of the receipt and disposition of distilled spirits at such premises. By taxpaid premises is meant the "taxpaid" or "free" warehouse or room maintained in conjunction with the distillery, or premises maintained at other locations, for the receipt, storage, and disposition of taxpaid distilled spirits. Separate records must be kept for each of such premises. The records shall contain all data necessary (1) to enable internal revenue officers to identify and trace such receipts and dispositions, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating thereto, and (2) to provide the distiller with records from which the monthly report on Form 338 may be compiled. Such records, in addition to any other information shown therein, must clearly and accurately reflect the following:

(a) The date of the transaction (or date of discovery in the case of casualty or theft).

(b) The name and address of each consignor and consignee.

(c) The actual quantity of distilled spirits involved (proof gallons if in packages, wine gallons if in bottles).

(d) The serial numbers of the cases or packages.

(e) The name of the producer.

(f) The country of origin, if imported.

All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, before the close of the business day next succeeding that on which the transaction occurs. (68A Stat. 619; 26 U. S. C. 5114.)

§ 221.774 REPORTS FROM TAXPAID PREMISES.—At the end of each month the distiller shall, for each taxpaid premises, prepare a report (or reports) on Form 338 showing, separately as to bulk and bottled spirits, the total quantities of taxpaid distilled spirits received and disposed of during the month and on hand at the beginning and end of the month. The report shall be prepared in duplicate. The original shall be submitted to the assistant regional commissioner not later than the 10th day of the month next succeeding that for which rendered, and the duplicate retained by the distiller. Distilled spirits in bulk containers shall be reported in proof gallons, and distilled spirits in bottles shall be reported in wine gallons. When reporting bulk spirits, Form 338 should be modified to show that bulk containers are involved, and that quantities are being reported in terms of proof gallons. Form 338 will be provided by users at their own expense, and, except for modifications as above, must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division.

FILING AND RETENTION OF RECORDS AND REPORTS

§ 221.775 FILING AND RETENTION OF RECORDS AND REPORTS.—All records required by this part, all auxiliary or supplemental records of individual operations and transactions from which such records are compiled, and copies of all reports submitted to the assistant regional commissioner shall be filed and maintained by the distiller for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. Records and reports of noncontiguous taxpaid premises shall be filed at such premises unless the assistant regional commissioner authorizes their filing at some other location. The files of records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers.

PAR. 6. 26 CFR Part 225, "Warehousing of Distilled Spirits", is amended as follows:

(A) Section 225.244, and the headnote thereto, is amended to read as follows:

§ 225.244 REPORTS.—Upon transfer of the business to the successor, the outgoing proprietor must file with the assistant regional commissioner a final report on Form 52 C, prepared in accordance with subpart VV, showing such transfer. (68A Stat. 643, 645; 26 U. S. C. 5231, 5242.)

(B) Section 225.255 is amended by striking from the first sentence the phrase "Form 1606" and inserting in lieu thereof the phrase "Form 2260".

(C) Section 225.287 is amended by striking from the last sentence the phrase "Form 1606" and inserting in lieu thereof the phrase "Form 2260".

(D) Section 225.586, and the headnote thereto, is amended to read as follows:

§ 225.586 PROPRIETOR'S RECORDS AND MONTHLY REPORT.—The proprietor shall keep records and render reports of all spirits removed from the warehouse, as provided in subpart VV. (68A Stat. 637; 26 U. S. C. 5197.)

(E) Section 225.715 is amended by striking from the last sentence the phrase "Form 1697" and inserting in lieu thereof the phrase "Form 2260".

(F) Section 225.718 is amended by striking from the last sentence the phrase "Form 1697" and inserting in lieu thereof the phrase "Form 2260".

(G) Section 225.719, and the headnote thereto, is amended to read as follows:

§ 225.719 MONTHLY REPORT OF DISTILLED SPIRITS STAMPS.—At the end of each month the proprietor shall prepare a report on Form 2260, in duplicate, showing a monthly summary account of all distilled spirits excise tax stamps. On or before the 10th day of the succeeding month the original thereof shall be submitted to the assistant regional commissioner in accordance with the instructions printed on the form. The copy shall be retained on the premises for a period of not less than two years, and during such period shall be available during business hours for examination by internal revenue officers. (68A Stat. 599, 614; 26 U. S. C. 5006, 5061.)

(H) Section 225.1035 is amended as follows:

(1) By striking the fourth, fifth, and sixth sentences, each of which begins "The district director".

(2) By striking from the seventh sentence the beginning phrase "The proprietor", and inserting in lieu thereof the phrase "Upon receipt of the stamps from the district director, the proprietor".

(3) By striking the last sentence.

(I) Section 225.1040 is amended by striking from the last sentence the phrase "Form 1606" and inserting in lieu thereof the phrase "Form 2260".

(J) Section 225.1047, and the undesignated centerhead immediately preceding that section, is revoked.

(K) Section 225.1048, and the headnote thereto, is amended to read as follows:

§ 225.1048 REMOVAL OF STRIP STAMPS PROHIBITED.—Strip stamps which have been affixed to bottles of distilled spirits shall not be removed therefrom, except in the process of breaking when the bottles are opened. Unused strip stamps may not be requisitioned, transferred, or possessed except as provided by law or regulations, and used strip stamps may not be possessed. (68A Stat. 602, 645; 26 U. S. C. 5008, 5243.)

(L) Subpart VV is amended to read as follows:

SUBPART VV.—RECORDS AND REPORTS OF PROPRIETOR

§ 225.1120 DAILY RECORDS OF REMOVAL FROM WAREHOUSE.—The proprietor shall maintain daily records of removals which shall contain all data necessary (1) to enable internal revenue officers to identify each lot of distilled spirits removed from the warehouse, to verify such removal, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating thereto, and (2) to provide the proprietor with records for compiling the monthly report, Form 52 C. Such records, in addition to any other information shown therein, shall show (1) the name and address of the consignee, (2) the date of removal, (3) the kind of spirits, (4) the name and registry number of the producing distiller, (5) the number of packages and cases (identifying tank car, tank truck, or pipeline removals), (6) the tax gallons removed, and (7) the serial numbers of cases or packages and identifying numbers of tank cars and tank trucks. All information required to be shown in the records required by this section shall be assembled or entered, as the case may be, before the close of the business day next succeeding the day on which the removals are made. (68A Stat. 619; 26 U. S. C. 5114)

§ 225.1121 MONTHLY REPORT OF REMOVALS FROM WAREHOUSE. FORM 52 C.—At the end of each month the proprietor shall prepare a report on Form 52 C, in duplicate, showing the total quantities of bulk and bottled-in-bond distilled spirits removed from the internal revenue bonded warehouse during the month. The original shall be submitted to the assistant regional commissioner on or before the 10th day of the succeeding month, and the copy shall be retained by the proprietor. Form 52 C will be provided by users at their own expense, and must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division. (68A Stat. 619; 26 U. S. C. 5114)

§ 225.1122 RECORDS AT TAXPAID PREMISES.—Every proprietor who maintains taxpaid premises shall keep daily records of the receipt and disposition of dis-

tilled spirits at such premises. By "taxpaid premises" is meant the "taxpaid" or "free" warehouse or room maintained in conjunction with the internal revenue bonded warehouse, or premises maintained at other locations, for the receipt, storage, and disposition of taxpaid distilled spirits. Separate records must be kept for each of such premises. The records shall contain all data necessary (1) to enable internal revenue officers to identify and trace the receipt and disposition of each lot of distilled spirits, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating thereto, and (2) to provide the proprietor with records from which his monthly report on Form 338 may be compiled. Such records, in addition to any other information shown therein, must clearly and accurately reflect the following:

(a) The date of the transaction (or date of discovery in the case of theft or casualty).

(b) The name and address of each consignor and consignee.

(c) The actual quantity of distilled spirits involved (proof gallons if in packages, wine gallons if in bottles).

(d) The serial numbers of the packages or cases.

(e) The name of the producer.

(f) The country of origin, if imported.

All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, before the close of the business day next succeeding the day on which the transaction occurs. (68A Stat. 619; 26 U. S. C. 5114)

§ 225.1123. Reports From Taxpaid Premises.—At the end of each month the proprietor shall, for each taxpaid premises, prepare a report (or reports) on Form 338 showing, separately as to bulk and bottled spirits, the total quantities of taxpaid distilled spirits received and disposed of during the month and on hand at the beginning and end of the month. The report shall be prepared in duplicate. The original shall be submitted to the assistant regional commissioner not later than the 10th day of the month next succeeding that for which rendered, and the duplicate shall be retained by the proprietor. Distilled spirits in bulk containers shall be reported in proof gallons, and distilled spirits in bottles shall be reported in wine gallons. When reporting bulk spirits, Form 338 should be modified to show that bulk containers are involved, and that quantities are being reported in terms of proof gallons. Form 338 will be provided by users at their own expense, and, except for modification as above, must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division.

§ 225.1124 Records and Reports of Off-Premises Export Storage.—The provisions of §§ 225.1122 and 225.1123 relating to records and reports of distilled spirits at taxpaid premises are applicable to distilled spirits which have been bottled or packaged especially for export with benefit of drawback and which are held at the proprietor's contiguous off-premises export storage. The provisions of Part 194 of this chapter which relate to records and reports of distilled spirits and wines at wholesale liquor dealers' premises are applicable to distilled spirits and wines which have been bottled or packaged especially for export with benefit of drawback and which are held at the proprietor's noncontiguous off-premises export storage. The provisions of Part 194 of this chapter which relate to records of receipt of wine at wholesale liquor dealers' premises are applicable to wine which has been bottled or packaged especially for export with benefit of drawback and which is received at the proprietor's contiguous or noncontiguous off-premises export storage. (68A Stat. 614; 26 U. S. C. 5062)

§ 225.1125 Daily Memorandum Report of Strip Stamps.—The proprietor shall furnish a daily report of bottled-in-bond strip stamp usage (both domestic and export) to the storekeeper-gauger, which shall show (1) the number of cases of distilled spirits bottled, by number and size of bottles, (2) the serial numbers of such cases, and (3) separate summaries, by denomination, of the domestic and the export bottled-in-bond strip stamps received, used, mutilated in cutting or overprinting, mutilated in bottling, destroyed under supervision, unaccounted for, and on hand at the beginning and end of the day. The report shall be furnished not later than the morning of the business day next succeeding the day on which the strip stamp transactions occur. Reports will not be required for days on which no transactions occur. Reports may be in simple memorandum form, or be a copy of a record or report prepared by the proprietor for his own use. Copies of such reports shall be filed as prescribed in § 225.1127.

§ 225.1126 MONTHLY REPORT OF STRIP STAMPS, FORM 2260.—At the end of each month the proprietor shall prepare a report (or reports) on Form 2260 showing, separately, a monthly summary account of domestic and export bottled-in-bond strip stamps. Reports shall be prepared in duplicate, and all copies shall be submitted to the internal revenue officer for verification of the monthly inventories of stamps on hand. After such verification the internal revenue officer will return all copies to the proprietor, who will, on or before the 10th day of the succeeding month, forward the original to the assistant regional commissioner and retain the copy for filing in accordance with § 225.1127. 68A Stat. 602; 26 U. S. C. 5008)

§ 225.1127 FILING AND RETENTION OF RECORDS AND REPORTS.—All records required by this part, all auxiliary or supplemental records of individual operations and transactions from which such records are compiled, and copies of all reports submitted to the assistant regional commissioner shall be filed and maintained by the warehouseman for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. Records and reports of noncontiguous taxpaid premises shall be filed at such premises, unless the assistant regional commissioner authorizes their filing at some other location. The files of records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers.

Par. 7. 26 CFR Part 230, "Bottling of Taxpaid Spirits", is amended as follows:

(A) Section 230.197 is amended as follows:

(1) By striking the word "subchapter" from the first sentence and inserting in lieu thereof the word "chapter".

(2) By striking from the ninth sentence, which begins "The proprietor will cancel", the word "subchapter" and inserting in lieu thereof the word "chapter".

(3) By striking from the 19th sentence, which begins "The proprietor shall", the phrase "Form 1697, properly modified", and inserting in lieu thereof the phrase "Form 2260".

(B) Section 230.201 is amended as follows:

(1) By striking from the first sentence the phrase "or to the wholesale liquor dealer premises or placed" and inserting in lieu thereof the phrase "or the wholesale liquor dealer premises, or be placed".

(2) By striking the last sentence.

(C) Section 230.223 is amended to read, "Red strip stamps will be furnished without charge to proprietors of taxpaid bottling houses by the district director of the district in which such bottling houses are located. Except in cases of emergency, they will not be furnished by district directors of other districts. The proprietor, on receipt of the copy of Form 428 and the stamps from the district director, will deliver the form and the stamps to the internal revenue officer for verification of receipt.".

(D) Section 230.231 is amended as follows:

(1) By striking from the headnote the word "Non-usable" and inserting in lieu thereof the word "Mutilated".

(2) By striking the first sentence.

(3) By striking from the second sentence the phrase "supervision of the" and inserting in lieu thereof the phrase "supervision of an".

(4) By changing the last sentence to read, "The proprietor will report on Form 2260 the number of each denomination of stamps so destroyed.".

(E) Subpart V is amended to read as follows:

SUBPART V.—PROPRIETOR'S RECORDS AND REPORTS

RECORDS

§ 230.280 DAILY RECORDS.—The proprietor shall maintain, at his taxpaid bottling house, daily records which shall include all data necessary (1) to enable internal revenue officers to identify and trace the movement of all distilled spirits and wines from receipt to disposition, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such distilled spirits and wines, and (2) to provide the proprietor with records from which the monthly report, Form 52 D, may be compiled. Such records must accurately and clearly reflect the following:

(a) The distilled spirits and wines received on the premises (including export storage and the contiguous wholesale liquor dealer room).

(b) The dumping and packaging or original bottling of distilled spirits and wines.

(c) The bottling of spirits previously packaged on the premises.

(d) The rebottling of bottled spirits removed from the case storage room, export storage, or the contiguous wholesale liquor dealer room.

(e) The distilled spirits and wines removed from the premises (including export storage and the contiguous wholesale liquor dealer room).

In addition to any other information shown thereon, such records shall, for each transaction or operation, show the date and the kind and quantity of distilled spirits or wine involved, and, where applicable, (1) the date and serial number of each Form 230, (2) the producer or rectifier of domestic spirits, (3) the country of origin of imported spirits, (4) the alcohol content of wines, (5) the serial numbers of bottling tanks used, (6) the number of cases or packages and their serial numbers, (7) the gains or losses during each operation, and (8) the identity of each consignor for receipts and of each consignee for shipments. Spirits packaged or bottled especially for export with benefit of drawback must be appropriately identified at each operation or transaction. Wines will be recorded in wine gallons only. Distilled spirits must be recorded in both wine and proof gallons, except that the removal of distilled spirits bottled for domestic consumption will be recorded in wine gallons only. All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, before the close of the business day next succeeding the day on which the operation or transaction occurs.

§ 230.281 WHOLESALE LIQUOR DEALER ROOM.—A contiguous wholesale liquor dealer room operated by the proprietor in connection with the taxpaid bottling house, whether or not it is used exclusively for the products of such taxpaid bottling house, will be considered a part of the bottling house premises for purposes of records and reports required by this part. (68A Stat. 619; 26 U. S. C. 5114.)

REPORTS

§ 230.282 DAILY MEMORANDUM REPORT OF DISTILLED SPIRITS BOTTLED AND STRIP STAMPS USED.—The proprietor shall furnish a daily report to the storekeeper-gauger showing:

(a) The number of cases of distilled spirits bottled, by number and size of bottle.

(b) The serial numbers of such cases.

(c) A summary, by denomination, of red strip stamps received, used, mutilated, unaccounted for, destroyed, and on hand at the beginning and end of the day.

The report shall be furnished not later than the morning of the business day next succeeding that on which the strip stamps were used. The report may be in simple memorandum form, or it may be a copy of a record prepared by the proprietor for his own use. Copies of such reports shall be filed as prescribed by § 230.285.

§ 230.283 MONTHLY REPORT OF RED STRIP STAMPS.—At the end of each month the proprietor shall prepare a report on Form 2260, showing a summary of all red strip stamp transactions which occurred during the month. The report shall be prepared in duplicate, and both copies shall be delivered to the

storekeeper-gauger for verification of the monthly inventories of stamps on hand. After such verification both copies shall be returned to the proprietor, who shall, on or before the 10th day of the succeeding month, forward the original to the assistant regional commissioner and retain the duplicate for his files. (68A Stat. 602; 26 U. S. C. 5008)

§ 230.284 MONTHLY SUMMARY REPORT.—At the end of each month the bottler shall prepare a report on Form 52 D, in duplicate, of all operations and transactions at the taxpaid bottling house during the month. The original of the report shall be submitted to the assistant regional commissioner not later than the tenth day of the succeeding month, and the duplicate shall be retained by the proprietor.

FILING AND RETENTION OF RECORDS AND REPORTS

§ 230.285 FILING.—All records required by this part, all auxiliary or supplemental records of individual operations and transactions from which such records are compiled, and copies of all reports submitted shall be filed and maintained by the bottler for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. The files of records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers.

PROCUREMENT OF FORMS

§ 230.286 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 52 D and 230 will be provided by users at their own expense and must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division. (68 A Stat. 619; 26 U. S. C. 5114.)

(F) Section 230.302 is amended as follows:

(1) By striking from the first sentence the phrase "on Form 52 D, or on a separate record with identifying data in accordance with § 230.285" and inserting in lieu thereof the phrase "in the daily records required by § 230.280".

(2) By striking the second sentence.

(G) Section 230.322 is amended to read, "Separate records will not be required for operations under a new individual or corporate name, or under each trade name or style. The proprietor shall, however, note on his daily records and on his monthly reports, Forms 52 D and 2260, the individual or corporate names or the trade names or styles under which operations were conducted during the month. In addition, the dates of operation under each such name shall be shown on Forms 52 D and 2260."

(H) Section 230.332 is amended by striking from the last sentence the phrase "part 2 of Form 182" and inserting in lieu thereof the phrase "Form 2260".

(I) Section 230.333 is amended to read, "Where there is a change in the proprietorship otherwise than by operation of law, the outgoing proprietor shall enter in his daily records of disposition and report on his Form 52 D all spirits transferred to his successor, who shall in turn enter in his daily records of receipt and report on his Form 52 D all spirits received from his predecessor. Where an administrator, executor, assignee, receiver, trustee, or other fiduciary succeeds to the business and qualifies to operate the same, his daily records and Form 52 D shall reflect such succession."

PAR. 8. 26 CFR Part 235, "Rectification of Spirits and Wines", is amended as follows:

(A) Section 235.418 is amended by striking from the 17th sentence, which begins "The proprietor shall", the phrase "Form 1697, properly modified," and inserting in lieu thereof the phrase "Form 2260".

(B) Section 235.465 is amended by striking the second sentence.

(C) Section 235.498 is amended by striking from the last sentence the phrase "also make appropriate entries on Form 45 of" and inserting in lieu thereof the phrase "report on Form 45".

(D) Section 235.544 is amended to read, "Section 5041, I. R. C., imposes a tax, at rates prescribed therein, on all wines (including imitation, substandard, or artificial wine, and compounds sold as wine, which contain 24 percent or less of alcohol by volume) in bond in, produced in, or imported into, the United States; such tax to be determined as of the time of removal for consumption or sale. All wines which contain more than 24 percent of alcohol by volume are classed as distilled spirits and taxed accordingly.".

(E) Section 235.551 is amended by changing the first sentence to read, "Section 5022, I. R. C., imposes a tax, at the rate prescribed therein, on all liqueurs, cordials, or similar compounds produced in the United States and not sold as wine, which contain more than 2½ percent by volume of wine of an alcohol content in excess of 14 percent by volume (other than bottled cocktails); such tax to be in lieu of the rectification tax imposed by Section 5021, I. R. C.".

(F) Section 235.627 is amended by striking from the last sentence the phrase "and Form 45".

(G) Section 235.720 is amended by changing the last sentence to read, "Report of such transfers of stamps must be made on Form 2260 by the proprietors of both premises.".

(H) Section 235.722 is amended by striking from the last sentence the phrase "Form 45" and inserting in lieu thereof the phrase "the Form 2260".

(I) Section 235.723 is amended as follows:

(1) By changing the headnote to read "Stamp report.".

(2) By striking from the first sentence the phrase "keep a record on Form 45" and inserting in lieu thereof the phrase "make a report on Form 2260".

(3) By striking the remainder of the section.

(J) Section 235.742 is amended by striking the last sentence.

(K) Section 235.747 is amended to read, "Red strip stamps will be furnished without charge to proprietors of rectifying plants by the district director of the district in which such plants are located. Except in cases of emergency, they will not be furnished by district directors of other districts. The proprietor, on receipt of the copy of Form 428 and the stamps from the district director, will deliver the form and the stamps to the storekeeper-gauger for verification of receipt.".

(L) Section 235.755 is amended as follows:

(1) By striking from the headnote the word "Nonusable" and inserting in lieu thereof the work "mutilated".

(2) By striking the first sentence.

(3) By striking from the last sentence the phrase "enter appropriate credit on Form 182 for" and inserting in lieu thereof the phrase "report on Form 2260".

(M) Section 235.807 is amended as follows:

(1) By striking from the first sentence the phrase "on Form 45 or Record 52, or on a separate record with identifying data in accordance with § 235.821" and inserting in lieu thereof the phrase "in the daily records as provided in § 235.815".

(2) By striking the second sentence, which begins "Broken cases".

(N) Subpart JJ is amended to read as follows:

SUBPART JJ.—RECTIFIER'S RECORDS AND REPORTS

RECORDS

§ 235.815 DAILY RECORDS.—The rectifier shall maintain, at his rectifying plant, daily records which shall include all data necessary (1) to enable internal revenue officers to identify and trace the movement of all distilled spirits and wines from receipt to disposition, and to ascertain whether there has been compliance with all internal revenue laws and regulations relating to such distilled spirits and wines, and (2) to provide the rectifier with records from which the monthly report, Form 45, may be compiled. Such records must accurately and clearly reflect the following:

(a) The distilled spirits, wines, and alcoholic flavoring materials received on the premises, including export storage and the contiguous wholesale liquor dealer room.

(b) The distilled spirits, wines, and alcoholic flavoring materials dumped for rectification.

(c) The rectification of each batch of distilled spirits and wines.

(d) The packaging or original bottling of each batch of distilled spirits and wines after rectification.

(e) The transfer of rectified products by pipeline to contiguous premises.

(f) The dumping and packaging or original bottling of distilled spirits and wines without rectification.

(g) The bottling of products previously packaged on the premises.

(h) The rebottling of bottled products removed from the finished products room, contiguous wholesale liquor dealer room, or export storage.

(i) The distilled spirits and wines removed from the premises. Separate records will be made of removals from the receiving room and removals from the finished products room (including export storage and the contiguous wholesale liquor dealer room).

In addition to any other information shown therein, such records shall, for each transaction or operation, show the date and the kind and quantity of distilled spirits or wine (including alcoholic flavoring materials) involved, and, where applicable, (1) the date and serial number of each Form 122, 230, or 237, (2) the producer or rectifier of domestic spirits, (3) the country of origin of imported spirits, (4) the alcohol content of wines and flavoring materials, (5) the serial numbers of bottling tanks used, (6) the serial number of the formula, (7) the number of cases or packages and their serial numbers (identifying tank cars, tank trucks, and pipeline removals as such), (8) the gains and losses during each operation, and (9) the identity of each consignor for receipts and of each consignee for shipments. Products packaged or bottled especially for export with benefit of drawback must be appropriately identified at each operation or transaction. Quantities shall be recorded in both wine and proof gallons, except that the removal of finished products bottled for domestic consumption will be recorded in wine gallons only. All information required to be shown in the daily records required by this section shall be assembled or entered, as the case may be, before the close of the business day next succeeding the day on which the operation or transaction occurs.

§ 235.816 WHOLESALE LIQUOR DEALER ROOM.—A contiguous wholesale liquor dealer room operated by the proprietor in connection with the rectifying plant, whether or not it is used exclusively for the products of such rectifying plant, will be considered a part of such rectifying plant for purposes of records and reports required by this part.

REPORTS

§ 235.817 DAILY MEMORANDUM REPORT OF DISTILLED SPIRITS BOTTLED AND STRIP STAMPS USED.—The rectifier shall furnish a daily report to the storekeeper-gauger showing (a) the number of cases of distilled spirits bottled, by number and size of bottle, (b) the serial numbers of such cases, and (c) a summary, by denomination, of red strip stamps received, used, mutilated, unaccounted for, destroyed, and on hand at the beginning and end of the day. The report shall be

furnished not later than the morning of the business day next succeeding that on which the strip stamps were used. The report may be in a simple memorandum form, or it may be a copy of a record prepared by the proprietor for his own use. Copies of such reports shall be filed as prescribed in § 235.821.

§ 235.818 MONTHLY REPORT OF RED STRIP STAMPS.—At the end of each month the proprietor shall prepare a report on Form 2260, showing a summary of all red strip stamp transactions which occurred during the month. The report shall be prepared in duplicate, and both copies shall be delivered to the storekeeper-gauger for verification of the monthly inventories of stamps on hand. After such verification, both copies shall be returned to the proprietor, who shall, on or before the 10th day of the succeeding month, forward the original to the assistant regional commissioner and retain the duplicate for his files. (68A Stat. 602; 26 U. S. C. 5008)

§ 235.819 REPORT OF RECTIFIED SPIRITS STAMPS (FOR BOTTLING TANKS).—At the end of each month the rectifier shall prepare a summary report on Form 2260, in duplicate, of all operations and transactions in rectified spirits stamps (for bottling tanks) which occurred during the month. He shall submit the original of the report to the assistant regional commissioner not later than the 10th day of the succeeding month, and retain the duplicate for his files. (68A Stat. 681; 26 U. S. C. 5555)

§ 235.820 MONTHLY SUMMARY REPORT.—At the end of each month the rectifier shall prepare a report on Form 45, in duplicate, of all operations and transactions at the rectifying plant during the month. He shall submit the original of the report to the assistant regional commissioner not later than the 10th day of the succeeding month, and retain the duplicate for his files. (68A Stat. 652, 681; 26 U. S. C. 5285, 5555)

FILING AND RETENTION OF RECORDS AND REPORTS

§ 235.821 FILING.—All records required by this part, all auxiliary or supplemental records of individual operations and transactions from which such records are compiled, and copies of all reports submitted shall be filed and maintained by the rectifier for a period of not less than two years in such manner as to facilitate inspection by internal revenue officers. The files of records and reports shall be available during regular business hours for examination and taking of abstracts therefrom by internal revenue officers. (68A Stat. 652, 681; U. S. C. 5285, 5555)

PROCUREMENT OF FORMS

§ 235.822 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 45, 122, 230, and 237 will be provided by users at their own expense and must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division. (68A Stat. 652, 681; 26 U. S. C. 5285, 5555)

(O) Section 235.851 is amended to read, "Separate records will not be required for operations under a new individual or corporate name or under each trade name or style. The rectifier shall, however, note on his daily records, and on his monthly reports on Forms 45 and 2260 the individual or corporate name or the trade names or styles under which operations were conducted during the month. In addition, the dates of operation under each such name shall be shown on Forms 45 and 2260.".

(P) Section 235.861 is amended as follows:

(1) By striking from the second sentence, which begins "The form", the phrase "of this part".

(2) By striking from the third sentence, which begins "Upon completion", the phrase "of this part".

(3) By striking from the last sentence the phrase "entries are made in Form 45" and inserting in lieu thereof the phrase "records are prepared as prescribed in § 235.815".

(Q) Section 235.865 is amended to read, "The outgoing rectifier may not transfer any strip stamps to his successor. Where the change of proprietorship of the plant is to be of a temporary nature, any strip stamps on hand belonging to the outgoing proprietor may be retained pending the qualification and resumption of operations by such proprietor, and he will continue to submit a monthly report on Form 2260 of such stamps.".

(R) Section 235.866 is amended as follows:

(1) By striking from the second sentence, which begins "Where the change", the phrase "and proper report will be rendered on Form 45", and inserting in lieu thereof the phrase ", who will continue to submit monthly reports of such stamps as prescribed in § 235.818".

(2) By striking the last sentence.

(S) Section 235.867 is amended to read, "Where there is a change in proprietorship otherwise than by operation of law, the outgoing rectifier shall enter in his daily records of disposition and report on his Form 45, all spirits transferred to his successor, who shall in turn enter in his daily records of receipt and report on his Form 45 all spirits as received from his predecessor.".

(T) Section 235.868 is amended by striking from the last sentence the phrase "Form 182" and inserting in lieu thereof the phrase "Form 2260".

PAR. 9. 26 CFR Part 240, "Wine", is amended by changing § 240.594 to read "Section 5041, I. R. C., imposes a tax, at rates prescribed therein, on all wines (including imitation, substandard, or artificial wine, and compounds sold as wine, which contain 24 percent or less of alcohol by volume) in bond in, produced in, or imported into, the United States; such tax to be determined as of the time of removal for consumption or sale. Wine containing more than 24 percent of alcohol by volume shall be classed as distilled spirits and taxed accordingly. The tax shall be determined and paid on the quantity of wine marked on the containers as provided in §§ 240.562 and 240.567, or (in case of pipeline removals) on the quantity determined as provided in § 240.597.".

This Treasury Decision shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

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

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved December 27, 1956.

W. RANDOLPH BURGESS,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register on January 3, 1957, at 8:46 a. m., and published in the issue of the Federal Register for January 4, 1957, 22 F. R. 111.)

26 CFR 194.227: Entry of miscellaneous items. Rev. Rul. 57-160

Miscellaneous items may not be stated on Form 52A, Wholesale Liquor Dealer's Monthly Report, to report different kinds of distilled spirits received by a wholesale dealer, in broken or partial cases, but may be stated on Form 52B, Wholesale Liquor Dealer's Monthly Report, covering spirits disposed of by him. Different kinds of spirits made up of broken cases reported as a single item on Form 52B may be spirits of more than one producer. Details are given for the reporting of such partial or broken cases in columns 4 and 8 of the form.

Advice has been requested with respect to the proper procedure of entering miscellaneous items on Forms 52A and 52B, Wholesale Liquor Dealer's Monthly Report. The specific questions are shown below, together with the answers thereto.

Section 194.225 of the Regulations relating to Liquor Dealers requires that wholesale liquor dealers prepare and submit, daily or periodically, a report on Form 52A of all distilled spirits received by him and on Form 52B of all distilled spirits disposed of by him, unless, upon application, the Assistant Regional Commissioner, Alcohol and Tobacco Tax, relieves the dealer from the requirement of preparing and submitting such daily or periodic report. Section 194.227 of the regulations provides for the reporting on Form 52B of certain miscellaneous items.

The questions and answers with respect to such miscellaneous items are as follows:

Question 1.—Is it permissible to use the term "Miscellaneous" on Form 52A with respect to spirits received in broken or partial cases?

Answer.—As indicated above, the regulations provide only for the reporting of miscellaneous items on Form 52B covering spirits *disposed* of by the wholesale dealer. Miscellaneous items may not be stated on Form 52A to report different kinds of spirits received in broken or partial cases.

Question 2.—Does the term "different kinds of spirits made up from broken cases" refer to different kinds of spirits of the same producer or different kinds of spirits distilled, rectified, or bottled by several producers?

Answer.—The term in question is held to mean that the different kinds of spirits may be from the same producer or from various producers.

Question 3.—May a shipment consisting of one type of spirits, as for example, 30 pints of whisky, which were produced by several different distillers be recorded on one line of Form 52B as "Miscellaneous," in column 4; and may the total quantity of such spirits be shown as a single entry in column 8? If not, must the name of each producer be recorded on a separate line in column 4 and the quantity of each distiller's product be shown in column 8?

Answer.—The name of the distiller(s) may be reported in column 4 as "Miscellaneous," and the total quantity shown in column 8.

Question 4.—If a shipment consists, for example, of 1.6 wine gallons of whisky, .8 wine gallon of gin, and .8 wine gallon of brandy, representing the products of several distillers but not identified with any full case serial number, and the wholesaler does not desire to avail himself of the procedure provided under section 194.227 of the regulations, may the producer be designated in column 4 on one line as "As-

sorted," or "Miscellaneous," and the amounts of each type of spirits entered on the same line in the appropriate columns 8, 9, and 10?

Answer.—The method outlined for entering such transactions is considered acceptable. Therefore, the answer to this question is in the affirmative.

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26 CFR 220.758: Record at taxpaid premises. Rev. Rul. 57–173
(Also Part III–C, Section 6; 27 CFR 3.12.)

A distiller, rectifier, or warehouseman and bottler acquiring taxpaid bulk distilled spirits may store them prior to bottling, on premises under his control but covered only by a wholesaler's basic permit. He may also store acquired taxpaid distilled spirits in original bulk containers in a commercial warehouse not under his control. No basic permit is required to cover a "taxpaid" or "free" warehouse, but bulk taxpaid spirits may be acquired and stored on such premises only by the holder of a basic permit as distiller, rectifier, or warehouseman and bottler. Such persons may establish a taxpaid warehouse, for the purpose of receiving and storing such bulk spirits, either in conjunction with his bonded premises, adjacent thereto, or at another location. Taxpaid bulk spirits withdrawn from an internal revenue bonded warehouse may be stored on any taxpaid premises or in commercial storage pending disposition. Appropriate records must be kept in all cases.

Advice has been requested with respect to the acquirement, receipt, storage, and sale of taxpaid bulk distilled spirits. The questions presented and answers thereto are as follows:

QUESTION No. 1.—May the holder of a basic permit, either as a distiller, warehouseman and bottler, or rectifier, who acquires taxpaid bulk spirits, store such spirits, prior to bottling, on premises under his control but covered only by a wholesaler's basic permit?

Answer. A distiller, rectifier, or warehouseman and bottler who acquires taxpaid bulk distilled spirits may store such spirits, prior to bottling, on premises under his control but covered only by a wholesaler's basic permit. Complete daily records covering the receipt and disposition of such bulk spirits must be maintained by the holder of the basic permit where the spirits are stored. Such transactions must also be included on Form 338, Wholesale Liquor Dealer's Monthly Report.

QUESTION No. 2.—May the holder of a basic permit as a distiller, warehouseman and bottler, or rectifier, who has acquired taxpaid distilled spirits in original bulk containers, store such spirits in a commercial storage warehouse not under the control of the permittee, but in the hands of a third party who does not hold a basic permit?

Answer. Such bulk distilled spirits may be stored in a commercial storage warehouse not under the control of the distiller, warehouseman and bottler, or rectifier. Complete daily records covering the receipt and disposition of the bulk spirits must be maintained by the holder of the basic permit at the commercial storage premises and Form 338 must be submitted in accordance with the pertinent regulations.

QUESTION No. 3.—What type of basic permit should be required to cover a "taxpaid" or "free" warehouse referred to in section 220.758 of the Regulations relating to the Production of Distilled Spirits? If it is covered by a wholesaler's basic permit because of the handling of spirits produced by other than the proprietor, by what right can

these spirits be acquired and stored on such premises by the proprietor as a wholesaler, who is prohibited by the Federal Alcohol Administration Act from receiving spirits in bulk?

Answer. No basic permit is required for this purpose. Such bulk spirits cannot be acquired and stored by the proprietor on taxpaid or free warehouse premises in his capacity as a wholesaler under the provisions of the Regulations relating to Bulk Sales and Bottling of Distilled Spirits. Spirits may be received and stored on such premises only by a person holding a basic permit as a distiller, warehouseman and bottler, or rectifier. Daily records must be maintained by the holder of the basic permit at the premises where the spirits are stored, and Form 338 must be prepared.

QUESTION No. 4.—Under section 3.12 of the Regulations relating to Bulk Sales and Bottling of Distilled Spirits, should the proprietor of a distillery or bonded warehouse who desires to establish a taxpaid warehouse for the purpose of receiving and storing bulk spirits be required to establish such warehouse in conjunction with or adjacent to the distillery or bonded warehouse premises, or may the taxpaid warehouse be located elsewhere, and, if located elsewhere, would a separate permit be required?

Answer. The proprietor may establish a taxpaid warehouse for the purpose of receiving and storing bulk spirits either in conjunction with, or adjacent to, the distillery or bonded warehouse premises, or the taxpaid warehouse may be located elsewhere. No separate basic permit is required in either case. In this connection, see also the answer to Question No. 3, above.

QUESTION No. 5.—May a rectifier establish a taxpaid warehouse off the qualified premises without procuring an additional permit?

Answer. A rectifier may establish a taxpaid warehouse off the qualified premises without procuring an additional permit. The proprietor must maintain complete daily records covering the receipt and disposition of such spirits at such taxpaid premises, and a monthly report on Form 338 must be prepared.

QUESTION No. 6.—In the event a proprietor of an internal revenue bonded warehouse is required to taxpay and withdraw packages of spirits from his warehouse, where may such taxpaid packages be stored pending their disposition?

Answer. The taxpaid bulk spirits in such case may be stored on any taxpaid premises or in commercial storage. Daily records must be maintained by the holder of the basic permit at the premises where the spirits are stored and a monthly report on Form 338 must be prepared.

QUESTION No. 7.—May the proprietor of an internal revenue bonded warehouse, who is also a rectifier, store taxpaid spirits on a vacant lot which is not a part of either qualified premises but within the fenced enclosure of the premises under the control of the proprietor?

Answer. The answer to this question is in the affirmative. Daily records must be maintained and Form 338 submitted by the holder of the basic permit. While the storage of spirits under such conditions would appear to be undesirable from the standpoint of protection from the elements, this is a matter which is not precluded by existing law or regulations.

The provisions of the Federal Alcohol Administration Act restricting the acquisition and disposal of distilled spirits in bulk do not limit their physical receipt and disposal to premises actually conducted or controlled by distillers, warehousemen and bottlers, or rectifiers. Therefore, such bulk spirits may be stored on premises as indicated above, subject to the maintenance of the proper records by the holder of the basic permit who may legally acquire or receive such spirits in bulk under the provisions of the Regulations relating to Bulk Sales and Bottling of Distilled Spirits.

Bulk taxpaid spirits thus legally acquired and stored may be sold or disposed of only to persons authorized by the provisions of the above regulations to acquire such spirits. In the event the spirits are sold and the vendor is not entitled to the exemption afforded by section 5113(a) of the Internal Revenue Code of 1954 and section 194.184 of the Regulations relating to Liquor Dealers, the holder of the basic permit (distiller, warehouseman and bottler, or rectifier, as the case may be) selling the spirits must pay special tax as a wholesale liquor dealer as to each premises where the wholesale liquor dealer business is carried on. The fact that a wholesale liquor dealer, as such, may not acquire or dispose of distilled spirits in bulk under the Regulations relating to Bulk Sales and Bottling of Distilled Spirits does not preclude the acquisition or sale of distilled spirits in bulk by a distiller, warehouseman and bottler, or rectifier, in such capacity, who must, except where specifically exempted, qualify for the sale of such spirits in wholesale quantities under the internal revenue laws.

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26 CFR 225.1121: Monthly report of removals from warehouse, Form 52C.

For instructions as to the proper reporting by warehousemen on Form 52C, Monthly Report—Internal Revenue Bonded Warehouse, see Rev. Proc. 57-22, page 752.

SUBPART E.—RETAIL DEALERS

SECTION 5123.—EXEMPTIONS

26 CFR 194.193: Sales of entire stock by retail liquor dealer in liquidation. Rev. Rul. 57-149

Section 5123(c) of the Internal Revenue Code of 1954 provides that special tax as a wholesale dealer in liquors or wholesale dealer in beer shall not apply to a retail dealer in liquors or to a retail dealer in beer because of such retail dealer selling out his entire stock of liquors in one parcel, or in parcels embracing not less than his entire stock of distilled spirits, of wines, or of beer. Section 194.193 of the Regulations relating to Liquor Dealers provides that a retail dealer in liquors may, without incurring special tax as a wholesale dealer in liquors, sell out his entire stock of alcoholic liquors in one parcel or in a number of parcels composing his entire stock, which parcels may contain distilled spirits, wine, or beer, or a combination

of any or all such liquors. *Held*, a retail liquor dealer who sells his entire stock of distilled spirits only in parcels of five gallons or more, but continues to sell beer and wine at the same location under his special tax stamp as a retail liquor dealer, incurs liability as a wholesale liquor dealer. However, a retail dealer selling distilled spirits, wine, and beer, who discontinues the business of selling distilled spirits and wine and disposes of his entire stock of distilled spirits and wine only, in quantities of five gallons or more to the same person at the same time, would not become liable for special tax as a wholesale dealer in liquors merely because he failed to dispose of his stock of beer at the time he disposed of his distilled spirits and wine.

SUBPART F.—NONBEVERAGE DOMESTIC DRAWBACK CLAIMANTS

SECTION 5132.—REGISTRATION AND REGULATION

26 CFR 197.95: Products requiring formulas. (Also Section 197.117.) Rev. Rul. 57–289

Under the provisions of section 197.117 of the Regulations relating to Drawback on Distilled Spirits Used in Manufacturing Nonbeverage Products, distilled spirits may be recovered from dregs or marc of percolation or extraction in the manufacture of a nonbeverage product and such spirits may be reused in the manufacture of a nonbeverage product of the kind in which originally used. Such recovered distilled spirits are not eligible for drawback. Under the provisions of section 197.118 of the regulations, distilled spirits recovered from an intermediate product may be used in the manufacture of a nonbeverage product and, when so used, are eligible for drawback. The use of recovered distilled spirits must be reported by the nonbeverage manufacturer in the manner provided in sections 197.117 and 197.118 of the regulations. Such operations would not subject the user to special tax as a rectifier or to the rectification tax. A manufacturer who recovers distilled spirits from a *finished* nonbeverage product, by distillation or otherwise, is liable for special tax as a rectifier. He is also liable for rectification tax on all such distilled spirits recovered. The formula for each product in which recovered distilled spirits are to be used must be submitted to the Director, Alcohol and Tobacco Tax Division, Washington 25, D. C., even though no new distilled spirits are used.

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26 CFR 197.117: Account of distilled spirits recovered in the manufacture of products eligible for drawback.

For restrictions with respect to the reuse of recovered distilled spirits by nonbeverage manufacturers, see Rev. Rul. 57–289, above.

SUBCHAPTER B.—DISTILLERIES

PART I.—ESTABLISHMENT

SECTION 5171.—PREMISES PROHIBITED FOR DISTILLING

26 CFR 182.7: Industrial alcohol plants; restrictions. Rev. Rul. 57–123

(Also Sections 220.51, 221.61.)

> Proprietors of industrial alcohol plants, registered distilleries, or fruit distilleries desiring to use stillage or spent beer in the manufacture of byproducts, upon special authorization, may do so on the bonded premises or they may establish byproducts plants off the bonded premises. Only stillage or spent beer containing less than one-half of one percent of alcohol by volume may be removed to a byproducts plant located off the bonded premises, and no alcohol may be recovered at such off-premises plant.

Advice has been requested with respect to the location of premises for the manufacture of byproducts by the utilization of stillage or spent beer.

Section 182.7 of the Industrial Alcohol Regulations provides that industrial alcohol plant premises may be used for the conduct of other businesses by the proprietor of the industrial alcohol plant not involving the production of alcoholic beverages but which, among other things, involve the use of byproducts or wastage from the production of alcohol. Similar provision is made in section 220.51 of the Regulations relating to the Production of Distilled Spirits and section 221.61 of the Regulations relating to the Production of Brandy with respect to the use of distillery premises for the conduct of businesses which involve the use of byproducts or wastage from the production of distilled spirits or brandy, respectively. The above sections of the respective regulations further provide that the Director, Alcohol and Tobacco Tax Division, must first determine, on application made to him in each case, that such use of the premises will not jeopardize the revenue and will not unduly increase administrative supervision.

Where proprietors of industrial alcohol plants, registered distilleries, or fruit distilleries, desire to use the stillage or spent beer from their distilling units in the manufacture of byproducts, such as vitamins, tartrates, dehydrated yeast, dried food, etc., they may, on application for such permission, manufacture such byproducts on their bonded premises or establish byproducts plants off their bonded premises. However, if the stillage or spent beer contains as much as one-half of one percent of alcohol by volume, or where any alcohol is recovered regardless of the alcoholic content of the stillage or spent beer, the operations must be conducted on the bonded premises.

Where the byproducts plant is located off the bonded premises, the removal of the stillage to the byproducts plant may be by pipeline or other methods approved by the Director or the Assistant Regional Commissioner, Alcohol and Tobacco Tax. No records will be required covering the stillage or spent beer removed or the products produced therefrom. However, it is the responsibility of the proprietor to

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determine that the stillage or other material removed to plants off the bonded premises contains less than one-half of one percent of alcohol by volume.

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26 CFR 220.51: Use of distillery premises for other business.

For the utilization, by proprietors of distilleries, of stillage or spent beer in the manufacture of byproducts, see Rev. Rul. 57–123, page 597.

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26 CFR 221.61: Use of distillery premises for other business.

For the utilization, by proprietors of distilleries, of stillage or spent beer in the manufacture byproducts, see Rev. Rul. 57–123, page 597.

SECTION 5178.—PLAN OF DISTILLERY

26 CFR 182.207: Preparation. T. D. 6225[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PARTS 182, 195, 198, 220, 221, 225, 230, 235, and 240

Amendments relating to plats and plans

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

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

In order (a) to include standard reproduction and blueprint paper as a material suitable for preparation to plat and plans sheets, (b) to permit use of the ozalid process in preparation of plats and plans, (c) to provide that other acceptable materials and processes for the preparation of plats and plans may be approved by the Director, Alcohol and Tobacco Tax Division, and (d) to make uniform in the various parts the language and requirements for the preparation of plats and plans, 26 CFR Parts 182, 195, 198, 220, 221, 225, 230, 235, and 240 are amended as follows:

PARAGRAPH 1. 26 CFR Part 182 is amended by changing § 182.207 to read as follows:

§ 182.207 PREPARATION.—Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat shall be not less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made

[1] 22 F. R. 979.

by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable.

PARAGRAPH 2. 26 CFR Part 195 is amended by changing § 195.96 to read as follows:

§ 195.96 PREPARATION.—Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat shall be not less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be fitted by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable.

PAR. 3. 26 CFR Part 198 is amended by changing § 198.96 to read as follows:

§ 198.96. PREPARATION.—Every plat and flow plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat shall be not less than 1/50 inch per foot. Each sheet of the plat and flow plan shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat and flow plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissoner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and flow plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable.

PAR. 4. 26 CFR Part 220 is amended by changing § 220.211 to read as follows:

§ 220.211 PREPARATION.—Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat shall be not less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable. (68A Stat. 631; 26 U. S. C. 5178)

PAR. 5. 26 CFR Part 221 is amended by changing § 221.216 to read as follows:

§ 221.216 PREPARATION.—Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat shall be not less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable. (68A Stat. 631; 26 U. S. C. 5178)

PAR. 6. 26 CFR Part 225 is amended by changing § 225.221 to read as follows:

§ 225.221 PREPARATION. Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat will not be less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1, and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process," the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and processes which he finds are equally acceptable. (68A Stat. 643; 26 U. S. C. 5231)

PAR. 7. 26 CFR Part 230 is amended by changing § 230.96 to read as follows:

§ 230.96 PREPARATION. Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat will not be less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least one inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner they they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable.

PAR. 8. 26 CFR Part 235 is amended by changing § 236.211 to read as follows:

§ 235.211 PREPARATION.—Every plat and plan shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready indentification, and each sheet of the plat shall show the cardinal points of the compass. The minimum scale of any plat will not be less than 1/50 inch per foot. Each sheet of the plat and plan shall be numbered, the first sheet being designated number 1, and the other sheets numbered in consecutive order. The dimensions of plat and plan sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats and plans shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable.

PAR. 9. 26 CFR Part 240 is amended by changing § 240.271 to read as follows:

§ 240.271 PREPARATION.—The plat of a bonded wine cellar shall be drawn to scale. Each sheet thereof shall bear a distinctive title, enabling ready identification, and shall show the cardinal points of the compass. The minimum scale of any plat shall be not less than 1/50 inch per foot. Each sheet of the plat shall be numbered, the first sheet being designated number 1 and the other sheets numbered in consecutive order. The dimensions of plat sheets shall be 15 by 20 inches, outside measurement, with a clear margin of at least 1 inch on each side of the drawing, lettering, and writing: *Provided*, That the assistant regional commissioner may authorize the use of larger sheets if they are folded to the 15 by 20-inch size and can be filed by the top margin (20-inch dimension) in such a manner that they may be used without removal from the file and will not unfold when the file is suspended in a cabinet. Plats shall be submitted on sheets of tracing cloth, sensitized linen, or standard reproduction or blueprint paper, and may be original drawings, or reproductions made by the "ditto process", the ozalid process, or by lithoprint, if such reproductions are clear and distinct. The Director may approve other materials and methods which he finds are equally acceptable.

Because this Treasury Decision is liberalizing in effect and noncontroversial in character, it is hereby found unnecessary to issue the Treasury Decision with notice and public procedure thereon under section 4(a), or subject to the effective date limitation of section 4(c), of the Administrative Procedure Act, approved June 11, 1946. Accordingly, this Treasury Decision shall be 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).)

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved February 12, 1957.

DAN THROOP SMITH,
Deputy to the Secretary of the Treasury.

(Filed by the Division of the Federal Register on February 15, 1957, at 8:53 a. m., and published in the issue of the Federal Register for February 16, 1957, 22 F. R. 979.)

PART II.—OPERATION

SECTION 5197.—DISTILLER'S RECORDS AND RETURNS

26 CFR 221.728: Records of successor.

For the revision in recordkeeping and reporting by storekeeper-gaugers, see T. D. 6221, page 566.

PART III.—GENERAL PROVISIONS RELATING TO DISTILLERIES AND DISTILLED SPIRITS

SECTION 5212.—PREVENTION AND DETECTION OF FRAUD

26 CFR 182.519: Marks and brands. Rev. Rul. 57-273
(Also Section 182.733.)

The standard United States proof gallon, defined in section 5002(d) of the Internal Revenue Code of 1954, and the standard United States wine gallon, defined in section 5041(c) of the Code, are used as a basis for determining the tax imposed by law on distilled spirits, including alcohol and denatured alcohol (where applicable). The standard measures prescribed by law are also prescribed by regulations for accounting purposes. See, for example, section 182.519 of the Industrial Alcohol Regulations with respect to the marking of containers of alcohol and section 182.733 thereof with respect to the marking of containers of denatured alcohol. *Held*, in order that alcohol may be purchased in units of kilograms or liters, no objection will be interposed to the showing on containers of pure and denatured alcohol of the metric equivalent in parenthesis after the United States proof gallon or United States wine gallon, but such metric equivalent may not be shown *in lieu of* the proof or wine gallons.

26 FCR 182.733: Marking of packages.

For the showing of the metric equivalent of proof and wine gallons on containers of denatured alcohol, see Rev. Rul. 57-273, above.

SUBCHAPTER C.—INTERNAL REVENUE BONDED WAREHOUSES

PART II.—OPERATION

SECTION 5231.—AUTHORITY TO ESTABLISH

26 CFR 225.51: Warehouse buildings. Rev. Rul. 57-161
(Also Section 5302; Section 182.41.)

"Quonset" type buildings may be used for internal revenue bonded warehouses and industrial alcohol bonded warehouses, provided they are erected as permanent structures and comply with the requirements

of the Regulations relating to Internal Revenue Bonded Warehouses and the Industrial Alcohol Regulations, respectively. The following construction requirements should be followed:

Foundations.—The foundation should preferably be of concrete and provision should be made for permanently anchoring the walls to the foundation.

Walls.—If the corrugated steel sheets are not to be applied over solid sheathing, they must be welded as follows: Three points along each end of each sheet and four points along each side of each sheet.

Floors.—Floors must be of wood, concrete, or other substantial material as required by the regulations.

Doors, windows, and ventilators.—All doors, windows, and ventilators must comply with the regulatory requirements for such openings.

SUBCHAPTER D.—RECTIFYING PLANTS

PART II.—OPERATION

SECTION 5282.—RECTIFICATION OF SPIRITS

26 CFR 235.400: Notice of dumping, Form 122. Rev. Rul. 57–162

Section 235.400 of the Regulations relating to the Rectification of Spirits and Wines, which relates to the dumping and gauging of spirits for rectification, provides in part that where packages are transferred to the rectifying plant directly upon taxpayment from a distillery or an internal revenue bonded warehouse and dumped for rectification within 30 days after receipt, the withdrawal gauge will be considered as satisfying the requirement that the spirits shall be gauged when dumped for rectification. *Held*, where alcohol received directly from an industrial alcohol plant or an industrial alcohol bonded warehouse and wine received directly from a bonded wine cellar are dumped for rectification within 30 days after receipt, the withdrawal gauge may be considered as satisfying the requirement that the spirits shall be gauged when dumped for rectification, in the same manner as distilled spirits transferred directly from a distillery or internal revenue bonded warehouse.

SUBCHAPTER E.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, DENATURING PLANTS, AND DENATURATION

PART I.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES AND DENATURING PLANTS

SECTION 5302.—ESTABLISHMENT OF INDUSTRIAL ALCOHOL BONDED WAREHOUSES

26 CFR 182.41: Construction.

For requirements with respect to the use of "Quonset" type buildings for internal revenue and industrial alcohol bonded warehouses, see Rev. Rul. 57–161, page 602.

SECTION 5306.—EXEMPTION OF INDUSTRIAL ALCOHOL PLANTS AND WAREHOUSES FROM CERTAIN LAWS

26 CFR 182.485: Exemption from special tax liability. Rev. Rul. 57–174

> The exemption from special tax as a wholesale or retail liquor dealer applies only if the taxpaid storeroom of an industrial alcohol plant or bonded warehouse is located on the bonded premises. The exemption does not apply to sales of taxpaid alcohol when such sales are consummated at a place not on bonded premises, except that where the premises at which the sales are consummated are contiguous to the bonded premises, and the operations of the plant or warehouse are directed from such contiguous premises, no special tax is incurred. Special tax liability is incurred at each place where sales are consummated off bonded premises except in the case of contiguous premises refered to in the preceding sentence.

Various questions have been presented to the Interstate Revenue Service with respect to the establishment of a taxpaid storeroom and the acceptance of orders for taxpaid alcohol at sales offices maintained by proprietors of industrial alcohol plants and industrial alcohol bonded warehouses, in connection with the exemption from the special tax liability provisions of section 182.485 of the Industrial Alcohol Regulations.

Section 182.485 of the regulations provides that the proprietor of an industrial alcohol plant or an industrial alcohol bonded warehouse may sell or offer for sale taxpaid alcohol in the taxpaid storeroom provided in connection with such plant or warehouse without being required to pay special tax as a wholesale or retail liquor dealer, provided the sales are made from the plant or bonded warehouse. It further provides that if taxpaid alcohol is sold elsewhere, the proprietor is not entitled to the exemption. Subsection (a) thereof holds that the exemption is applicable to alcohol taxpaid in the industrial alcohol plant or bonded warehouse and stored in the taxpaid storeroom provided in connection therewith since such taxpaid storeroom is covered by the basic permit required to be held by the proprietor of the industrial alcohol plant or bonded warehouse. However, subsection (a) also provides that the exemption will not apply if the taxpaid alcohol stored in a taxpaid storeroom provided in connection with an industrial alcohol plant or bonded warehouse is transferred to another similar taxpaid storeroom established in connection with another plant or bonded warehouse or to any other premises.

The questions and answers are as follows:

QUESTION No. 1.—It is intended, under the Industrial Alcohol Regulations, that the "taxpaid storeroom" referred to in sections 182.31a, 182.42, 182.456a, 182.485, and 182.648 thereof shall be located on bonded premises?

Answer. Yes, the taxpaid storeroom must be located on bonded premises.

QUESTION No. 2.—It is the intent of section 182.485, in the statement "provided the sales are made from the plant or bonded warehouse," that such sales shall be consummated on bonded premises?

Answer. Yes, except in the case of sales consummated on contiguous premises as described in the answer to Question No. 4, below.

QUESTION No. 3.—If taxpaid alcohol is stored on premises not on industrial alcohol plant or bonded warehouse premises, and sales of such alcohol are subsequently consummated at a place not on bonded premises, does the exemption of section 182.485 apply?

Answer. No.

QUESTION No. 4.—If taxpaid alcohol is stored in a taxpaid storeroom provided in connection with the industrial alcohol plant or bonded warehouse, and sales of such alcohol are subsequently consummated at a place not on bonded premises, does the exemption of section 182.485 apply?

Answer. No, except that it is the position of the Internal Revenue Service that sales of taxpaid alcohol stored in taxpaid storerooms maintained on industrial alcohol plant or bonded warehouse premises may be consummated on premises contiguous to, but not a part of, the bonded premises without incurring liability for special tax, provided the operations of the plant or warehouse are directed from such contiguous premises.

QUESTION No. 5.—If alcohol, when taxpaid, is delivered directly from the industrial alcohol plant or bonded warehouse to the customer, although the sales of such alcohol have been consummated at a place not on bonded premises, does the exemption of section 182.485 apply:

Answer. No, except in the case of contiguous premises as described in the answer to Question No. 4, above.

QUESTION No. 6.—If the taxpaid alcohol is not stored on bonded premises, does the proximity of the place of storage to the bonded premises affect the liability for special tax?

Answer. No.

QUESTION No. 7.—If the place where the sales of taxpaid alcohol are consummated is not on industrial alcohol plant or bonded warehouse premises, does the degree of its proximity to such bonded premises affect the liability for special tax?

Answer. No, except in the case of contiguous premises as described in the answer to Question No. 4.

QUESTION No. 8.—If sales of taxpaid alcohol are consummated at premises other than industrial alcohol plant or bonded warehouse premises, is special tax liability by reason of such sales incurred at each place where such sales are consummated?

Answer. Yes, except in the case of contiguous premises described in the answer to Question No. 4.

SECTION 5310.—WITHDRAWAL OF ALCOHOL FREE OF TAX

26 CFR 182.139: Use of specially denatured alcohol. Rev. Rul. 57–290

(Also Section 5331; Section 212.19.)

In order to meet the needs of chemical, medical, and school laboratories not eligible to obtain tax-free alcohol for laboratory use under section 182.164 of the Industrial Alcohol Regulations, specially denatured alcohol Formula 3–A has been approved for use in the manufacture of reagent alcohol. The reagent alcohol may be manufactured

by specially denatured alcohol permittees engaged in the laboratory supply business, and may be sold only to such laboratories and other scientific users. It shall contain 95 parts by volume of specially denatured alcohol Formula 3–A and five parts by volume of isopropyl alcohol, and shall be labeled as follows:

Front Label: REAGENT ALCOHOL
Specially Denatured Alcohol 3A—95 parts by vol.
Isopropyl Alcohol — 5 parts by vol.
CAUTION * * *, POISON
CONTAINS METHYL ALCOHOL
NOT FOR INTERNAL OR EXTERNAL USE
Back Label: ANTIDOTE: Directions

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26 CFR 182.860: General. Rev. Rul. 57–86

Section 182.860 of the Industrial Alcohol Regulations provides, in part, for the reprocessing, bottling, and repackaging of products such as bay rum, lilac vegetal, hair lotions, dry shampoos, deodorant sprays, skin lotions, perfumes, etc., and requires that persons who desire to reprocess, bottle, or repackage such products must procure permission therefor from the Assistant Regional Commissioner, Alcohol and Tobacco Tax. *Held*, the requirement that permission be obtained applies regardless of the size of the containers in which the products are procured. Certain transactions not considered commercial bottling operations are, however, excepted. Examples of such transactions not requiring permission to bottle are (1) general retail stores purchasing perfumes in containers of one gallon or less for dispensing in small (*e. g.* 1 ounce or less) bottles over the counter, and (2) barber shops or beauty parlors furnishing small quantities of beauty preparations to customers for use by them in their homes. Such transactions of a limited character are not the commercial bottling operations restricted by the regulations. On the other hand, any concern which makes a business of rebottling products under its own name as a distributor and carries such repackaged products in stock or sells them to other retailers is a commercial bottler and is required to obtain permission to purchase and rebottle such products, regardless of the size of container in which obtained.

PART II.—DENATURATION

SECTION 5331.—WITHDRAWAL FROM BOND FREE OF TAX

26 CFR 182.140: Application, Form 1479.

For procedure with respect to filing an application on Form 1479 for an original or a renewal permit, Form 1481, to include all articles and preparations covered by Forms 1479–A approved during the period covered by the permit, see Rev. Proc. 57–21, page 751.

26 CFR 212.19: Formula No. 3–A.

For the manufacture of reagent alcohol with specially denatured alcohol Formula No. 3–A, for use by laboratories, see Rev. Rul. 57–290, page 605.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5361.—BONDED WINE CELLAR PREMISES

26 CFR 240.485: Spanish type blending sherry. Rev. Rul. 57–274
(Also Section 7805; 235.58.)

A product which is to be marketed as a barbecue basting sauce and in which wine is used as an ingredient is not a "wine product" within the meaning of section 5361 of the Internal Revenue Code of 1954 and may not be produced on bonded wine cellar premises. Such a product, if unfit for beverage use, may be made with taxpaid wine off bonded wine cellar premises as a product exempt from the special and commodity taxes, under the provisions of subpart D of the Regulations relating to the Rectification of Spirits and Wines.

SECTION 5367.—RECORDS

26 CFR 240.900: Form 702.

For the method of showing the serial numbers of Forms 2050, Wine Tax Return, on Form 702, Monthly Report of Wine Cellar Operations, see Rev. Proc. 57–19, page 749.

SECTION 5368.—GAUGING, MARKING, AND STAMPING

26 CFR 240.562: Marks. Rev. Rul. 57–197

> Where a bottle label is attached to the Government side of wine cases in conjunction with required Government markings, such of the required information, *e. g.* the name, registry number, kind, etc., shown on the bottle label need not be repeated on the additional tag or markings on the container.

Advice has been requested whether, if a bottle label is securely affixed to the Government side of a wine case, any of the required information, such as the name, registry number, kind, and alcohol content of the wine, which is shown conspicuously on the bottle label, need be repeated on the additional label or tag containing the rest of the required information, such as the serial number and the wine gallon contents of the case.

Section 240.562 of the Wine Regulations requires, in part, that each case or other container used to remove wine must be marked in a plain and durable manner with the serial number, the name of the

proprietor, the registry number, and location of the wine cellar, and the kind and alcohol content of the wine. It provides that such marks may be cut, printed, or otherwise legibly and durably marked on the container, or placed upon a label or tag securely affixed to the container. Section 240.564 of the regulations specifies additional information which may be shown on the Government head or Government side of containers, including bottle labels.

It is held that such of the required information as is conspicuously shown on the bottle label securely affixed to the wine case need not be otherwise shown thereon. However, the bottle label containing such required information must be placed in direct conjunction with the additional information required to be shown on the case so as to permit ready ascertainment of all the prescribed information.

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26 CFR 240.579: Labeling bottled wine. Rev. Rul. 57-291

Section 240.579 of the Wine Regulations prescribes certain information to be shown on bottle labels for wine and provides that where wine is bottled for aging, or other storage purposes, the label need not be affixed until the wine is removed, provided the containers in which the bottled wine is stored are marked to show the kind (class and type) and alcohol content of the wine. *Held*, wine in unlabeled bottles may, pursuant to this provision, be transferred in bond to another bonded wine cellar or bonded winery operated by the same proprietor for labeling at the receiving premises. However, such bottled wine must be sufficiently identified to show the kind (class and type) and the alcohol content in order that it may be properly labeled in accordance with the Regulations relating to the Labeling and Advertising of wine, prior to removal from the receiving premises.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.529: Materials authorized for treatment of wine. Rev. Rul. 57-175

Revenue Ruling 56-551, C. B. 1956-2, 1043, authorized the use, by winemakers, of ascorbic acid, within specified limitations, to prevent deterioration of flavor and darkening of color of apple wine. It is now further concluded that the use of ascorbic acid in the production of vermouth and other wines, for the purpose of preventing overoxidation, is consistent with good commercial practice authorized by section 240.529 of the Wine Regulations and section 5382 of the Internal Revenue Code of 1954. Accordingly, ascorbic acid may be so used, subject to the provisions of sections 240.529 and 240.530 of the regulations. As in the case of apple wine containing ascorbic acid within the specified limitations, the use thereof in vermouth and other wines need not be shown on the labels.

Revenue Ruling 56–551, *supra*, is hereby supplemented to include the use of ascorbic acid in vermouth and other wines. Also, Revenue Ruling 55–603, C. B. 1955–2, 709, containing a list of materials authorized for use in the treatment of wine, is also hereby supplemented.

SECTION 5386.—SPECIAL NATURAL WINES

26 CFR 240.440.—Materials. Rev. Rul. 57–99

Under the provisions of section 5386 of the Internal Revenue Code of 1954 and section 240.440 of the Wine Regulations, special natural wines may be made, pursuant to an approved formula, from a base of natural wine exclusively, with the addition before, during, or after fermentation, 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. *Held*, only such vanillin, as is a natural product and is identified as such by the winemaker, is acceptable for use as an ingredient in the production of a special natural wine. Vanillin which is synthetic may not be so used.

SUBCHAPTER G.—BREWERIES

PART II.—OPERATIONS

SECTION 5411.—USE OF BREWERY

26 CFR 245.10: Restrictions. Rev. Rul. 57–176

A brewer may, on and after January 1, 1957, be permitted to use his brewery office, located on bonded premises, for administrative activities in connection with the purchase and sale of beer produced and bottled by another brewer.

Revenue Ruling 55–365, C. B. 1955–1, 600, revoked.

Advice has been requested whether, pursuant to the Beer Regulations, revised effective January 1, 1957, a brewer may use his brewery office on bonded premises for administrative activities in connection with the purchase and sale of beer produced and bottled by another brewer.

Section 245.30 of the Beer Regulations in effect at the time Revenue Ruling 55–365, C. B. 1955–1, 600, was issued provided as follows:

A brewery may not be established or operated in any dwelling house, shed, yard, or inclosure connected therewith or on board any vessel or boat, or in any building or on any premises where distilled spirits, alcohol, vinegar, or ether are manufactured, produced, or stored; or where any liquor or beverages (other than beer, cereal beverages, and soft drinks produced and packaged or bottled at the brewery or beer produced and packaged or bottled at any other brewery owned by the same brewer) are kept, sold, or dealt in either at wholesale or retail.

The Beer Regulations, as revised, effective January 1, 1957, provide in section 245.10, with respect to restrictions in the use of a brewery, as follows:

A brewery may not be established or operated in any dwelling house or on board any vessel or boat; or in any building or on any premises where the revenue will be jeopardized or the effective administration of this part will be hindered.

Section 245.12 of the revised regulations provides, in part, that if the brewer desires to use the brewery for purposes other than those specifically provided therein, an application may be submitted to the Director, Alcohol and Tobacco Tax Division, through the Assistant Regional Commissioner, Alcohol and Tobacco Tax, for permission to do so.

It is held that, under the revised Beer Regulations, effective January 1, 1957, a brewer may use his brewery office on the bonded premises for administrative activities in connection with the purchase and sale of beer produced and bottled by another brewer, provided application for permission to do so is submitted in the manner indicated and it is determined that no jeopardy would result to the revenue because of such operations and the effective administration of the regulations would not be hindered.

Revenue Ruling 55–365, *supra*, is hereby revoked, effective January 1, 1957.

SECTION 5413.—BREWERS PROCURING BEER FROM OTHER BREWERS

26 CFR 245.300: Notice to Assistant Regional Commissioner. Rev. Rul. 57-25

(Also Part III–C, Section 3; 27 CFR 1.22.)

Section 245.300 of the Beer Regulations provides that, upon written notice to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, a brewer may obtain from another brewer beer finished and ready for sale. *Held*, a brewer who engages in the business of purchasing malt beverages from another brewer is required to possess a wholesaler's basic permit under the provisions of section 3(c) of the Federal Alcohol Administration Act.

SECTION 5415.—RECORDS AND RETURNS

26 CFR 245.226: Form 103.

For instructions for the showing of the serial numbers of Forms 2034, Beer Tax Return, on Form 103, Brewer's Monthly Report of Operations, see Rev. Proc. 57–17, page 747.

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5552.—INSTALLATION OF METERS, TANKS, AND OTHER APPARATUS

26 CFR 230.66: Pipe lines. Rev. Rul. 57–275

(Also Section 235.140.)

Since deionized (demineralized) water is not a product of distillation, pipe lines conveying such water, at taxpaid bottling houses and

rectifying plants, are considered to be in the same category as public utility lines, and, therefore, are held not to be subject to the regulations imposed on pipe lines used to convey distilled water, as contained in section 230.66 of the Regulations relating to the Bottling of Taxpaid Spirits and section 235.140 of the Regulations relating to the Rectification of Spirits and Wines. For restrictions as to the use of demineralized and partially demineralized water in the reduction in proof of distilled spirits, see Revenue Ruling 54–619, C. B. 1954–2, 461, as supplemented by Revenue Ruling 57–122, page 560 of this Bulletin.

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26 CFR 235.140: Distilled water pipelines.

For requirements as to the marking of deionized water pipe lines at rectifying plants, see Rev. Rul. 57–275, page 610.

SECTION 5556.—REGULATIONS

26 CFR 182.439 Completion of operation required. Rev. Rul. 57–150

(Also Sections 182.440, 220.706, 220.709.)

> Where a plant operated alternately as a registered distillery and an industrial alcohol plant uses only one type of mash and the spirits or alcohol produced are 190 degrees or more of proof, the stills may be considered sufficiently boiled out when the spirits are at the production proof for the product of the successor. Rev. Rul. 55–130, C. B. 1955–1, 603, modified.

Advice has been requested whether stills may be considered sufficiently boiled out, preparatory to alternate operations of a plant as a registered distillery or an industrial alcohol plant, when the spirits are at the production proof for the product of the successor where (1) only one type of mash is used at the plant and (2) only spirits or alcohol of 190 degrees or more of proof are produced.

Revenue Ruling 55–130, C. B. 1955–1, 603, provides that, where a plant operated alternately as a distillery or alcohol plant uses only one type of mash and the spirits or alcohol produced are identical except for designation, the stills may be considered sufficiently boiled out when spirits drop in proof to a point below that required for the type of spirits being produced.

Further consideration has been given to the matter of completion of distilling operations preparatory to the alternate operation of a plant and it has been concluded that under the circumstances stated the requirements of the Industrial Alcohol Regulations and of the Regulations relating to the Production of Distilled Spirits, as to boiling out stills prior to alternate operations, will be met. Accordingly, it is held, that where a plant operated alternately in the manner indicated uses only one type of mash and the spirits or alcohol produced are 190 degrees or more of proof, the stills may be considered sufficiently boiled out when the spirits are at the production proof for the product of the successor.

Revenue Ruling 55–130, *supra*, is hereby modified accordingly.

26 CFR 182.440: Transfer of materials, etc.

For requirements as to boiling out stills prior to alternate plant operations where spirits of 190 degrees of proof or more only are produced, see Rev. Rul. 57–150, page 611.

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26 CFR 220.706: Completion of operation required.

For requirements as to boiling out stills prior to alternate plant operations where spirits of 190 degrees or more of proof only are produced, see Rev. Rul. 57–150, page 611.

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26 CFR 220.709: Transfer of materials, etc.

For requirements as to boiling out stills prior to alternate plant operations where spirits of 190 degrees or more of proof only are produced, see Rev. Rul. 57–150, page 611.

CHAPTER 66.—LIMITATIONS

SUBCHAPTER B.—LIMITATIONS ON CREDIT OR REFUND

SECTION 6511.—LIMITATIONS ON CREDIT OR REFUND

26 CFR 194.201. Time limit on filing of claim. (Also Part III–B, Section 3313; Section 194.201.) Rev. Rul. 57–73

A dealer who has paid special tax as a retail beer dealer for a period of eight years, but who should have paid special tax as a retail liquor dealer for such period, desires to settle his outstanding tax liability by paying the difference between the tax due as a liquor dealer and the tax paid as a beer dealer, plus penalty. Section 3313 of the Internal Revenue Code of 1939 provides that claims for refund or credit must be filed within four years from the date of payment. Section 3775(b) thereof provides that the credit of an overpayment in respect of any tax shall be void if such refund of overpayment would be considered erroneous under section 3774. The provisions of this section are applicable to all periods prior to January 1, 1955. Section 3774 provides in part that a refund of any portion of any internal revenue tax shall be considered erroneous if made after the expiration of the period of limitations for filing a claim therefor, unless within such period a claim is filed. Section 6511 of the Internal Revenue Code of 1954, effective on and after January 1, 1955, contains similar provisions, except that a statutory period of three years is provided, or under some circumstances a period of two years. *Held*, an overpayment, or an otherwise erroneous or illegal payment of internal revenue tax, the refund or credit of which would be barred by the statutory period for filing claims, may not be credited against a tax which is presently due and unpaid.

CHAPTER 68.—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

SUBCHAPTER A.—ADDITIONS TO THE TAX AND ADDITIONAL AMOUNTS

SECTION 6651.—FAILURE TO FILE TAX RETURN

For application of the delinquency penalty provisions to special (commodity) tax on stills, see Rev. Rul. 57–98, page 564.

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7122.—COMPROMISES

26 CFR 194.251: Reuse or refilling containers.

For availability of abstract and statement on accepted offers in compromise of refill cases, see Rev. Proc. 57–16, page 746.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

For the change in alcohol tax forms, see Rev. Proc. 57–2 page 723.

26 CFR 200.45: FAA permits. Rev. Rul. 57–74
(Also Part III–C, Section 4;
27 CFR 1.50.)

Section 4 of the Federal Alcohol Administration Act provides that a basic permit shall, after due notice and opportunity for hearing, be revoked if it is found that the permittee has not engaged in the operations authorized by the permit for a period of more than two years. The term "operations" as used therein, with respect to a distiller's basic permit, includes both the production of distilled spirits and the sale of the spirits produced under the permit. Accordingly, if the holder of a distiller's basic permit has not engaged in distilling operations for more than two years, but holds title to distilled spirits of his own production still remaining in a warehouse, his permit would not be subject to revocation because of inactivity so long as he was engaged in disposing of such spirits. Distiller's basic permit held by a non-operating owner of a registered distillery would be subject to revocation, provided such permittee not only had not operated his distillery but had not held title to spirits of his own

production for two years. Since a distiller's basic permit is not required to authorize the ownership of distillery premises operated under lease by another permittee, the permit of the owner of the distillery premises is subject to revocation if he did not produce or have on hand distilled spirits of his own production within a two-year period not withstanding the operation of the distillery by a lessee within that period.

For a determination as to whether a rectifier's basic permit is inactive, see Rev. Rul. 57–85, page 624.

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26 CFR 235.58: Food products.

For restrictions as to the manufacture of a barbecue basting sauce using wine as an ingredient, see Rev. Rul. 57–274, page 607.

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.

CHAPTER 26.—LIQUOR

SUBCHAPTER A.—DISTILLED SPIRITS

PART I.—PROVISIONS RELATING TO TAX

SECTION 2803.—STAMPS FOR CONTAINERS OF DISTILLED SPIRITS

(Also Sections 2806, 2913.) Ct. D. 1803

ALCOHOL TAX—INTERNAL REVENUE CODE OF 1939—DECISION OF SUPREME COURT

1. CONSPIRACY TO POSSESS AND TRANSPORT ALCOHOL IN UNSTAMPED CONTAINERS AND TO EVADE PAYMENT OF FEDERAL TAXES ON THE ALCOHOL. CONVICTION SUSTAINED.

Petitioner was one of five co-defendants convicted in a joint trial of conspiring to deal unlawfully in alcohol. Without deleting references therein to the petitioner, the trial court admitted in evidence a confession of another defendant, made after termination of the conspiracy, but the trial court stated clearly at the time, on several other occasions, and in its charge to the jury, that the confession was to be considered only in determining the guilt of the confessor and not that of any of the other defendants. Admission of the confession was postponed to the end of the government's case. In the main, the confession merely corroborated what the government had already established; its references to the petitioner were largely cumulative; and there was nothing in the record indicating that the jury was confused or failed to follow the court's instructions. Held, petitioner's conviction was sustained.

2. CASE DISTINGUISHED.

Krulewitch v. *United States*, 336 U. S. 440, distinguished.

3. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Second Circuit, 229 F. 2d 319, affirmed.

SUPREME COURT OF THE UNITED STATES

Orlando Delli Paoli, petitioner, v. *United States of America*

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

[January 14, 1957.]

OPINION

Mr. Justice Burton delivered the opinion of the Court.

A joint trial in this case resulted in the conviction of five co-defendants on a federal charge of conspiring to deal unlawfully in alcohol. Only the petitioner,

Orlando Delli Paoli, appealed. The principal issue is whether the trial court committed reversible error, as against petitioner, by admitting in evidence a confession of a co-defendant, made after the termination of the alleged conspiracy. The trial court declined to delete references to petitioner from the confession but stated clearly that the confession was to be considered only in determining the guilt of the confessor and not that of other defendants. For the reasons hereafter stated, we agree that, under the circumstances of this case, such a restricted admission of the confession did not constitute reversible error.

In the United States District Court for the Southern District of New York, the jury convicted petitioner and four co-defendants, Margiasso, Pierro, Whitley and King, of conspiring to possess and transport alcohol in unstamped containers and to evade payment of federal taxes on the alcohol.[1] The Government's witnesses testified that they had observed actions of the defendants which disclosed the procedure through which Margiasso, Pierro and petitioner supplied unstamped alcohol to their customers, such as King and Whitley. The Government also offered, for use against Whitley alone, his written confession made in the presence of a government agent and of his own counsel after the termination of the conspiracy.[2] The court postponed the introduction of Whitley's confession until the close of the Government's case. At that time, the court admitted it with an emphatic warning that it was to be considered solely in determining the guilt of Whitley and not in determining the guilt of any other defendant. The court repeated this admonition in its charge to the jury.

The Court of Appeals affirmed petitioner's conviction, with one judge dissenting. 229 F. 2d 319. We granted certiorari especially to consider the admissibility of Whitley's post-conspiracy confession. 350 U. S. 992.

I.

Petitioner first attacks the sufficiency of the evidence connecting him with the conspiracy. The Government's evidence, exclusive of Whitley's confession, showed that the defendants' conspiracy to deal in unstamped alcohol centered around a garage used for storage purposes in a residential district of the Bronx in New York City and a gasoline service station, also in the Bronx. The service station was used by Margiasso, Pierro and petitioner as a place to meet customers and transfer alcohol.

In December 1949, petitioner, using the alias of "Bobbie London," was associated with Margiasso and Pierro in inspecting the garage and in negotiating for its purchase. For $2,000 in cash, title to the garage and an adjacent cottage was taken in the name of Pierro's sister. In 1950, the garage was repaired, its windows boarded up and its doors strengthened and padlocked. Petitioner lived not far away, in the Bronx, and was observed, from time to time, at the garage or using a panel truck which was registered under a false name. During the daytime, this truck generally was parked near petitioner's home or the garage but neighbors testified that it was in use late at night. In it petitioner transported various articles to the garage or elsewhere. On one occasion, petitioner, with Margiasso, loaded it with bundles of cartons suited to the packing of 5-gallon cans. Late in 1951, petitioner used an additional truck, also registered under a false name. In addition, he frequently drove to the service station in a Cadillac car. On December 18, 1951, he used this car in making delivery of a large package to a near-by bar.

During December 1951, the service station often was used as a meeting place for Margiasso, Pierro and petitioner. Margiasso and petitioner were there on the evening of December 28.[3] At about 7 and 10 p. m., respectively, King and Whitley arrived. Each turned over his car to Margiasso. Margiasso drove King's car to the garage and returned with it heavily loaded. King then drove

[1] In violation of 18 U. S. C., section 371, and I. R. C., sections 2803(a), 2806(e), and 2913. Margiasso and King were also indicted and convicted for the substantive crime of possession of 19 5-gallon cans of unstamped alcohol, and Margiasso of another 113 of such cans.

[2] The confession appears as an appendix to the dissenting opinion below in 229 F. 2d, at 324–326. It is also printed as an appendix, *infra*.

[3] On that occasion, the procedure followed closely the pattern observed by government agents on December 18 when, at 9 p. m., Margiasso and petitioner had been at the service station. A Pontiac car, with two occupants, drove up. The occupants got out. Margiasso drove away in their car and, half an hour later, returned with it heavily loaded. When the two men drove it away, government agents tried to follow it. However, they lost it in traffic and no arrests were made. The agents noted the car's license number, found it registered under a false name, and, on December 28, recognized it as the one in which Whitley then came to the service station.

it away. Government agents followed him until he stopped in Harlem. There they arrested him and took possession of 19 5-gallon cans of unstamped alcohol found in his car. Later in the evening, Margiasso took Whitley's car to the garage and was arrested in it when leaving the still open garage. The agents thereupon seized 113 5-gallon cans of unstamped alcohol they found in the garage. Whitley, who had been waiting for Margiasso at the service station with $1,000 in a paper bag, was arrested on the agents' return with Margiasso.

Petitioner's presence at the service station on the evening of December 28 was closely related to these events. He waited there with King for Margiasso to return with King's car containing the 19 cans of alcohol. He was there again with Margiasso at about 10 p. m. but left shortly before Whitley came. He returned while Margiasso, Whitley and the agents were there and was arrested while attempting to drive away.

Petitioner contends that the above evidence shows merely that he was a friend and associate of Pierro and Margiasso. We conclude, however, from the record as a whole, that the jury could find, beyond a reasonable doubt, that petitioner was associated with Pierro and Margiasso in the purchase of the garage and the use of the panel truck, that he knew that unstamped alcohol was stored in the garage, that he had access to it and that he was an active participant in the transfers of alcohol to Whitley and King. Accordingly, we agree with Circuit Judge Learned Hand's statement made for the court below, following his own summary of the evidence of petitioner's participation in the conspiracy:

> "Not only was all this enough to connect him with the business, but the jurors could hardly have failed to find that he was in the enterprise. The whole business was illegal and carried on surreptitiously; and the possibility that unless he were a party to the venture, Pierro and Margiasso would have associated [with] him to the extent we have mentioned is too remote for serious discussion." 229 F. 2d. at 320.[4]

II.

In considering the admissibility of the Whitley confession, we start with the premise that the other evidence against petitioner was sufficient to sustain his conviction. If Whitley's confession had included no reference to petitioner's participation in the conspiracy, its admission would not have been open to petitioner's objection. Similarly, if the trial court had deleted from the confession all references to petitioner's connection with the conspiracy, the admission of the remainder would not have been objectionable. The impracticality of such deletion was, however, agreed to by both the trial court and the entire court below and cannot well be controverted.

This Court long has held that a declaration made by one conspirator, in furtherance of a conspiracy and prior to its termination, may be used against the other conspirators. However, when such a declaration is made by a conspirator *after the termination of the conspiracy, it may be used only against the declarant and under appropriate instructions to the jury.*

> "* * * Declarations of one conspirator may be used against the other conspirator not present on the theory that the declarant is the agent of the other, and the admissions of one are admissible against both under a standard exception to the hearsay rule applicable to the statements of a party. *Clune* v. *United States*, 159 U. S. 590, 593. See *United States* v. *Gooding*, 12 Wheat. 460, 468–470. But such declaration can be used against the co-conspirator only when made in furtherance of the conspiracy. *Fiswick* v. *United States*, 329 U. S. 211, 217; *Logan* v. *United States*, 144 U. S. 263, 308–309. There can be no furtherance of a conspiracy that has ended. Therefore, the declarations of a conspirator do not bind the co-conspirator if made after the conspiracy has ended. That is the teaching of *Krulewitch* v. *United States*, *supra* [336 U. S. 440], and *Fiswick* v. *United States*, *supra*. Those cases dealt only with declarations of one conspirator after the conspiracy had ended. * * *
>
> "Relevant declarations or admissions of a conspirator made in the absence of the co-conspirator, and not in furtherance of the conspiracy, may be admissible in a trial for conspiracy as against the declarant to prove

[4] Participation in a criminal conspiracy may be shown by circumstantial as well as direct evidence. See, *e. g.*, *Blumenthal* v. *United States*, 332 U. S. 539, 557; *Glasser* v. *United States*, 315 U. S. 60, 80; *Direct Sales Co.* v. *United States*, 319 U. S. 703; *United States* v. *Manton*, 107 F. 2d 834, 839

the *declarant's* participation therein. The court must be careful at the time of the admission and by its instructions to make it clear that the evidence is limited as against the declarant only. Therefore, when the trial court admits against all of the conspirators a relevant declaration of one of the conspirators after the conspiracy has ended, without limiting it to the declarant, it violates the rule laid down in *Krulewitch*. Such declaration is inadmissible as to all but the declarant. * * *

"* * * These declarations [*i. e.*, those admissible only as to the declarant] must be carefully and clearly limited by the court at the time of their admission and the jury instructed as to such declarations and the limitations put upon them. Even then, in most instances of a conspiracy trial of several persons together, the application of the rule places a heavy burden upon the jurors to keep in mind the admission of certain declarations and to whom they have been restricted and in some instances for what specific purpose. While these difficulties have been pointed out in several cases, *e. g.*, *Krulewitch* v. *United States*, *supra*, at 453 (concurring opinion); *Blumenthal* v. *United States*, 332 U. S. 539, 559–560; *Nash* v. *United States*, 54 F. 2d 1006, 1006–1007, the rule has nonetheless been applied. *Blumenthal* v. *United States*, *supra*; *Nash* v. *United States*, *supra*; *United States* v. *Gottfried*, 165 F. 2d 360, 367." *Lutwak* v. *United States*, 344 U. S. 604, 617–618, 619. See also, *Opper* v. *United States*, 348 U. S. 84, 95.

Petitioner contends that *Krulewitch* v. *United States*, 336 U. S. 440, requires the exclusion of a post-conspiracy confession of a co-conspirator. That case dealt with the scope of the co-conspirators' exception to the hearsay rule. This Court held that the utterance of a co-conspirator made after the termination of the conspiracy was inadmissible against other co-conspirators. Unlike the instant case, the declarant was not on trial and the question whether his utterance, implicating other alleged conspirators, could be admitted in a joint trial solely against the declarant, under proper limiting instructions, was neither presented nor decided.

The issue here is whether, under all the circumstances, the court's instructions to the jury provided petitioner with sufficient protection so that the admission of Whitley's confession, strictly limited to use against Whitley, constituted reversible error. The determination of this issue turns on whether the instructions were sufficiently clear and whether it was reasonably possible for the jury to follow them.[5]

When the confession was admitted in evidence, the trial court said:

"The proof of the Government has now been completed except for the testimony of the witness Greenberg as to the alleged statement or affidavit of the defendant Whitley. This affidavit or admission will be considered by you solely in connection with your determination of the guilt or innocence of the defendant Whitley. It is not to be considered as proof in connection with the guilt or innocence of any of the other defendants.

"The reason for this distinction is this: An admission by defendant after his arrest of participation in alleged crime may be considered as evidence by the jury against him, together with other evidence, because it is, as the law describes it, an admission against interest which a person ordinarily would not make. However, if such defendant after his arrest implicates other defendants in such an admission it is not evidence against those defendants because as to them it is nothing more than hearsay evidence."

The substance of this admonition was repeated several times during the cross-examination of one of the government agents before whom the confession was made and a final warning to the same effect was included in the court's charge to the jury.[6] Nothing could have been more clear than these limiting instruc-

[5] For long-standing recognition that possible prejudice against other defendants may be overcome by clear instructions limiting the jury's consideration of a post-conspiracy declaration solely to the determination of the guilt of the declarant, see also *Cwach* v. *United States*, 212 F. 2d 520, 526–527; *United States* v. *Simone*, 205 F. 2d 480, 483–484; *Metcalf* v. *United States*, 195 F. 2d 213, 217; *United States* v. *Leviton*, 193 F. 2d 848, 855–856; *United States* v. *Gottfried*, 165 F. 2d 360, 367; *United States* v. *Pugliese*, 153 F. 2d 497, 500–501; *Johnson* v. *United States*, 82 F. 2d 500; *Nash* v. *United States*, 54 F. 2d 1006, 1007; *Waldeck* v. *United States*, 2 F. 2d 243, 245.

[6] "Before you make those motions—I will again advise the jury that any admissions by the defendant Whitley after the date of his arrest can be considered by you in connection with the determination of the guilt or innocence of the defendant Whitley together with the other testimony. But any admissions by the defendant Whitley are not to be considered as proof in connection with the guilt or innocence of any of the other defendants. The reason for that I explained before to you, that the admission by a defendant after his arrest of participation in an alleged crime may be considered as evidence by the jury against

tions. Petitioner, who made no objection to these instructions at the trial, concedes their clarity.

We may also fairly proceed on the basis that the jury followed these instructions. Several factors favor this conclusion: (1) The conspiracy was so simple in its character that the part of each defendant in it was easily understood. There was no mass trial and no multiplicity of evidentiary restrictions. (2) The separate interests of each defendant were emphasized throughout the trial. Margiasso and petitioner were represented by one attorney. Each of the other defendants was represented by a separate attorney. Throughout the trial, the separate interests of each defendant were repeatedly emphasized by his attorney and recognized by the court.[7] A separate trial never was requested on behalf of any defendant. (3) The trial court postponed the introduction of Whitley's confession until the rest of the Government's case was in, thus making it easier for the jury to consider the confession separately from the other testimony. This separation was pointed out by the trial court. Neither side thereafter introduced any evidence. (4) In the main, Whitley's confession merely corroborated what the Government already had established. In the light of the Government's uncontradicted testimony implicating petitioner in the conspiracy, the references to petitioner in the confession were largely cumulative. (5) There is nothing in the record indicating that the jury was confused or that it failed to follow the court's instructions.

It is a basic premise of our jury system that the court states the law to the jury and that the jury applies that law to the facts as the jury finds them. Unless we proceed on the basis that the jury will follow the court's instructions where those instructions are clear and the circumstances are such that the jury can reasonably be expected to follow them, the jury system makes little sense. Based on faith that the jury will endeavor to follow the court's instructions, our system of jury trial has produced one of the most valuable and practical mechanisms in human experience for dispensing substantial justice.

> "To say that the jury might have been confused amounts to nothing more than an unfounded speculation that the jurors disregarded clear instructions of the court in arriving at their verdict. Our theory of trial relies upon the ability of a jury to follow instructions. There is nothing in this record to call for reversal because of any confusion or injustice arising from the joint trial. The record contains substantial competent evidence upon which the jury could find petitioner guilty." *Opper* v. *United States*, 348 U. S. 84, 95. See also, *Lutwak* v. *United States*, 344 U. S. 604, 615–620; *Blumenthal* v. *United States*, 332 U. S. 539, 552–553.

There may be practical limitations to the circumstances under which a jury should be left to follow instructions but this case does not present them. As a practical matter, the choice here was between separate trials and a joint trial in which the confession would be admitted under appropriate instructions. Such a choice turns on the circumstances of the particular case and lies largely within the discretion of the trial judge. Accordingly, we conclude that leaving petitioner's case to the jury under the instructions here given was not reversible error and the judgment of the Court of Appeals is

Affirmed.

Mr. Justice Frankfurter, whom Mr. Justice Black, Mr. Justice Douglas, and Mr. Justice Brennan join, dissenting.

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him with the other evidence because it is, as the law describes it, an admission against interest which a person ordinarily would not make. However, if such a person after his arrest implicates other defendants in such admission it is not evidence against them, because as to those defendants it is nothing more than hearsay evidence. I advise you of that in connection with the testimony of the last witness [Greenberg] as to any oral statements made by Whitley or any written statements made by Whitley."

[7] Safeguarding the separate interests of the defendants, the court also said:

"The existence of the conspiracy and each defendant's connection with it must be established by individual proof based upon reasonable inference to be drawn from such defendant's own actions, his own conduct, his own declarations, and his own connection with the actions and conduct of the other alleged co-conspirators.

* * * * * * *

"To find any defendant guilty of conspiracy you must find that he actively participated therein. Mere knowledge of an illegal act on the part of any co-conspirator is insufficient. Mere association of one defendant with another does not establish the existence of a conspiracy.

* * * * * * *

". . . if you find that every circumstance relied upon as incriminating is susceptible of two interpretations, each of which appears to be reasonable, and one of which points to a defendant's guilt, the other to his innocence, it is your duty to accept that of innocence and reject that which points to guilt."

APPENDIX TO OPINION OF THE COURT

"Whitley's confession reads as follows:

"UNITED STATES OF AMERICA,
"SOUTHERN JUDICIAL DISTRICT OF NEW YORK,

"*ss.:*

"JAMES WHITLEY, being duly sworn, deposes and says:

"I reside at 65 West 133rd Street, Apartment 4E, New York, N. Y. I make this statement in the presence of my attorney, Mr. Bertram J. Adams of 299 Broadway, New York, N. Y., after being fully advised that under the Constitution of the United States I have the privilege and right of not saying anything at all; that if I answer any question anything I say could be used against me in any criminal proceeding. Being fully aware of my rights, I make this statement of my own free will to Special Investigators Albert Miller and William Greenberg in the office of the Alcohol and Tobacco Tax Division, 143 Liberty Street, New York, N. Y.

"Sometime around Thanksgiving of 1949, a friend of mine introduced me to a man known to me as Tony. This man asked me if I wanted to buy some alcohol and I told him I did. The meeting occurred on 126th Street in Harlem. The man then told me to meet him the next day at a candy store on the south side of 119th Street, just east of First Avenue. When I got there, Tony introduced me to a man whose name I do not know. This man told me to meet him that night on 100th Street and Second Avenue. I met him there. He took my car and drove away. A little while later he came back and told me the car was parked on 103rd Street and Second Avenue. I had purchased two 5-gallon cans of alcohol on that occasion and paid him just before he drove away in my car. Thereafter, I would meet this man around the candy store about twice a week and the same procedure would be followed. This continued until about June or July of 1950.

"Tony was about 5' 4'' in height, about 55 years of age had a dark complexion and stocky build and, I believe, had brown eyes. He was apparently of Italian extraction. The other man who sold me the alcohol was apparently also of Italian descent, and he had a dark complexion. He spoke in broken English. He had black hair and was about 27 or 28 years of age and was about 5' 9'' in height. (Sometime in 1950, Investigator Whited of the Alcohol and Tobacco Tax Division asked me about him and showed me his picture.)

"At about that time, this man sent me to Carl. He introduced Carl to me and told me that Carl would take care of me from then on. I would meet Carl on Second Avenue between 121st Street and 122nd Street in a seafood restaurant and would purchase the alcohol from him.

"Carl is about 5' 10'' in height, has blond hair, blue eyes, light complexion and is about 30 years of age. He is apparently of Italian descent. He is about 160 pounds. Carl would usually come to my home to see me and ask me if I needed anything.

"Just before Carl went to jail in 1950 he introduced me to Bobby. I have been shown a photograph bearing ATU 3643 N. Y. dated 12/29/51 of Orlandi Delli Paoli, and I identify it as that of the man known to me as Bobby. This was sometime in the summer of 1951. Bobby would come to my house to see me. If I placed an order with him he would set the date and the time for seven or eight o'clock in the evening when I was to pick up the alcohol. The first time I met him at 138th Street and Bruckner Boulevard, in the Bronx. He took my car and was gone about one-half hour and then returned with the alcohol. The second time I met him on the corner of Bruckner Boulevard and Soundview Avenue. From then on he would alternate the procedure; I would meet him one night on 138th Street and the next time at Soundview Avenue.

"About two months ago, I began meeting Bobby at the Shell gasoline station known as the Bronx River Service Station on Bruckner Boulevard just past the bridge crossing over to Bronx River. I would usually leave my car parked on the street near the gas station and meet Bobby outside of the gas station. He told me not to go into the gas station as the attendant might not like it.

"About a month ago, Bobby introduced me to another man whose name I do not know. I have been shown a photograph marked ATU 3642 N. Y., dated 12/29/51 of Carmine Margiasso, and identify it as that of the man to whom Bobby introduced me. Bobby also told me that if he was not present when I met Margiasso, I was not to give Margiasso any money but was to pay him (Bobby) the next time

I saw him. Margiasso also followed the same procedure: He would take my car, would be gone about 20 minutes, and then return with the alcohol. Margiasso picked up my car about four times.

"My purchases from Bobby would consist of two or three 5-gallon cans of alcohol at a time and were made once or twice a week. The last two times I paid Bobby $38 a can.

"On the evening of Friday, December 28, 1951, I had ordered two cans, and when Margiasso took my car I waited in the lunch room near the gas station. When I thought it was time for Margiasso to return, I went over to the gas station and waited in the office after purchasing a package of cigarettes. Two officers who were Federal officers came in and placed me and William Hudson under arrest. Shortly after that happened, Bobby drove up and was arrested by the Federal officers.

"I have read the above statement consisting of three pages and it is true to the best of my knowledge and belief.

"(Signed) JAMES WHITLEY
"James Whitley

"Sworn to before me
this 5th day of January 1952.

"(Signed) WILLIAM GREENBERG
William Greenberg, Spec. Inv.

"WITNESS:
"(Signed) ALBERT MILLER
Albert Miller, Spec. Inv."

229 F. 2d 319, 324–326.

SECTION 2806.—PENALTIES AND FORFEITURES

Admission into evidence of confession of co-defendant, made after termination of alleged conspiracy to deal unlawfully in alcohol. See Ct. D. 1803, page 615.

PART IV.—MISCELLANEOUS PROVISIONS RELATING TO DISTILLED SPIRITS

SECTION 2913.—PENALTY FOR UNLAWFUL REMOVAL OR CONCEALMENT OF SPIRITS

Admission into evidence of confession of co-defendant, made after termination of alleged conspiracy to deal unlawfully in alcohol. See Ct. D. 1803, page 615.

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

26 CFR 194.201: Time limitation on filing of claim.

For the time limit for crediting an erroneous tax payment against a tax currently due, see Rev. Rul. 57–73, page 612.

SUBPART C.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATIONS 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.

FEDERAL ALCOHOL ADMINISTRATION ACT

SECTION 3.—UNLAWFUL BUSINESS WITHOUT PERMIT

27 CFR 1.21: Domestic producers, rectifiers, blenders, and warehousemen. (Also Section 5(e); Section 5.80.) — Rev. Rul. 57–124

A rectifier's basic permit and/or a warehousing and bottling basic permit must be obtained by the proprietor of a class 6 customs bonded warehouse desiring to rectify and/or bottle spirits for export. Such spirits bottled for export, however, are not subject to the labeling provisions of the Regulations relating to the Labeling and Advertising of Distilled Spirits and the labels need not be approved.

Advice has been requested with respect to the permit and labeling requirements for the rectification and bottling of spirits at a class 6 customs bonded warehouse.

Section 3(b) of the Federal Alcohol Administration Act provides, in part, that it shall be unlawful, except pursuant to a basic permit issued under the Act, (1) to engage in the business of rectifying or blending distilled spirits or wine, or bottling or warehousing and bottling distilled spirits, or (2) for any person so engaged to sell or deliver for sale, contract to sell or ship in interstate or foreign commerce, directly or indirectly, distilled spirits or wine so rectified, blended, or bottled or warehoused and bottled. There is nothing in the Act or in the Regulations relating to the Basic Permit Requirements, issued thereunder, exempting proprietors of class 6 customs bonded warehouses from these permit requirements. Accordingly, the proprietor of any such establishment who desires to rectify, blend, or bottle distilled spirits in bond for export must obtain a rectifier's basic permit and/or a warehousing and bottling basic permit, as the case may be. Permits of either class issued to any such proprietors should be serially numbered and identified in the same manner, and in the same sequence, as permits issued to rectifying plants and tax-paid bottling houses.

Section 5.80 of the Regulations relating to the Labeling and Advertising of Distilled Spirits provides that such regulations shall not apply to distilled spirits for export. Therefore, it is held that distilled spirits rectified and bottled in a class 6 customs bonded warehouse for export are not subject to the labeling provisions of these regulations and certificates of label approval need not be secured to cover the labels attached to such products. However, labels attached thereto must comply with customs requirements, and the kind or class and type of the spirits (or wines), if stated, must be in substantial conformity with the kind or class and type as known to the trade, as

defined in the Regulations relating to the Labeling and Advertising of Wine and the Regulations relating to the Labeling and Advertising of Distilled Spirits, applicable to domestic and imported distilled spirits and wine.

The term "export" as used in these labeling and advertising regulations does not include shipments to Puerto Rico, Hawaii, or Alaska. Therefore, distilled spirits rectified and/or bottled for shipment thereto are subject to these labeling provisions, and the labels used thereon must be approved under these regulations. On the other hand, the regulations issued pursuant to chapter 51 of the Internal Revenue Code of 1954 differ in this respect from the regulations issued pursuant to the Federal Alcohol Administration Act in that they include as exportations shipments to Puerto Rico. See, for example, Revenue Ruling 56–553, C. B. 1956–2, 1038, relative to shipments of specially denatured alcohol to permittees in Puerto Rico. For the internal revenue requirements relative to the labeling of distilled spirits bottled in bond for exportation, see sections 225.992 through 225.994 of the Regulations relating to the Warehousing of Distilled Spirits, and for the requirements of distilled spirits bottled especially for export with benefit of drawback, see section 252.59 of the Regulations relating to Drawback on Liquors Exported.

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27 CFR 1.22: Wholesalers. Rev. Rul. 57–26

A wholesaler's basic permit under the Federal Alcohol Administration Act must be obtained to cover distilled spirits, wine, or malt beverages purchased for resale at wholesale, regardless of whether or not such purchases for resale are confined to intrastate commerce.

Advice has been requested whether distilled spirits, wine, or malt beverages may be purchased for sale at wholesale within a state without first obtaining a wholesaler's basic permit.

Section 3 of the Federal Alcohol Administration Act provided in part as follows:

"In order effectively to regulate interstate or foreign commerce in distilled spirits, wine, and malt beverages, to enforce the twenty-first amendment, and to protect the revenue and enforce the postal laws with respect to distilled spirits, wine, and malt beverages: * * * (c) it shall be unlawful, except pursuant to a basic permit issued under this Act * * * (1) to engage in the business of purchasing for resale at wholesale distilled spirits, wine, or malt beverages; or (2) for any person so engaged to receive or to sell, offer or deliver for sale, contract to sell, or ship, in interstate or foreign commerce, directly or indirectly or through an affiliate, distilled spirits, wine, or malt beverages so purchased."

It is held that, pursuant to the above provisions of law, no person may engage in the business of purchasing either distilled spirits, wine, or malt beverages for resale at wholesale without possessing a wholesaler's basic permit under the Act, even though such purchases and sales are confined to intrastate commerce and the question of whether or not the alcoholic beverages are manufactured in the state where purchased and sold is immaterial.

For wholesaler's basic permit requirements covering the purchase of beer by one brewer from another, see Rev. Rul. 57–25, page 610.

SECTION 4.—PERMITS

27 CFR 1.50: Revocation or suspension. Rev. Rul. 57–85
(Also Part III–A, Section 7805; 26 CFR 200.45.)

Section 4(e) of the Federal Alcohol Administration Act provides in part that a basic permit shall be revoked, after due notice and opportunity for hearing to the permittee, if it is found that the permittee has not engaged in operations authorized by the permit for a period of more than two years. *Held*, a basic permit may not be revoked under the above provision in any case where the permittee is engaged in *any* of the operations authorized by his permit. For example, since a rectifier is required to hold a rectifier's basic permit to dispose of spirits rectified and bottled by him, such rectifier would not be in an inactive status while engaged in the disposition of any such spirits.

For determination of activity of a distiller's basic permit, see Rev. Rul. 57–74, page 613.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

27 CFR 4.31: Misbranding. Rev. Rul. 57–27
(Also Section 5.31.)

> All of the mandatory information on labels is not required to be reproduced on cartons or other wrappers for imported distilled spirits or wine by reason of such carton or other wrapper bearing a required notation as to the country of origin, or, in the case of distilled spirits, the statement "This package may be opened for examination by internal revenue officers."

Advice has been requested whether, where there appears on a carton a statement as to the country of origin, pursuant to a customs requirement, or the statement "This package may be opened for examination by internal revenue officers," pursuant to Treasury Decision 6205, C. B. 1956–2, 1012, such carton must also contain all of the mandatory information referred to in section 31 of the Regulations relating to the Labeling and Advertising of Wine, or section 31 of the Regulations relating to the Labeling and Advertising of Distilled Spirits.

Sections 31 of the respective regulations, which are similar in their content, provide that if the container or bottle is in an individual carton, covering, or other wrapper used for sale at retail (other than a shipping carton, covering, or wrapper of the container), displaying thereon any written, printed, graphic, or other matter, other than the name and address of the producer, importer, or person by whom bottled or packed (and, in addition, the name and address of the person for whom bottled or packed), and such individual covering, carton, or other wrapper obscures the mandatory label information required to be stated, and such individual covering, carton, or other

wrapper fails to reproduce on it, in the same manner, all information so obscured; or if any statement required to appear on the label, or upon such individual covering, carton, or other wrapper, is obscured in any other manner or is modified in any manner, the container shall be deemed to be misbranded.

Pursuant to a notice issued by the Bureau of Customs, dated September 17, 1956, 21 F. R. 7192, the imported container in which an article is imported and sold to the ultimate purchaser must be marked to indicate the name of the country of origin of the imported article contained therein when practice shows that the ultimate purchaser of the imported article does not usually have an opportunity to remove the article from the container prior to purchase.

The regulations relating to the Warehousing of Distilled Spirits, the Bottling of Taxpaid Distilled Spirits, and the Rectification of Spirits and Wines, as amended by Treasury Decision 6205, *supra*, provide that bottles of distilled spirits may be enclosed in sealed, opaque cartons or wrappers if such cartons or wrappers bear the legend, "This package may be opened for examination by internal revenue officers."

The question here involved is whether the language "any written, printed, graphic or other matter," contained in section 31 of the said labeling and advertising regulations, is intended to include the above statements required to be placed on outer wrappers. While on a literal reading alone, the language of the regulations is specific, it should be construed in the light of its obvious purpose to require the reproduction of all mandatory information on any carton or wrapper which contains written, printed, or graphic matter descriptive of or pertaining to the contents of the packages. It is accordingly held that the provisions of section 31 of the Regulations relating to the Labeling and Advertising of Wine, and section 31 of the Regulations relating to the Labeling and Advertising of Distilled Spirits, do not operate to require the reproduction of all the mandatory information on cartons or wrappers which bear only a statement of the country of origin or the language required by Treasury Decision 6205, *supra*.

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27 CFR 5.31: Misbranding.

For circumstances under which all the mandatory label information need not be reproduced on an outer wrapper, see Rev. Rul. 57–27, page 624.

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27 CFR 5.80: Exports.

For requirements with respect to spirits rectified and/or bottled in a Class 6 customs bonded warehouse for export, see Rev. Rul. 57–124, page 622.

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27 CFR 7.20: General. (Also Section 7.41.) Rev. Rul. 57–177

Keg beer, shipped into a state which has adopted malt beverage labeling requirements similar to those imposed under the Federal Alcohol Administration Act and which permits the sale to consumers of beer in such containers, must be covered by a certificate of label approval for the labels affixed to the containers.

Advice has been requested whether a brewer is required to obtain a certificate of label approval for labels affixed to keg beer removed from the brewery premises.

Section 7.1(e) of the Regulations relating to the Labeling and Advertising of Malt Beverages defines a container as any can, bottle, barrel, keg, or other closed receptacle, irrespective of size or of the material from which made, for use for the sale of malt beverages at retail. Section 7.20 of the regulations provides that the labeling requirements contained in such regulations shall apply to malt beverages sold or shipped or delivered for shipment, or otherwise introduced or received in any state from any place outside thereof, only to the extent that the law of such state imposes similar requirements with respect to the labeling of malt beverages not sold or shipped or delivered for shipment or otherwise introduced into or received in such state from any place outside thereof. Subject to the above limitation subsection (b) thereof provides, in part, that no person engaged in business as a brewer shall sell or ship, or deliver for sale or shipment, or otherwise introduce in interstate commerce, or receive therein, any malt beverages in containers unless such malt beverages are packaged and such packages are marked, branded, and labeled in conformity with such regulations.

Section 7.40 of the regulations provides, in part, that the provisions of section 7.41 shall apply only to persons bottling or packing malt beverages (other than malt beverages in customs custody) for shipment, or delivery for sale or shipment, into a state, the laws or regulations of which require that all malt beverages sold or otherwise disposed of in such state be labeled in conformity with section 7.20 to 7.29, inclusive.

Section 7.41 provides, in part, that no person shall bottle or pack malt beverages, or remove such malt beverages from the plant where bottled or packed, unless, upon application to the Director, Alcohol and Tobacco Tax Division, he has obtained, and has in his possession, a Certificate of Label Approval, Form 1649, covering such malt beverages.

If a brewer ships beer in kegs into a state which has adopted the labeling requirements issued pursuant to the Federal Alcohol Administration Act and such state permits the sale to consumers of beer in containers of the size involved, the brewer is required to obtain certificates of label approval under the Act covering the sets of labels affixed to such containers.

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27 CFR 7.41: Certificates of label approval.

For requirements with respect to the labeling of keg beer introduced into interstate commerce, see Rev. Rul. 57–177, page 625.

SECTION 6.—BULK SALES AND BOTTLING

27 CFR 3.10: Sale of distilled spirits in bulk. (Also Section 3.25.) — Rev. Rul. 57–292

A wholesale liquor dealer holding a basic permit under the Federal Alcohol Administration Act, and otherwise qualified, may

purchase distilled spirits in bulk for sale for industrial use only, but the spirits must be shipped or delivered directly to the industrial user by the warehouseman, distiller, or rectifier. He may not receive distilled spirits in bulk at his premises except alcohol for resale for industrial use.

Advice has been requested whether a wholesale liquor dealer may purchase taxpaid rum in bulk to fill an order placed with him by industrial user.

Section 3.10 of the Regulations relating to Bulk Sales and Bottling of Distilled Spirits provides that it is unlawful for any person to sell, offer to sell, contract to sell, or otherwise dispose of distilled spirits in bulk, for nonindustrial use, except for export or to a distiller, warehouseman, rectifier, proprietor of a class 8 customs bonded warehouse, or to Governmental agencies of the United States. Section 3.25 of such regulations provides that distillers, rectifiers, and other permittees engaged in the sale or other disposition of distilled spirits for nonindustrial use shall not sell or otherwise dispose of distilled spirits in bulk (other than alcohol) for industrial use, unless such distilled spirits are shipped or delivered directly to the industrial user thereof.

Section 2.12 of the Regulations relating to the Nonindustrial Use of Distilled Spirits and Wine provides, in part, that the use of distilled spirits or wine in the manufacture of flavoring extracts, syrups, or food products is regarded as "industrial" and will be excluded from any application of the term "nonindustrial use" as used in such regulations.

In view of the above regulations, it is held that a wholesale liquor dealer may purchase rum in bulk (in containers having a capacity in excess of one wine gallon) for sale for industrial use, provided the rum is shipped or delivered directly to the industrial user thereof by the warehouseman, distiller, or rectifier. Since a wholesaler may not receive distilled spirits in bulk at his premises, except alcohol for resale for industrial use, either in its original containers or after repackaging in containers in excess of one wine gallon and less than five wine gallons, he may not receive the bulk rum in question on his premises for redelivery to the industrial user.

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27 CFR 3.12: Acquiring or receiving distilled spirits in bulk for warehousing and bottling.

For the receipt and storage of taxpaid bulk distilled spirits, see Rev. Rul. 57–173, page 593.

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27 CFR 3.25: General.

For the extent to which wholesalers may purchase distilled spirits in bulk, see Rev. Rul. 57–292, page 626.

PART IV

LEGISLATION AND TREATIES

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*The Tax Conventions in this Bulletin were previously omitted from publication in the Bulletin. Thus, they were not readily available to subscribers. The text of the income tax convention between the United States and Honduras, effective for taxable years beginning on or after January 1, 1957, is published in Internal Revenue Bulletin 1957–26, beginning at page 33. This convention appears in the "List of Tax Conventions to Which the United States Is a Party as of February 7, 1957" as a convention signed but not in effect.

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PART IV

LEGISLATION AND TREATIES

SUBPART A.—TAX CONVENTIONS

LIST OF TAX CONVENTIONS TO WHICH THE UNITED STATES IS A PARTY AS OF FEBRUARY 7, 1957

Conventions now in effect relating to taxes on income:

Country	Official text symbol	Signed	Ratifications exchanged	Effective date	Citation
Australia	TIAS 2880 [1]	May 14, 1953	Dec. 14, 1953	Jan. 1, 1953	C. B. 1954-2, 614 (T. D. 6108)
Belgium	TIAS 2833	Oct. 28, 1948	Sept. 9, 1953	Jan. 1, 1953	C. B. 1954-1, 132 (T. D. 6056)
Supplemental	TIAS 2833	Sept. 9, 1952	Sept. 9, 1953	Jan. 1, 1953	C. B. 1954-2, 626 C. B. 1956-1, 815 (T. D. 6160)
Canada	TS 983; 969 [2]	Mar. 4, 1942	June 15, 1942	Jan. 1, 1941	C. B. 1943, 526 (T. D. 5206)
Supplemental	TIAS 2347	June 12, 1950	Nov. 21, 1951	Jan. 1, 1951	C. B. 1955-1, 624 C. B. 1953-2, 59 (T. D. 6047)
Denmark	TIAS 1854	May 6, 1948	Dec. 1, 1948	Jan. 1, 1948	C. B. 1949-1, 104 (T. D. 5692) C. B. 1950-1, 76 (T. D. 5777)
Finland	TIAS 2596	Mar. 3, 1952	Dec. 18, 1952	Jan. 1, 1952	C. B. 1953-2, 185 (T. D. 6030) C. B. 1956-2, 1067 (T. D. 6202)
France	TS 885	Apr. 27, 1932	Apr. 9, 1935	(Terminated)	
Second convention.	TS 988	July 25, 1939	Dec. 30, 1944	Jan. 1, 1945	C. B. 1945, 522 C. B. 1946-1, 134 (T. D. 5499)
Supplemental	TIAS 1982	Oct. 18, 1946	Oct. 17, 1949	Jan. 1, 1950	C. B. 1956-1, 837
Germany	TIAS 3133	July 22, 1954	Dec. 20, 1954	Jan. 1, 1954	C. B. 1955-1, 635 C. B. 1955-1, 641 (T. D. 6122)
Greece	TIAS 2902	Feb. 20, 1950	Dec. 30, 1953	Jan. 1, 1953	C. B. 1954-2, 638 (T. D. 6109)
Protocol	TIAS 2902	Apr. 20, 1953	Dec. 30, 1953	Jan. 1, 1953	
Ireland	TIAS 2356	Sept. 13, 1949	Dec. 31, 1951	Jan. 1, 1951	C. B. 1952-1, 89 (T. D. 5897)
Italy	----------	Mar. 30, 1955	Oct. 26, 1956	Jan. 1, 1956	C. B. 1956-2, 1096, 1105 (T. D. 6215)
Japan	TIAS 3176	Apr. 16, 1954	Apr. 1, 1955	Jan. 1, 1955	C. B. 1955-1, 658 C. B. 1955-1, 665 (T. D. 6130)
Netherlands	TIAS 1855	Apr. 29, 1948	Dec. 1, 1948	Jan. 1, 1947	C. B. 1949-1, 92 (T. D. 5690) C. B. 1950-1, 92 (T. D. 5778)
Supplementa	TIAS 3366	June 15, 1955	Nov. 10, 1955	Nov. 10, 1955	C. B. 1955-2, 777 (T. D. 6153) C. B. 1956-2, 1105
Netherlands Antilles [3]	TIAS 3367	----------	----------	Jan. 1, 1955	C. B. 1955-2, 777 (T. D. 6153) C. B. 1956-2, 1105

[1] Treaties and International Agreements.
[2] Treaty Series.
[3] Notes exchanged November 10, 1955.

Conventions now in effect relating to taxes on income—Continued

Country	Official text symbol	Signed	Ratifications exchanged	Effective date	Citation
New Zealand	TIAS 2360	Mar. 16, 1948	Dec. 12, 1951	Jan. 1, 1951	C. B. 1953–1, 238 (T. D. 5957)
Norway	TIAS 2357	June 13, 1949	Nov. 11, 1951	Jan. 1, 1951	C. B. 1953–1, 228 (T. D. 5956) C. B. 1955–2, 793 (T. D. 6150)
South Africa	TIAS 2510	Dec. 13, 1946	July 15, 1952	July 1, 1946	C. B. 1954–2, 651
Protocol	TIAS 2510	July 14, 1950	July 15, 1952	July 1, 1948	C. B. 1954–2, 655
Sweden	TS 958	Mar. 3, 1939	Nov. 13, 1939	Jan. 1, 1940	C. B. 1940–2, 43 (T. D. 4975)
Switzerland	TIAS 2316	May 24, 1951	Sept. 27, 1951	Jan. 1, 1951	C. B. 1951–2, 75 (T. D. 5867) C. B. 1955–2, 814 (T. D. 6149)
United Kingdom	TIAS 1546	Apr. 16, 1945	July 25, 1946	Jan. 1, 1945	C. B. 1946–2, 73 (T. D. 5532) C. B. 1947–1, 209 C. B. 1947–2, 100 (T. D. 5569)
Protocol	TIAS 1546	June 6, 1946	July 25, 1946	Jan. 1, 1945	C. B. 1947–1, 217
Supplemental	TIAS 3165	May 25, 1954	Jan. 19, 1955	Jan. 19, 1955	P. 665, this Bulletin
Honduras	----------	June 25, 1956	Feb. 6, 1957	Jan. 1, 1957	I. R. B. 1957–26, 33

Conventions signed but not in effect:

Country	*Signed*
Austria	October 26, 1956
France, supplemental	June 22, 1956
Canada, supplemental	August 8, 1956

NOTE.—Formal negotiations for the conclusion of income tax conventions have been held with representatives of Colombia, Cuba, Israel, Luxemburg, Mexico, Pakistan, the Philippines, and Uruguay. Exploratory discussions have also been held with representatives of Argentina, Brazil, Egypt, India, Paraguay and Venezuela. Proposals are under consideration for extension of the convention with the United Kingdom to Aden, Barbados, British Honduras, the Central African Confederation (Rhodesias and Nyasaland), Cyprus, Dominica, the Falkland Islands, Gambia, the Gold Coast, Grenada, Jamaica, the Leeward Islands, Nigeria, Ste. Lucia, St. Vincent, the Seychelles Islands, Sierra Leone, Trinidad and Tobago. Proposal is also under consideration for extension of the convention with Belgium to the Belgian Congo and Ruanda–Urundi.

Conventions now in effect relating to taxes on gifts:

Country	Official text Symbol	Signed	Ratifications Exchanged	Effective date	Citation
Australia	TIAS 2879	May 14, 1953	Dec. 14, 1953	Dec. 14, 1953	P. 637, this Bulletin
Japan	TIAS 3175	Apr. 16, 1954	Apr. 1, 1955	Apr. 1, 1955	C. B. 1955–1, 654

Conventions now in effect relating to estate taxes and death duties:

Country	Official text symbol	Signed	Ratifications exchanged	Effective date	Citation
Australia	TIAS 2903	May 14, 1953	Jan. 7, 1954	Jan. 7, 1954	P. 633, this Bulletin
Canada	TS 989	June 8, 1944	Feb. 6, 1945	June 14, 1941	C. B. 1945, 381 (T. D. 5455)
Supplemental	TIAS 2348	June 12, 1950	Nov. 21, 1951	Nov. 21, 1951	C. B. 1954–2, 633
Finland	TIAS 2595	Mar. 3, 1952	Dec. 12, 1952	Dec. 18, 1952	P. 641, this Bulletin
France	TIAS 1982	Nov. 18, 1946	Nov. 17, 1949	Nov. 17, 1949	C. B. 1956–1, 837
Protocol	TIAS 1982	May 17, 1948	Nov. 17, 1949	Nov. 17, 1949	
Greece	TIAS 2901	Feb. 20, 1950	Dec. 30, 1953	Dec. 30, 1953	P. 645, this Bulletin
Protocol	TIAS 2901	July 18, 1953	Dec. 30, 1953	Dec. 30, 1953	
Ireland	TIAS 2355	Sept. 13, 1949	Dec. 20, 1951	Dec. 20, 1951 or Jan. 1, 1951	P. 650 this Bulletin
Italy		Mar. 30, 1955	Oct. 26, 1956	Oct. 26, 1956	C. B. 1956–2, 1089
Japan	TIAS 3175	Apr. 16, 1954	Apr. 1, 1955	Apr. 1, 1955	C. B. 1955–1, 654
Norway	TIAS 2358	June 13, 1949	Dec. 11, 1951	Dec. 11, 1951	P. 653, this Bulletin
South Africa	TIAS 2509	Apr. 10, 1947	July 15, 1952	July 15, 1952 or July 1, 1944	P. 659, this Bulletin
Protocol	TIAS 2509	July 14, 1950	July 15, 1952	July 1, 1944	
Switzerland	TIAS 2533	July 9, 1951	Sept. 17, 1952	Sept. 17, 1952	P. 657, this Bulletin
United Kingdom	TIAS 1547	Apr. 16, 1945	July 25, 1946	July 25, 1946 or Jan. 1, 1945	C. B. 1947–1, 146; C. B. 1947–1, 125 (T. D. 5565); C. B. 1954–2, 306 (T. D. 6085)

Conventions signed but not in effect:

Country	*Signed*	
Belgium	May 27, 1954	(Ratified by United States)

NOTE.—Formal negotiations for the conclusion of estate tax conventions have been held with representatives of Austria, Colombia, Germany, Luxemburg, Mexico, the Philippines, Sweden and Uruguay. Exploratory discussions have also been held with representatives of Argentina, Brazil, Cuba, Denmark, Honduras, India, Israel, the Netherlands, New Zealand, and Venezuela.

UNITED STATES–AUSTRALIA ESTATE TAX CONVENTION

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 taxes on the estates of deceased persons was signed at Washington, D. C., on May 14, 1953. The convention was approved for ratification by the United States Senate on July 9, 1953, and was duly ratified by the President on July 23, 1953. It was ratified by Australia on December 14, 1953. The instruments of ratification were exchanged at Canberra, Australia, on January 7, 1954, and the President proclaimed the convention on January 20, 1954. It is effective with respect to estates of persons dying on or after January 7, 1954. The convention reads as follows:

ARTICLE I

(1) The taxes which are the subject of this convention are—
  (a) In the United States: The Federal estate tax;
  (b) In Australia: The Commonwealth estate duty.

(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 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;

(b) the term "Australia" means the Commonwealth of Australia and includes the Territories of Papua, New Guinea and Norfolk Island;

(c) the term "tax" means the Federal estate tax imposed by the United States, or the Commonwealth estate duty imposed by Australia, as the context requires;

(d) 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;

(e) the term "territory" when used in relation to one or the other of the contracting States, means Australia or the United States, as the context requires.

(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 therwise requires, have the meaning which it has under the laws of that State relating to the taxes which are the subject of this convention.

(3) For the purpose of this convention, the question whether a decedent was a citizen, or was domiciled in any part of the territory, of one of the contracting States at the time of his death shall be determined in accordance with the law in force in that territory.

ARTICLE III

(1) Where a person dies a citizen of the United States or domiciled in any part of the territory of either contracting State, the situs of rights and interests, legal or equitable, in or over the classes of property specified in this paragraph shall, for the purposes of the imposition of tax upon the estate of that person by reason only of the situs of property being within the taxing State and for the purposes of the credit allowable under Article V of this convention, be determined exclusively in accordance with the following rules:

(a) Immovable property (otherwise than by way of security) shall be deemed to be situated at the place where the land concerned is located;

(b) Tangible movable property (otherwise than by way of security and other than property for which specific provision is hereinafter made) and bank or currency notes and other forms of currency recognized as legal tender at the place of issue shall be deemed to be situated at the place where that property or currency is located, or, if *in transitu*, at the place of destination;

(c) Debts (including bonds other than bonds referred to in subparagraph (d) hereof, bills of exchange and promissory notes, whether negotiable or not), secured or unsecured and whether under seal or not, excluding the forms of indebtedness for which specific provision is made elsewhere in this paragraph, shall be deemed to be situated at the place where the debtor is resident, but if the debtor, at the time of the decedent's death, has an established place of business in the State in which the decedent was domiciled and debts were incurred in carrying on the business of that establishment, the debts so incurred shall be deemed to be situated in that State;

(d) Bonds, stocks, debentures, and other debts being securities, issued by any government, municipality or public authority shall be deemed to be situated at the place where that government, municipality or public authority is located;

(e) Bank accounts shall be deemed to be situated at the place where the bank or branch thereof, at which the account was kept, is located;

(f) Moneys, payable under a policy of assurance or insurance or under an annuity contract, whether under seal or not, shall be deemed to be situated where the policy or annuity contract provides that the moneys shall be payable, or, if the policy or annuity contract does not provide where the moneys shall be payable—

(i) in the case of a company (corporation)—at the place where it is incorporated;

(ii) in any other case—at the place of residence of the person by whom the moneys are payable;

(g) A partnership shall be deemed to be situated at the place where the business of the partnership is carried on, but only to the extent of the partnership business at that place;

(h) Ships and aircraft and shares thereof shall be deemed to be situated at the place of registration of the ship or aircraft;

(i) Goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on;

(j) Patents, trade marks and designs shall be deemed to be situated at the place where they are registered;

(k) Copyright, franchise, and rights or licenses to use any copyrighted material, patent, trade mark or design shall be deemed to be situated at the place where the rights arising therefrom are exercisable;

(l) Rights or causes of action *ex delicto* surviving for the benefit of an estate of a deceased person shall be deemed to be situated at the place where such rights or causes of action arose;

(m) Judgment debts shall be deemed to be situated at the place where the judgment is originally obtained.

(2) The situs of rights or interests, legal or equitable, in or over property not specified in paragraph (1) of this article, shall be determined in accordance with the law in force in the contracting State imposing the tax or allowing the credit.

ARTICLE IV

(1) In determining the amount on which tax is to be computed, permitted deductions shall be allowed in accordance with the law in force in the contracting State imposing the tax.

(2) Where, upon the death of a person, tax is imposed by one contracting State and that person, at the time of his death, was not domiciled in any part of the territory of that State, but was a citizen, or was domiciled in some part of the territory, of the other contracting State, the State so imposing that tax—

(a) shall allow as an exemption an amount not less than an amount which bears the same proportion to any specific exemption that would have been allowed under the laws of that State if that person had been domiciled therein as the value of the property subjected to that tax bears to the value of the property which would have been subjected to that tax if that person had been so domiciled; and

(b) shall (except for the purposes of sub-paragraph (a) of this paragraph and except for the purposes of any proportional allowance provided for in the laws of the contracting State imposing that tax) take no account, in determining the amount or rate of that tax, of property situated outside its territory.

ARTICLE V

(1) Where a contracting State imposes tax by reason of a decedent's being domiciled in some part of its territory or being its citizen, that State shall allow against so much of its tax (as otherwise computed) as is attributable to property situated in the territory of the other contracting State, a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed by that other contracting State as is attributable to that property; but this paragraph shall not apply as respects so much of that property as is referred to in paragraph (2) of this article.

(2) Where each contracting State imposes tax by reason of a decedent's being domiciled in some part of its territory or being its citizen, each contracting State shall allow against so much of its tax (as otherwise computed) as is attributable to property which is situated—

(a) outside the territory of each contracting State; or

(b) in the territory of each contracting State,

a credit which bears the same proportion to—

(c) the amount of its tax so attributable; or

(d) the amount of the other State's tax attributable to that property,

whichever is the less, as the first-mentioned amount bears to the sum of both amounts.

(3) The amount of the tax in each contracting State attributable to any property shall be ascertained after deducting from the total amount of tax any applicable diminution or credit, other than the credit to be allowed under this article: *Provided*, That, in case another credit for death duty is allowable with

respect to the same property pursuant to any other convention between the crediting State under this convention and any other State, or pursuant to a law of the crediting State, the total credits shall not exceed the amount of tax of the crediting State attributable to that property computed before allowance of those credits, and in computing credit under paragraph (2) of this article with respect to property situated outside both contracting States any credit allowable by either contracting State for death duty payable in the country where the property is situated shall be taken into account in ascertaining the amount of tax of that contracting State attributable to that property. Any diminution or credit to be allowed on account of Federal gift tax or Commonwealth gift duty paid or payable on any gift comprised in the estate is the amount remaining after deducting any credit allowed or allowable under any convention in force between the contracting States for the avoidance of double-taxation with respect to taxes on gifts.

(4) Subject to the provisions of paragraph (3) of this article, the amount of credit allowable by one of the contracting States shall not be reduced as a result of the allowance of a credit for any death duty to which this convention does not relate.

(5) A credit or refund of tax resulting from the application of this article shall not be granted unless a claim for that credit or refund, accompanied by all the information necessary for the purpose of ascertainig the amount of the credit or refund, is made within six years from the date of the decedent's death.

(6) A refund of tax resulting from the application of this article shall be made without payment of interest on the amount refunded.

(7) Credit against tax imposed by one of the contracting States shall not be finally allowed for tax imposed by the other contracting State until the latter tax (reduced by credit, if any, allowable under this article) has been paid.

ARTICLE VI

(1) The taxation authorities of the contracting States shall exchange such information (being information available under the Federal estate tax or the Commonwealth estate duty laws of the contracting States) as is necessary for carrying out the provisions of this convention or for the prevention of fraud or 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 VII

Where an executor, administrator, trustee or beneficiary 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 his State of citizenship or domicile or, if a corporation or company, to the State in which it is created, organized or incorporated and, should the 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 any double taxation that may be involved.

ARTICLE VIII

(1) The provisions of this convention shall not be construed so as to deny or affect in any manner any right of diplomatic or other official representatives of either contracting State to exemptions which they may now enjoy or which may hereafter be granted to those representatives.

(2) This convention shall not be construed as increasing the liability of the estate of any person under the estate tax laws of the United States.

(3) Should any difficulty or doubt arise as to the interpretation or application of this convention or its relationship to conventions between one of the contracting States and any other State, the taxation authorities of the contracting Sates may, subject to applicable rights of appeal, settle the question by mutual agreement.

(4) 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 IX

(1) This convention shall be ratified and the instruments of ratification shall be exchanged at Canberra as soon as possible.

(2) This convention shall come into force on the date of exchange of instruments of ratification and shall be effective only as to the estates of persons dying on or after that date.

(3) This convention shall remain in force indefinitely but either contracting State may on or before the 31st day of March in any calendar year after the year 1955 give the other contracting State notice of termination, in which event the convention shall not be effective in respect of the estates of decedents dying after the 30th day of September in the year in which that notice is given.

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–AUSTRALIA GIFT TAX CONVENTION

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 taxes on gifts was signed at Washington, D. C., May 14, 1953. The convention was approved for ratification by the United States Senate on July 9, 1953, and was duly ratified by the President on July 23, 1953. It was ratified by Australia on December 14, 1953. The instruments of ratification were exchanged at Canberra, Australia, on December 14, 1953, and the President proclaimed the convention on December 22, 1953. It is effective with respect to gifts made on or after December 14, 1953. The convention reads as follows:

ARTICLE I

(1) The taxes which are the subject of this convention are—
(a) In the United States: The Federal gift tax:
(b) In Australia: The Commonwealth gift duty.

(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 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;
(b) the term "Australia" means the Commonwealth of Australia and includes the Territories of Papua, New Guinea and Norfolk Island;
(c) the term "tax" means the Federal gift tax imposed by the United States, or the Commonwealth gift duty imposed by Australia, as the context requires;
(d) 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;

(e) the term "territory", when used in relation to one or the other of the Contracting States, means Australia or the United States, as the context requires.

(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.

(3) For the purposes of this convention, the question whether a donor was a citizen, or was domiciled in any part of the territory, of one of the contracting States at the time of the gift shall be determined in accordance with the law in force in that territory.

ARTICLE III

(1) Where a donor at the time of the gift was a citizen of the United States or domiciled in any part of the territory of either contracting State, the situs at the time of the gift of rights and interests, legal or equitable, in or over the classes of property specified in this paragraph shall, for the purposes of the imposition of tax in respect of the gift by reason only of the situs of property being within the taxing State and for the purposes of the credit to be allowed under Article V of this convention, be determined exclusively in accordance with the following rules:

(a) Immovable property (otherwise than by way of security) shall be deemed to be situated at the place where the land concerned is located;

(b) Tangible movable property (otherwise than by way of security and other than property for which specific provision is hereinafter made) and bank or currency notes and other forms of currency recognized as legal tender at the place of issue shall be deemed to be situated at the place where that property or currency is located, or, if *in transitu*, at the place of destination;

(c) Debts (including bonds other than bonds referred to in sub-paragraph (d) hereof, bills of exchange and promissory notes, whether negotiable or not), secured or unsecured and whether under seal or not, excluding the forms of indebtedness for which specific provision is made elsewhere in this paragraph, shall be deemed to be situated at the place where the debtor is resident, but if the debtor, at the time of the gift, has an established place of business in the State in which the donor is domiciled and debts where incurred in carrying on the business of that establishment, the debts so incurred shall be deemed to be situated in that State;

(d) Bonds, stocks, debentures, and other debts being securities, issued by any government, municipality or public authority shall be deemed to be situated at the place where that government, municipality or public authority is located;

(e) Bank accounts shall be deemed to be situated at the place where the bank or branch thereof, at which the account was kept, is located;

(f) Moneys, payable under a policy of assurance of insurance or under an annuity contract, whether under seal or not, shall be deemed to be situated where the policy or annuity contract provides that the moneys shall be payable or, if the policy or annuity contract does not provide where the moneys shall be payable

(i) in the case of a company (corporation)—at the place where it is incorporated;

(ii) in any other case—at the place of residence of the person by whom the moneys are payable;

(g) A partnership shall be deemed to be situated at the place where the business of the partnership is carried on but only to the extent of the partnership business at that place;

(h) Ships and aircraft and shares thereof shall be deemed to be situated at the place of registration of the ship or aircraft;

(i) Goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on;

(j) Patents, trade marks and designs shall be deemed to be situated at the place where they are registered;

(k) Copyright, franchises, and rights or licenses to use any copyrighted material, patent, trade mark or design shall be deemed to be situated at the place where the rights arising therefrom are exercisable.

(2) The situs of rights or interests, legal or equitable, in or over property not specified in paragraph (1) of this article, shall be determined in accordance with the law in force in the contracting State imposing the tax or allowing the credit.

ARTICLE IV

(1) In determining the amount on which tax is to be computed, permitted deductions shall be allowed in accordance with the law in force in the contracting State imposing the tax.

(2) Where tax is imposed by one contracting State in respect of a gift by a donor who, at the time of the gift, was not domiciled in any part of the territory of that State, but was a citizen, or was domiciled in some part of the territory, of the other contracting State, the State so imposing that tax—

(a) shall allow as an exemption an amount not less than an amount which bears the same proportion to any specific exemption that would have been allowed under the laws of that State if that person had been domiciled therein as the value of the property subjected to that tax bears to the value of the property which would have been subjected to that tax if that person had been so domiciled; and

(b) shall (except for the purposes of sub-paragraph (a) of this paragraph and except for the purposes of any proportional allowance provided for in the laws of the contracting State imposing that tax) take no account in determining the amount or rate of that tax, of property situated outside its territory.

ARTICLE V

(1) Where a contracting State imposes tax by reason of a donor's being domiciled in some part of its territory or being its citizen, that State shall allow against so much of its tax (as otherwise computed) as is attributable to property situated in the territory of the other contracting State, a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed by that other contracting State as is attributable to that property; but this paragraph shall not apply as respects so much of that property as is referred to in paragraph (2) of this article.

(2) Where each contracting State imposes tax by reason of a donor's being domiciled in some part of its territory or being its citizen, each contracting State shall allow against so much of its tax (as otherwise computed) as is attributable to property which is situated—

(a) outside the territory of each contracting State; or

(b) in the territory of each contracting State, a credit which bears the same proportion to—

(c) the amount of its tax so attributable; or

(d) the amount of the other State's tax attributable to that property, whichever is the less, as the first-mentioned amount bears to the sum of both amounts.

(3) The amount of the tax in each contracting State attributable to any property shall be ascertained after deducting from the total amount of tax any applicable diminution or credit, other than the credit to be allowed under this Article: *Provided*, That, in case another credit for duty on gifts is allowable with respect to the same property pursuant to any other convention between the crediting State under this convention and any other State, or pursuant to a law of the crediting State, the total credits shall not exceed the amount of tax of the crediting State attributable to that property computed before allowance of those credits, and in computing credit under paragraph (2) of this article with respect to property situated outside both contracting States any credit allowable by either contracting State for duty on gifts payable in the country where the property is situated shall be taken into account in ascertaining the amount of tax of that contracting State attributable to that property.

(4) A credit or refund of tax resulting from the application of this Article shall not be granted unless a claim for that credit or refund, accompanied by all the information necessary for the purpose of ascertaining the amount of the credit or refund, is made within six years from the date of the gift.

(5) A refund of tax resulting from the application of this article shall be made without payment of interest on the amount refunded.

(6) Credit against tax imposed by one of the contracting States shall not be finally allowed for tax imposed by the other contracting State until the

latter tax (reduced by credit, if any, allowable under this Article) has been paid.

ARTICLE VI

(1) The taxation authorities of the contracting States shall exchange such information (being information available under the Federal gift tax or the Commonwealth gift duty laws of the contracting States) as is necessary for carrying out the provisions of this convention or for the prevention of fraud or 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 VII

Where a donor or donee 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 his State of citizenship or domicile or, if a corporation or company, to the State in which it is created, organized or incorporated and, should the 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 any double taxation that may be involved.

ARTICLE VIII

(1) The provisions of this convention shall not be construed so as to deny or affect in any manner any right of diplomatic or other official representatives of either contracting State to exemptions which they may now enjoy or which may hereafter be granted to those representatives.

(2) This convention shall not be construed as increasing the liability of any donor under the gift tax laws of the United States.

(3) Should any difficulty or doubt arise as to the interpretation or application of this convention or its relationship to conventions between one of the contracting States and any other State, the taxation authorities of the contracting States may, subject to applicable rights of appeal, settle the question by mutual agreement.

(4) 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 IX

(1) This convention shall be ratified and the instruments of ratification shall be exchanged at Canberra as soon as possible.

(2) This convention shall come into force on the date of exchange of instruments of ratification and shall be effective only as to gifts made on or after that date.

(3) This convention shall remain in force indefinitely but either contracting State may on or before the 31st day of March in any calendar year after the year 1955 give the other contracting State notice of termination, in which event the convention shall not be effective in respect of gifts made after the 30th day of September in the year in which that notice is given.

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:

[SEAL] WALTER BEDELL SMITH

FOR THE GOVERNMENT OF THE COMMONWEALTH OF AUSTRALIA:

[SEAL] PERCY C. SPENDER

UNITED STATES-FINLAND ESTATE TAX CONVENTION

A convention between the United States and the Republic of Finland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates and inheritances was signed at Washington on March 3, 1952. The convention was approved for ratification by the United States Senate on July 4, 1952, and was ratified by the President on July 21, 1952. The convention was duly ratified by Finland on December 12, 1952. The instruments of ratification were exchanged at Helsinki on December 18, 1952, and the President proclaimed the convention on December 22, 1952. It is effective with respect to estates or inheritances in the case of persons who die on or after December 18, 1952. The convention reads as follows:

ARTICLE I

(1) The taxes referred to in this convention are the following taxes asserted upon death:

(a) In the case of the United States of America: The Federal estate tax, and

(b) In the case of the Republic of Finland: The inheritance tax, the communal tax on inheritance, bequests, or devices, and the "poors percentage."

(2) The present convention shall also apply to any other taxes of a substantially similar character imposed by either contracting State subsequently to the date of signature of the present convention.

ARTICLE II

(1) As used in this convention:

(a) The term "United States" means the United States of America, and when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(b) The term "Finland" means the Republic of Finland.

(c) The term "tax" means the Federal estate tax imposed in the United States, or the inheritance tax, the communal tax on inheritances, bequests or devises, or the "poors percentage", imposed in Finland, as the context requires.

(d) The term "competent authorities" means, in the case of the United States, the Commission of Internal Revenue, as authorized by the Secretary of the Treasury, and in the case of Finland, the Taxation Department of the Ministry of Finance.

(2) In the application of the provisions of the present convention by one of the contracting States, any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under the tax laws of that State.

ARTICLE III

(1) For the purposes of the present convention, the question whether a decedent was at the time of his death domiciled in or a citizen of the United States, or whether the decedent or the beneficiary of a deceased person's estate was a resident in Finland at the time of the decedent's death, shall be determined in accordance with the laws in force in the United States or Finland, respectively.

(2) In the case of a decedent who at the time of death was a citizen of or domiciled in the United States, or in the case of decedent who at the time of death was a resident of Finland, or in the case of a beneficiary of a deceased person's estate who at the time of the death of such person was a resident of Finland, the situs of any of the following property or property rights shall, for the purposes of the imposition of the tax where the tax is imposed on the basis of the situs of property, and for the purposes of credit, be determined exclusively in accordance with the following rules:

(a) Immovable property shall be deemed to be situated at the place where the land involved is located. The question whether any property or right

in property constitutes immovable property shall be determined in accordance with the law of the place where the land involved is located.

(b) Tangible movable property (other than such property for which specific provision is hereinafter made) and bank or currency notes and other forms of currency recognized as legal tender in the place of issue, shall be deemed to be situated at the place where such property or currency are located at the time of death, or, if *in transitu*, at the place of destination.

(c) Debts (including bonds, promissory notes, bills of exchange, and insurance) shall be deemed to be situated at the place where the debtor resides, or if the debtor is a corporation, at the place in or under the laws of which such corporation was created or organized.

(d) Shares or stock in a corporation (including shares or stock held by a nominee where the beneficial ownership is evidenced by scrip certificates or otherwise) shall be deemed to be situated at the place in or under the laws of which such corporation was created or organized.

(e) Ships and aircraft and shares thereof shall be deemed to be situated at the place of registration or documentation of the ship or aircraft.

(f) Goodwill as a trade, business, or professional asset shall be deemed to be situated at the place where the trade, business, or profession to which it pertains is carried on.

(g) Patents, trade-marks, and designs shall be deemed to be situated at the place where they are registered or used.

(h) Copyrights, franchises, rights to artistic and scientific works, and rights or licenses to use any copyrighted material, artistic and scientific works, patents, trade-marks, or designs shall be deemed to be situated at the place where the rights arising therefrom are exercisable.

(i) All property other than hereinbefore mentioned shall be deemed to be situated in accordance with the laws of the contracting State imposing the tax on the basis of situs of property within such State, but if neither of the contracting States impose the tax on the basis of situs of property therein, then all such other property shall be deemed to be situated where the deceased person was domiciled at the time of his death.

ARTICLE IV

(1) In the case of a decedent (other than a citizen or domiciliary of the United States) who at the time of his death was a resident of Finland, the United States, in imposing the tax:

(a) shall allow a specific exemption, which would be allowable under its law if the decedent had been domiciled in the United States, in an amount not less than the proportion thereof which the value of the property subjected to its tax bears to the value of the property which would have been subjected to its tax if such decedent had been domiciled in the United States; and

(b) shall (except for the purpose of sub-paragraph (a) of this paragraph and for the purpose of any other proportionate allowance otherwise provided) take no account of property situated according to Article III outside the United States in determining the amount or rate of tax.

(2) In the case of a decedent (other than a resident of Finland) who at the time of his death was a citizen of or domiciled in the United States, or in the case of a beneficiary of a deceased person's estate (other than a beneficiary who at the time of the decedent's death was a resident of Finland), and such deceased person was at time of death a citizen of or domiciled in the United States, the taxation authority in Finland, in imposing the tax:

(a) shall allow a specific exemption, which would be allowable under its law if the decedent or beneficiary, as the case may be had been resident in Finland, in an amount not less than the proportion thereof which the value of the property subjected to its tax bears to the value of the property which would have been subjected to its tax if such decedent or beneficiary had been resident in Finland; and

(b) shall (except for the purpose of sub-paragraph (a) of this paragraph and for the purpose of any other proportionate allowance otherwise provided) take no account of property situated according to Article III outside Finland in determining the amount or rate of tax.

ARTICLE V

(1) If the decedent was at the time of his death domiciled in or a citizen of the United States, the United States shall allow against its tax (computed without application of this article) a credit for the amount of the tax imposed in Finland with respect to property situated in Finland and included for tax purposes in both contracting States, but the amount of the credit shall not exceed the portion of the tax imposed by the United States which is attributable to such property. The provisions of this paragraph shall not apply with respect to any property referred to in paragraph (3) of this article.

(2) If the decedent was at the time of his death a resident of Finland, or if the beneficiary of the deceased person's estate was at the time of the death of such person a resident of Finland, the taxation authority in Finland shall allow against its tax (computed without application of this article) a credit for the amount of the tax imposed by the United States with respect to property situated in the United States and included for tax purposes in both contracting States, but the amount of the credit shall not exceed the portion of the tax imposed in Finland which is attributable to such property. The provisions of this paragraph shall not apply with respect to any property referred to in paragraph (3) of this article.

(3) If in a particular case taxes are imposed in one of the contracting States by reason of the decedent's domicile or citizenship thereof and in the other contracting State by reason of the decedent's or beneficiary's residence therein, the taxation authorities in each contracting State shall allow against their taxes (computed without application of this article) a credit for the part of the taxes imposed in other contracting State with respect to property included for tax in both States and situated or deemed to be situated—

(a) in both contracting States, or

(b) outside of both States.

The total of the credits authorized by this paragraph shall be equal to the amount of the taxes imposed with respect to such property in the contracting State imposing the smaller amount of taxes, and shall be divided between the two States in proportion to the amount of taxes imposed in each of the two States with respect to such property.

(4) For the purpose of this article, the amount of the tax in each contracting State attributable to any designated property shall be ascertained after taking into account any applicable diminution or credit otherwise provided, except any credit authorized by this article.

ARTICLE VI

(1) Any claim for credit or for a refund of tax founded on the provisions of the present convention shall be made within six years from the date of death of the decedent.

(2) Any refund shall be made without payment of interest on the amount so refunded.

ARTICLE VII

The competent authorities of the contracting States shall exchange such information (being information available under the respective taxation laws of the contracting States) as is necessary for carrying out the provisions of the present convention or for the prevention of fraud or the administration of statutory provisions against tax 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.

ARTICLE VIII

Each of the contracting States may collect taxes, which are the subject of of this convention, imposed by the other contracting State (as though such tax were imposed by the former State) as will ensure that the credit or any other benefit granted under the present convention shall not be enjoyed by persons not entitled to such benefits.

ARTICLE IX

The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it except that such State may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a trade, business, industrial or professional secret or trade process.

ARTICLE X

Where the representative of the estate of a decedent or beneficiary of such estate shows proof that the action of the revenue authorities of one of the contracting States has resulted or will result in double taxation contrary to the provisions of the present convention, such representative or beneficiary shall be entitled to present the facts to the contracting State of which the decedent was a citizen at the time of death or of which the beneficiary is a citizen, or if the decedent was not a citizen of either of the contracting States at the time of death or if the beneficiary is not a citizen of either of the contracting States, such facts may be presented to the contracting State in which the decedent was domiciled or resident at time of death or in which the beneficiary is domiciled or resident. The competent authority of the State to which the facts are so presented shall undertake to come to an agreement with the competent authority of the other contracting State with a view to equitable avoidance of the double taxation in question.

ARTICLE XI

(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 this convention shall in no case increase the tax liability in either contracting State.

(3) Should any difficulty or doubt arise as to the interpretation or application of the present convention or its relationship to conventions between one of the contracting States and any other State, the competent authorities of the contracting States may settle the question by mutual agreement.

ARTICLE XII

(1) The competent authorities of the two contracting States may prescribe regulations necessary to carry into effect the present convention within the respective States. With respect to the provisions of this convention relating to exchange of information and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, costs of collection, minimum amounts subject to collection and related matters.

(2) The competent authorities of the two contracting States may communicate with each other directly for the purpose of giving effect to the provisions of this convention.

ARTICLE XIII

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Helsinki as soon as possible.

(2) The present convention shall become effective on the day of the exchange of instruments of ratification and shall be applicable to estates or inheritances in the case of persons who die on or after that date. 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 that 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 Washington, in duplicate, in the English and Finnish languages, the two texts having equal authenticity, this third day of March, 1952.

FOR THE PRESIDENT OF THE UNITED STATES OF AMERICA:
DEAN ACHESON [SEAL]
FOR THE PRESIDENT OF THE REPUBLIC OF FINLAND:
JOHAN A. NYKOPP [SEAL]

UNITED STATES–GREECE ESTATE TAX CONVENTION

A convention between the United States and Greece for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates of deceased persons was signed at Athens, Greece, on February 20, 1950, and a Supplementary Protocol was signed at Athens on July 18, 1953. The convention and protocol were approved for ratification by the United States Senate on September 17, 1951, with a reservation to Article IX, which relates to reciprocal assistance in connection with the collection of taxes. The convention was ratified by the President on December 5, 1951, subject to the said reservation. The convention and the protocol were duly ratified by Greece on December 22, 1953. By a second protocol Greece accepted the reservation and on December 30, 1953, instruments of the ratification were exchanged at Athens. The convention and supplementary protocol were proclaimed by the President on January 15, 1954, and they are effective with respect to the estates and inheritances in the case of persons who die on or after December 30, 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 estate tax, and
(b) In the case of Greece: the tax on inheritances.
(2) The present convention is concluded with reference to United States and Greek law in force on the day of its signature. Accordingly, if these laws are appreciably modified, the competent authorities of the two States will consult together for the purpose of adapting the provisions of the present convention to such changes.

ARTICLE II

(1) In the present convention:
(a) The term "United States" means the United States of America, and, for the application of this convention, includes the States, the Territories of Alaska and Hawaii, and the District of Columbia.
(b) The term "Greece" means the territories of the Kingdom of Greece.
(c) The term "tax" means the Greek tax on inheritances or the Federal estate tax of the United States, as the context requires.
(d) The term "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his duly authorized representative, and, in the case of 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) Immovable property situated in Greece shall be exempt from the application of the taxes imposed by the United States.
(2) Immovable property situated in the United States shall be exempt from the application of the taxes imposed by Greece.

(3) The question whether rights relating to or secured by immovable property are to be considered as immovable property for the purposes of the present convention shall be determined in accordance with the laws of the contracting State imposing the tax.

ARTICLE IV

(1) For the purposes of the present convention, the question whether a decedent was domiciled in the territory of one of the contracting States at the time of his death shall be determined in conformity with the laws in force in that territory.

(2) In the case of a person domiciled in the territory of one of the contracting States, the situs of any of the following property or property rights shall, for the purpose of the imposition of the tax and for the purpose of the credit provided for in Article VI, be determined exclusively in accordance with the following rules:

(a) Corporeal movable property, except as hereinafter prescribed, as well as bank notes, any other kind of money which is legal tender at the place of issuance, and bearer checks, shall be deemed to be situated where it is physically located at the time of the decedent's death.

(b) Ships and aircraft shall be deemed to be situated at the place of documentation or registration of the ship or aircraft.

(c) The goodwill of a business firm or the goodwill attached to the practice of one of the liberal professions shall be deemed to be situated where the business is carried on or the profession is practiced.

(d) Patents, trademarks and designs shall be deemed to be situated at the place where they are registered.

(e) Copyrights and rights or licenses to use any copyrighted material, patent, trademark or design shall be deemed to be situated at the place where the rights arising thereform are exercisable.

(f) Shares in a corporation (including shares held by a nominee for the benefit of decedent) shall be deemed to be situated at the place under the laws of which such corporation was created or organized.

(g) Bills of exchange shall be deemed to be situated at the place of the drawee's residence, negotiable promissory notes at the place of residence of the maker, and checks payable to a designated payee at the place of such payee's residence.

(h) Claims secured by a mortgage on immovable property or on ships shall be deemed to be situated at the place where, in accordance with the provisions of the present convention, the immovable property or the ship is deemed to be situated.

(i) Bonds, bank deposits, and claims of any other nature, secured or unsecured, and other property not otherwise mentioned hereinbefore, shall be deemed to be situated in the State in which the deceased person was domiciled at the time of his death.

ARTICLE V

The contracting State which imposes tax in the case of a decedent who, at the time of his death, was not a citizen or subject of such contracting State and was not domiciled in its territory, but was a citizen or subject of the other contracting State or was domiciled in the territory of such other contracting State:

(a) shall allow every abatement, exemption, deduction, or credit (except the marital deduction provided by the United States Revenue Act of 1948), which would be applicable under its law if the decedent had been domiciled in its territory, in an amount not less than the proportion thereof which the value of the property, situated according to Article IV in such State and subject to the tax of such State, bears to the value of the property which would have been subject to the tax of such State if the decedent had been domiciled in its territory, and

(b) shall (except for the purpose of the subparagraph (a) of this article and for the purpose of any other proportionate allowance otherwise provided) take no account of property situated according to Article IV outside its territory in determining the amount or rate of tax.

ARTICLE VI

(1) The contracting State imposing tax in the case of a deceased person, who, at the time of his death, was domiciled in such State or was a citizen

or subject thereof, shall allow against its tax a credit for the amount of the tax imposed by the other Contracting State with respect to property situated in the territory of such other contracting State and included for tax purposes by both States, but the amount of credit shall not exceed the portion of the tax imposed by the former State which is attributable to such property. No credit shall be allowed under this paragraph for property which is situated or deemed to be situated in both contracting States.

(2) If the decedent is regarded by each of the contracting States as having been domiciled in its own territory at the time of his death, each State shall allow against its tax a credit for the part of the tax [imposed by the other State with respect to property included for tax][1] purposes by both States and situated or deemed to be situated outside both territories. The credit authorized by this paragraph shall be equal to the amount of tax imposed with respect to such property by the State imposing the smaller tax, and shall be divided between the two States in proportion to the amount of tax imposed by each of the two contracting States with respect to such property.

(3) For the purposes of this article, the amount of the tax of each contracting State attributable to any designed property shall be ascertained after taking into account any applicable abatement, credit, remission, diminution, or increase, as provided by its law, other than any credit authorized by this article.

ARTICLE VII

(1) Any claim for a credit or a refund of tax founded on the provisions of the present convention shall be made within a period of five years from the date of the termination of the period during which the return is required to be filed under the applicable law of the respective contracting States.

(2) Any such refund shall be made without payment of interest on the amount so refunded.

ARTICLE VIII

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 IX

(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 estates of citizens or subjects, of the State to which application is made, except where such citizen or subject or estate is entitled under Article VI of the present convention to a credit for the avoidance of double taxation.

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[1] This part of treaty text was omitted in error in the English translation of the treaty when signed in Greece.

ARTICLE X

(1) In no case [shall] [2] the provisions of Articles VIII and IX 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 XI

(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, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

ARTICLE XII

When 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] [2] 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 he claim be upheld, the competent authority of such State shall undertake to come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

ARTICLE XIII

(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 day of the exchange of instruments of ratification and shall be applicable solely to estates or inheritances in the case of persons who die on or after that date. 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 that 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

HENRY F. GRADY [SEAL]

FOR THE GOVERNMENT OF THE KINGDOM OF GREECE

PAN. PIPINELIS [SEAL]

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 the estate of deceased persons, signed in Athens on February 20, 1950, the undersigned, The Honorable JOHN E. PEURI-

[2] These words of the treaty text were omitted in error in the English translation of the treaty when signed in Greece.

FOY, 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 and having considered the fact that the aforesaid convention was approved by the United States Senate subject to the deletion of Article IX thereof, have reached an understanding that Article IX of the aforesaid convention shall be deemed as deleted from the convention and that Articles X and XI which follow shall be deemed as applicable in accordance with the said deletion of Article IX.

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 Paliament 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 18th day of July 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 thereto 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 the estate of deceased persons, 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 certin reservation with respect thereto, as follows:

> "The Government of the United States of America does not accept Article IX of the convention, relating to reciprocal assistance in the collection of taxes."

The text of the said reservation 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 reservation by a supplementary protocol signed in Athens on July 18, 1953, and ratified by Legislative Decree No. 2734, of: October 31, 1953, promulgated with the advice and consent of the Interim Parliamentary Committee provided in paragraph 2, Article XXXV of the Greek Constitution and published in the Greek Government Gazette, Volume I, Folio 329 of November 12, 1953.

Accordingly, it is understood by the two Governments that, upon entry into force of the convention aforesaid in accordance with its provisions, the convention is modified in accordance with the said reservation, so that, in effect, Article IX of the convention aforesaid is deemed to be deleted.

Accordingly, Articles X and XI of the convention aforesaid, in so far as they refer to Article IX, shall be deemed to be applicable in accordance with the said deletion of Article IX.

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 ESTATE TAX CONVENTION

A convention between the United States and Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates was signed at Dublin on September 13, 1949. The convention was approved for ratification by the United States Senate on September 17, 1951, and was ratified by the President on October 18, 1951. The convention was duly ratified by Ireland on December 10, 1951. The instruments of ratification were exchanged at Washington, D. C., on December 20, 1951, and the President proclaimed the convention on December 24, 1951. It is effective with respect to estates of persons who die on or after December 20, 1951. The convention reads 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 estate tax, and

(b) In Ireland, the estate duty imposed in that territory.

(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.

(c) The term "territory" when used in relation to one or the other contracting party means the United States or Ireland, as the context requires.

(d) The term "tax" means the estate duty imposed in Ireland or the United States Federal estate tax, as the context requires.

(2) 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) For the purposes of the present convention, the question whether a decedent was domiciled in any part of the territory of one of the contracting parties at the time of his death shall be determined in accordance with the law in force in that territory.

(2) Where a person dies domiciled in any part of the territory of one contracting party, the situs of any rights or interests, legal or equitable, in or over any of the following classes of property which for the purposes of tax form part of the estate of such person or pass on his death, shall, for the purposes of the imposition of tax and for the purposes of the credit to be allowed under Article V, be determined exclusively in accordance with the following rules, but in cases not within such rules the situs of any such rights or interests shall be determined for those purposes in accordance with the law relating to tax in force in the territory of the other contracting party:

(a) Immovable property shall be deemed to be situated at the place where such property is located;

(b) Tangible movable property (other than such property for which specific provision is hereinafter made) and bank or currency notes, other forms of currency recognised as legal tender in the place of issue, negotiable bills of exchange and negotiable promissory notes, shall be deemed to be situated at the place where such property, notes, currency or documents are located at the time of death, or, if *in transitu*, at the place of destination;

(c) Debts, secured or unsecured, other than the forms of indebtedness for which specific provision is made herein, shall be deemed to be situated at the place where the decedent was domiciled at the time of death;

(d) Shares or stock in a corporation other than a municipal or governmental corporation (including shares or stock held by a nominee where the beneficial ownership is evidenced by scrip certificates or otherwise) shall be deemed to be situated at the place in or under the laws of which such corporation was created or organized; but, if such corporation was created or organized under the laws of the United Kingdom of Great Britain and Northern Ireland or under the laws of Northern Ireland, and if the shares or stock of such corporation when registered on a branch register of such corporation kept in Ireland are deemed under the laws of the United Kingdom or of Northern Ireland and of Ireland to be assets situated in Ireland, such shares or stock shall be deemed to be assets situated in Ireland;

(e) Moneys payable under a policy of assurance or insurance on the life of the decedent shall be deemed to be situated at the place where the decedent was domiciled at the time of death;

(f) Ships and aircraft and shares thereof shall be deemed to be situated at the place of registration or documentation of the ship or aircraft;

(g) Goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on;

(h) Patents, trademarks and designs shall be deemed to be situated at the place where they are registered;

(i) Copyright, franchises, and rights or licenses to use any copyrighted material, patent, trademark or design shall be deemed to be situated at the place where the rights arising therefrom are exercisable;

(j) Rights or causes of action *ex delicto* surviving for the benefit of an estate of a decedent shall be deemed to be situated at the place where such rights or causes of action arose;

(k) Judgment debts shall be deemed to be situated at the place where the judgment is recorded:

provided that if, apart from this paragraph, tax would be imposed by one contracting party on any property which is situated in its territory, this paragraph shall not apply to such property unless, by reason of its application or otherwise, tax is imposed or would but for some specific exemption be imposed thereon by the other contracting party.

ARTICLE IV

(1) In determining the amount on which tax is to be computed, permitted deductions shall be allowed in accordance with the law in force in the territory in which the tax is imposed.

(2) Where tax is imposed by one contracting party on the death of a person who at the time of his death was not domiciled in any part of the territory of that contracting party but was domiciled in some part of the territory of the other contracting party, no account shall be taken in determining the amount or rate of such tax of property situated outside the former territory: provided that this paragraph shall not apply as respects tax imposed—

(a) In the United States in the case of a United States citizen dying domiciled in any part of Ireland; or

(b) In Ireland in the case of property passing under a disposition governed by the law of Ireland.

ARTICLE V

(1) Where one contracting party imposes tax by reason of a decedent's being domiciled in some part of its territory or being its national, that party shall allow against so much of its tax (as otherwise computed) as is attributable to property situated in the territory of the other contracting party, a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed in the territory of such other party as is attributable to such property; but this paragraph shall not apply as respects any such property as is mentioned in paragraph (2) of this article.

(2) Where each contracting party imposes tax by reason of a decedent's being domiciled in some part of its territory, each party shall allow against so much of its tax (as otherwise computed) as is attributable to property which is situated, or is deemed under paragraph (2) of Article III to be situated,

(a) in the territory of both parties, or

(b) outside both territories,

a credit which bears the same proportion to the amount of its tax so attributable or to the amount of the other party's tax attributable to the same property, whichever is the less, as the former amount bears to the sum of both amounts.

(3) Where Ireland imposes duty on property passing under a disposition governed by its law, that party shall allow a credit similar to that provided by paragraph (1) of this article.

(4) For the purposes of this article, the amount of the tax of a contracting party attributable to any property shall be ascertained after taking into account any credit, allowance or relief, or any remission or reduction of tax, otherwise than in respect of tax payable in the territory of the other contracting party; and if, in respect of property situated outside the territories of both parties, a contracting party allows against its tax a credit for tax payable in the country where the property is situated, that credit shall be taken into account in ascertaining, for the purposes of paragraph (2) of this article, the amount of the tax of that party attributable to the property.

ARTICLE VI

(1) Any claim for a credit or for a refund of tax founded on the provisions of the present convention shall be made within six years from the date of the death of the decedent in respect of whose estate the claim is made, or, in the case of a reversionary interest where payment of tax is deferred until on or after the date on which the interest falls into possession, within six years from that date.

(2) Any such refund shall be made without payment of interest on the amount so refunded, save to the extent to which interest was paid on the amount so refunded when the tax was paid.

ARTICLE VII

(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; in the case of Ireland, the Revenue Commissioners or their authorized representative.

ARTICLE VIII

(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) The present convention shall come into force on the date of exchange of ratification and shall be effective only as to

(a) the estates of persons dying on or after such date; and

(b) the estate of any person dying before such date and after the last day of the calendar year immediately preceding such date whose personal representative elects, in such manner as may be prescribed, that the provisions of the present convention shall be applied to such estate.

ARTICLE IX

(1) The present convention shall remain in force for not less than three years after the date of its coming into force.

(2) If not less than six months before the expiration of such period of three years, neither of the contracting parties shall have given to the other contracting party, through diplomatic channels, written notice of its intention to terminate the present convention, the convention shall remain in force after such period of three years until either of the contracting parties shall have given written

notice of such intention, in which event the present convention shall not be effective as to the estates of persons dying on or after the date (not being earlier than the sixtieth day after the date of such notice) specified in such notice, or, if no date is specified, on or after the sixtieth day after the date of such notice.

IN WITNESS WHEREOF the above-named plenipotentiaries have signed the present convention and have affixed thereto their seals.

DONE AT 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-NORWAY ESTATE AND INHERITANCE TAX CONVENTION

A convention between the United States and Norway for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates and inheritances was signed at Washington D. C., on June 13, 1949, and ratified by Norway on August 12, 1949. The convention was approved for ratification by the United States Senate on September 17, 1951, subject to the resservation that the United States does not accept Article IX of the convention, relating to reciprocal assistance in the collection of taxes. It was duly ratified by the President on November 26, 1951, subject to the aforesaid reservation, which Norway accepted. The instruments of ratification were exchanged at Washington D. C., on December 11, 1951, and the President proclaimed the convention on December 13, 1951. It is effective with respect to estates or inheritances in the case of persons dying on or after December 11, 1951. The convention reads as follows:

ARTICLE I

(1) The taxes referred to in this convention are the folowing taxes asserted upon death:

(a) In the case of the United States of America: the Federal estate tax, and

(b) In the case of Norway: the tax on inheritances, including death gifts.

(2) The present convention shall also apply to any other estate or inheritance taxes of a substantially similar character imposed by either contracting State subsequently to the date 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 of Hawaii, and the District of Columbia.

(b) The term "Norway" means the Kingdom of Norway; the provisions of the convention shall not, however, extend to Svalbard and Jan Mayen, nor do they apply to the Norwegian dependencies outside Europe.

(c) The term "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his authorized representatives; and in the case of Norway, the Ministry of Finance and Customs.

(2) In the application of the provisions of the present convention by one of the contracting States, any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own laws.

ARTICLE III

(1) For the purposes of the present convention, the question whether a decedent was domiciled in one of the contracting States at the time of his death, shall be determined in accordance with the law in force in that State.

(2) In the case of the death of a person who was a citizen of or domiciled in one of the contracting States, the situs of any of the following property or property rights shall, for the purposes of the imposition of the tax and for the purposes of the credit, be determined exclusively in accordance with the following rules:

(a) Real property shall be deemed to be situated at the place where the land involved is located. The question whether any property or right in property constitutes real property shall be determined in accordance with the law of the place where the land involved is located.

(b) Tangible movable property (other than such property for which specific provision is hereinafter made) and bank or currency notes and other forms of currency recognized as legal tender in the place of issue, shall be deemed to be situated at the place where such property or currency are located at the time of death, or, if *in transit*, at the place of destination.

(c) Debts (including insurance but not including the forms of indebtedness for which specific provision is herein made) shall be deemed to be situated at the place where the debtor resides, or if the debtor is a corporation, at the place in or under the laws of which such corporation was created or organized.

(d) Bonds, promissory notes, and bills of exchange shall be deemed to be situated in accordance with the laws of the contracting State imposing the tax on the basis of situs of property, and if neither contracting State imposes the tax on the basis of situs they shall be deemed to be situated at the place of the decedent's domicile.

(e) Shares or stock in a corporation (including shares or stock held by a nominee where the beneficial ownership is evidenced by scrip certificates or otherwise) shall be deemed to be situated at the place in or under the laws of which such corporation was created or organized.

(f) Ships and aircraft and shares thereof shall be deemed to be situated at the place of registration or documentation of the ship or aircraft.

(g) Goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on.

(h) Patents, trademarks and designs shall be deemed to be situated at the place where they are registered or used.

(i) Copyrights, franchises, rights to artistic, and scientific works and rights or licenses to use any copyrighted material, artistics, and scientific works, patents, trade-marks or designs shall be deemed to be situated at the place where the rights arising therefrom are exercisable.

(j) All property other than hereinbefore mentioned shall be deemed to be situated in the State in which the deceased person was domiciled at the time of his death.

ARTICLE IV

The contracting State which imposes tax in the case of a decedent who at the time of his death was not a citizen of such State and was not domiciled in that State but was a citizen of or domiciled in the other State—

(a) shall allow a specific exemption which would be allowable under its law if the decedent had been domiciled in that State in an amount not less than the proportion thereof which the value of the property subjected to its tax bears to the value of the property which would have been subjected to its tax if the decedent had been domiciled in that State; and

(b) shall (except for the purposes of subparagraph (a) of this Article and for the purpose of any other proportionate allowance otherwise provided) take no account of property situated according to Article III outside that State in determining the amount or rate of tax.

ARTICLE V

(1) The contracting State imposing tax in the case of a deceased person, who, at the time of his death, was domiciled in such State or was a citizen thereof, shall allow against its tax (as otherwise computed) a credit for the amount of the tax imposed by the other contracting State with respect to prop-

erty situated in such other contracting State and included for tax purposes by both States, but the amount of the credit shall not exceed the portion of the tax imposed by the former State which is attributable to such property. The provisions of this paragraph shall not apply with respect to any property referred to in paragraph (2) of this article.

(2) If the decedent is regarded by each of the contracting States as being domiciled therein or a citizen thereof or one State imposes tax by reason of the decedent's being domiciled therein and the other State imposes tax by reason of the decedent being its citizen, each State shall, in addition to the credit authorized by paragraph (1) of this article, allow against its tax (as otherwise computed) a credit for the part of the tax imposed by the other State with respect to property included for tax purposes by both States and situated or deemed to be situated

(a) in both contracting States, or

(b) outside of both States.

The total of the credits authorized by this paragraph shall be equal to the amount of tax imposed with respect to such property by the State imposing the smaller tax and shall be divided between the two States in proportion to the amount of tax imposed by each of the two contracting States with respect to such property.

(3) For the purpose of this article, the amount of the tax of each contracting State attributable to any designated property shall be ascertained after taking into account any applicable abatement, remittance, diminution or credit, as provided by its law other than any credit authorized by this article.

ARTICLE VI

(1) Any claim for credit or for a refund of tax founded on the provisions of the present convention shall be made within six years from the date of death of the decedent.

(2) Any refund shall be made without payment of interest on the amount so refunded.

ARTICLE VII

With a view to the more effective imposition of the taxes to which the present convention relates, each of the contracting States undertakes, subject to reciprocity, to furnish such information in the matter of taxation, which the authorities of the State concerned have at their disposal or are in a position to obtain under their own law, as may be of use to the authorities of the other State in the assessment of the taxes in question and to lend assistance in the service of documents in connection therewith. Any information so exchanged shall be treated as secret and shall only be disclosed to persons (including a court) concerned with the assessment, determination and collection of the taxes which are the subject of the present convention, or the determination of appeals in relation thereto. No information shall be exchanged which would disclose a trade, business, industrial or professional secret. Information and correspondence relating to the subject matter of this article shall be exchanged between the competent authorities of the contracting States in the ordinary course or on request.

ARTICLE VIII

(1) In accordance with the preceding article, the competent authorities of the contracting States shall furnish information to each other without special request as follows:

(a) In the case of the United States: information disclosed by the United States estate tax records relative to estates of deceased persons who were domiciled in, or citizens of, Norway, and such information as is available, in the estates of deceased persons who were domiciled in, or citizens of, the United States, with respect to property situated in Norway.

(b) In the case of Norway: information disclosed by the Norwegian inheritance tax records relative to estates of deceased persons who were domiciled in or citizens of the United States and such information as is available in the estates of deceased persons who were domiciled in or citizens of Norway with respect to property situated in the United States.

(2) The information referred to in this article shall be transmitted as soon as practicable in the course of audit of the estate and inheritance tax records.

ARTICLE IX

(1) The contracting States undertake to lend assistance and support to each other in the collection of the taxes which are the subject of the present convention, together with interest, costs, and additions to the taxes.

(2) In the case of applications for enforcement of taxes, revenue claims of each of the contracting States which have been finally determined may be accepted for enforcement by the other contracting State and may be collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes

(3) Any application shall include a certification that under the laws of the State making the application the taxes have been finally determined.

(4) The assistance provided for in this article shall not be accorded with respect to the citizens or corporations or other entities or estates of citizens of the State to which application is made except where they are entitled under Article V of the present convention to a credit for the avoidance of double taxation.

ARTICLE X

The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it except that such State may refuse to comply with a request for reasons of public policy or if compliance with the request would involve violation of a trade, business, industrial or professional secret.

ARTICLE XI

Where an estate of a decedent or a beneficiary thereof shows proof that the action of the revenue authorities of one of the contracting States has resulted or will result in double taxation contrary to the provisions of the present convention. such estate or beneficiary shall be entitled to lodge a claim with either contracting State, but if the decedent was, or the beneficiary is, a citizen of or a corporation or other entity created or organized in one of the contracting States the claim must be filed with the latter State. Should the claim be upheld, the competent authority of such State shall undertake to come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

ARTICLE XII

(1) The competent authorities of the two contracting States may prescribe regulations necessary to carry into effect the present convention within the respective States. With respect to the provisions of this convention relating to exchange of information, service of documents, and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedures, forms of application and replies thereto, conversion of currency, disposition of amounts collected, costs of collection, minimum amounts subject to collection and related matters.

(2) The competent authorities of the two contracting States may communicate with each other directly for the purpose of giving effect to the provisions of this convention.

ARTICLE XIII

(1) The provisions of this convention shall not be construed to deny or affect in any manner the right of diplomatic and consular officers to other or additional exemptions now enjoyed or which may hereafter be granted to such officers.

(2) The provisions of the present convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance now or hereafter accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

(3) Should any difficulty or doubt arise as to the interpretation or application of the present convention, or its relationship to conventions between one of the contracting States and any other State, the competent authoriies of the contracting States may settle the question by mutual agreement.

ARTICLE XIV

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) The present convention shall become effective on the day of the exchange of instruments of ratification and shall be applicable to estates or inheritances in the case of persons who die on or after that date. 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 that 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 Washington, in duplicate, in the English and Norwegian languages, the two texts having equal authenticity, this thirteenth day of June 1949.

FOR THE PRESIDENT OF THE UNITED STATES OF AMERICA:
[SEAL] JAMES E. WEBB
FOR HIS MAJESTY THE KING OF NORWAY:
[SEAL] WILHELM MUNTHE MORGENSTIERNE

UNITED STATES–SWITZERLAND ESTATE AND INHERITANCE TAX CONVENTION

A convention between the United States and Switzerland for the avoidance of double taxation with respect to taxes on estates and inheritances was signed at Washington, D. C., on July 9, 1951. The convention was approved for ratification by the United States Senate on July 4, 1952, and was ratified by the President on July 21, 1952. The convention was duly ratified by the Swiss Confederation on July 12, 1952. The instruments of ratification were exchanged at Bern, Switzerland, on September 17, 1952, and the President proclaimed the convention on October 7, 1952. It is effective with respect to estates and in inheritances in the case of persons who die on or after September 17, 1952. The convention reads as follows:

ARTICLE I

(1) The taxes referred to in this convention are the following taxes asserted upon death:

(a) In the case of the United States of America: The Federal estate tax, and

(b) In the case of The Swiss Confederation: Estate and inheritance taxes imposed by the cantons and any political subdivision thereof.

(2) The present convention shall also apply to any other estate or inheritance taxes of a substantially similar character imposed by the United States or the Swiss cantons or any political subdivision thereof subsequently to the date of signature of the present convention.

ARTICLE II

(1) As used in this convention:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(b) The term "Switzerland" means The Swiss Confederation.

(c) The term "tax" means the Federal estate tax imposed by the United States, or the inheritance or estate taxes imposed in Switzerland, as the context requires.

(d) 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 Switzerland, the Director of the Federal Tax Administration as authorized by the Federal Department of Finances and Customs.

(2) In the application of the provisions of the present convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own laws.

(3) For the purposes of the present convention, each contracting State may determine whether the decedent was at the time of death domiciled therein or a citizen thereof.

ARTICLE III

In imposing the tax in the case of a decedent who at the time of death was not a citizen of the United States and was not domiciled therein, but who was at the time of his death a citizen of or domiciled in Switzerland, the United States shall allow a specific exemption which would be allowable under its law if the decedent had been domiciled in the United States in an amount not less than the proportion thereof which the value of the total property (both movable and immovable) subjected to its tax bears to the value of the total property (both movable and immovable) which would have been subjected to its tax if the decedent had been domiciled in the United States. If a tax is imposed in Switzerland by reason of movable property being situated within the territorial jurisdiction of the tax authority (and not by reason of the decedent's domicile therein or by reason of the decedent's Swiss citizenship) in the case of an estate of a decedent who at the time of his death was a citizen of or domiciled in the United States, the tax authority in Switzerland shall allow a specific exemption which would be allowable under its law if the decedent had been domiciled within its territorial jurisdiction in an amount not less than the proportion thereof which the value of the total property (both movable and immovable) subjected to its tax bears to the value of the total property (both movable and immovable) which would have been subjected to its tax if the decedent had been domiciled within its territorial jurisdiction.

ARTICLE IV

(1) If the tax authority in the United States determines that the decedent was a citizen of or domiciled in the United States at the time of his death, and the tax authority in Switzerland determines that the decedent was a citizen of or domiciled in Switzerland at the time of his death, the tax authority in each contracting State shall allow against its tax (computed without application of this article) a credit for the tax imposed in the other contracting State with respect to the following property included for tax by both States (but the amount of the credit shall not exceed the portion of the tax imposed in the crediting State which is attributable to such property) :

(a) Shares or stock in a corporation (including shares or stock held by a nominee where the beneficial ownership is evidenced by scrip certificates or otherwise) created or organized under the laws of such other contracting State or a political subdivision thereof,

(b) Debts (including bonds, promissory notes, bills of exchange, and insurance) if the debtor resides in such other State, or if the debtor is a corporation created or organized under the laws of such other State or a political subdivision thereof,

(c) Corporeal movable property (including bank or currency notes and other forms of currency recognized as legal tender in the place of issue) physically located in such other State at the time of death of the decedent, and

(d) Any other property which the competent authorities of both contracting States agree upon as constituting property situated in such other State.

(2) For the purpose of this article, the amount of the tax of each contracting State attributable to any particular property shall be ascertained after taking into account any applicable diminution or credit as provided by its law other than any credit authorized by this article.

(3 The credit provided by this article shall be allowed only upon condition that the tax for which credit may be authorized has been fully paid; and the competent authority of the contracting State in which such tax is imposed shall certify to the competent authority of the contracting State in which credit may be allowed such information pertaining thereto as is necessary to carry out the provisions of this article.

ARTICLE V

(1) Any claim for a credit or refund of tax founded on the provisions of the present convention shall be made within five years from the date of death of the decedent.

(2) Any refund or credit shall be made without payment of interest on the amount so refunded.

ARTICLE VI

Where the representative of the estate of a decedent or a beneficiary of such estate can show proof that the action of the tax authorities of one of the contracting States has resulted or will result in double taxation contrary to the provisions of the present convention, such representative or beneficiary shall be entitled to present the facts to the contracting State of which the decedent was a citizen at time of death or of which the beneficiary is a citizen, or if the decedent was not a citizen of either of the contracting States at the time of death or if the beneficiary is not a citizen of either of the contracting States, such facts may be presented to the contracting State in which the decedent was domiciled at time of death or in which the beneficiary is domiciled. The competent authority of the State to which the facts are presented shall undertake to come to an agreement with the competent authority of the other contracting State with a view to equitable avoidance of the double taxation in question.

ARTICLE VII

(1) The competent authorities of the two contracting States may prescribe rules and 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. Any information so received 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.

(3) Should any difficulty or doubt arise as to the interpretation or application of the present convention or its relationship to conventions between one of the contracting States and any other State, the competent authorities of the contracting States may settle the question by mutual agreement.

ARTICLE VIII

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Berne as son as possible.

(2) The present convention shall become effective on the day of the exchange of instruments of ratification and shall be applicable to estates or inheritances in the case of persons who die on or after that date. 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 that 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 with respect to estates or inheritances in the cases of persons who die on or after the first day of January following the expiration of the six-month period.

DONE at Washington, in duplicate, in the English and German languages, the two texts having equal authenticity, this 9th day of July, 1951.

FOR THE PRESIDENT OF THE UNITED STATES OF AMERICA:
[SEAL] DEAN ACHESON
FOR THE SWISS FEDERAL COUNCIL:
[SEAL] CHARLES BRUGGMANN

UNITED STATES–UNION OF SOUTH AFRICA ESTATE TAX CONVENTION

A convention between the United States and the Union of South Africa for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates was signed at Capetown on April 10, 1947, and the Supplementary Protocol was signed at Pretoria on July 14, 1950. The convention and supplementary protocol were approved for ratification by the United States Senate on September

17, 1951, with an understanding that application of Article VIII(4) of the convention, as amended by Article I of the protocol, would be limited to those cases in which the estate of a decedent claims a credit under Article V of the convention. The convention was ratified by the President on December 14, 1951, subject to the above understanding. The convention was duly ratified by the Union of South Africa on June 18, 1952. The instruments of ratification were exchanged at Washington, D. C., on July 15, 1952, and the President proclaimed the convention on August 19, 1952. It is effective with respect to estates of persons who die on or after July 15, 1952, except that, upon the election of a personal representative, it shall be effective as to the estates of persons dying before the exchange of ratifications and after June 30, 1944. The convention and supplementary protocol read 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 estate tax, and
(b) In the Union of South Africa, the estate duty imposed by the Union.
(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 "Union" means the Union of South Africa.
(c) The term "territory," when used in relation to one or the other contracting party, means the United States or the Union, as the context requires.
(d) The term "tax" means the United States Federal estate tax or the estate duty imposed by the Union, as the context requires.
(e) The term "Commissioner for Inland Revenue" means the Commissioner for Inland Revenue of the Union or his duly authorised representatives.
(f) The term "Commissioner of Internal Revenue" means the Commissioner of Internal Revenue of the United States, or his duly authorised representative.
(g) The term "competent authority" means the Commissioner for Inland Revenue or the Commissioner of Internal Revenue and their duly authorised representatives.
(h) The term "corporation" when used in relation to the Union shall be regarded as the equivalent of the term "company" as used in the revenue laws of that State.
(2) 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) For the purposes of the present convention, the question whether a decedent was at the time of his death domiciled in any part of the United States or ordinarily resident in any part of the Union shall be determined in accordance with the laws in force in the United States and the Union respectively.
(2) Where a person was at the time of his death domiciled in any part of the United States or ordinarily resident in any part of the Union, then as regards the United States, the situs of any of the following rights and interests, legal or equitable which for the purposes of tax form part of the estate of such person or pass on his death, shall, for the purposes of the imposition of tax, be determined exclusively in accordance with the following rules, and as regards the Union, tax may be imposed on any of the following rights or

interests which are deemed under those rules to be situated in its territory, but shall not be imposed on any of the said rights or interests which are deemed to be situated outside its territory unless such person was at the time of his death ordinarily resident in some part of its territory:

(a) Rights or interests (otherwise than by way of security) in or over immovable property shall be deemed to be situated at the place where such property is located;

(b) Rights or interests (otherwise than by way of security) in or over tangible movable property, other than such property for which specific provision is hereinafter made, and in or over bank or currency notes, other forms of currency recognised as legal tender in the place of issue, negotiable bills of exchange and negotiable promissory notes, shall be deemed to be situated at the place where such property, notes, currency or documents are located at the time of death, or, if *in transitu*, at the place of destination;

(c) Debts, secured or unsecured, including securities issued by any government, municipality or public authority and debentures and debenture stock issued by any corporation, but excluding the forms of indebtedness for which specific provision is made herein, shall be deemed to be situated in the United States if the decedent was at the time of his death domiciled in some part of the United States, and in the Union if the decedent was at the time of his death ordinarily resident in some part of the Union;

(d) Shares or stock in a corporation (including shares or stock held by a nominee where the beneficial ownership is evidenced by script certificates or otherwise) shall be deemed to be situated at the place in or under the laws of which such corporation was created or organised;

(e) Monies payable under a policy of assurance or insurance on the life of the decedent shall be deemed to be situated in the United States if the decedent was at the time of his death domiciled in some part of the United States, and in the Union if the decedent was at the time of his death ordinarily resident in some part of the Union;

(f) Ships and aircraft and shares thereof shall be deemed to be situated at the place of registration or documentation of the ship or aircraft;

(g) Goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on;

(h) Patents, trade marks and designs shall be deemed to be situated at the place where they are registered;

(i) Copyright, franchises, and rights or licenses to use any copyrighted material, patent, trade mark or design shall be deemed to be situated at the place where the rights arising therefrom are exercisable;

(j) Rights or causes of action *ex delicto* surviving for the benefit of an estate of a decedent shall be deemed to be situated at the place where such rights or causes of action arose;

(k) Judgment debts shall be deemed to be situated at the place where the judgment is recorded;

Provided that if, apart from this paragraph, tax would be imposed by one contracting party on any property, this paragraph shall not apply to such property unless, by reason of its application or otherwise, tax is imposed or would but for some specific exemption be imposed thereon by the other contracting party.

ARTICLE IV

(1) In determining the amount on which tax is to be computed permitted deductions shall be allowed in accordance with the law in force in the territory in which the tax is imposed.

(2) Where tax is imposed in the United States on the death of a person who was not domiciled in any part of the United States but was ordinarily resident in some part of the Union, or where tax is imposed in the Union on the death of a person who was not ordinarily resident in any part of the Union but was domiciled in some part of the United States, no account shall be taken, in determining the amount or rate of the tax so imposed, of property which is deemed under paragraph (2) of Article III to be situated outside the territory of the contracting party imposing such tax; provided that this paragraph shall not apply as respects tax imposed in the United States in the case of a United States citizen who at the time of his death was ordinarily resident in the Union.

ARTICLE V

(1) Where the United States imposes tax by reason of a decedent's being its national, the United States shall allow against so much of its tax (as otherwise computed) as is attributable to property situated in the Union, a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed in the Union as is attributable to that property; but this paragraph shall not apply in a case to which paragraph (2) (a) or paragraph (3) is applicable.

(2) Where each contracting party imposes tax on any property on the death of a person who at the time of his death was—

(a) domiciled in some part of the United States but not ordinarily resident in any part of the Union, or

(b) ordinarily resident in some part of the Union but not domiciled in any part of the United States,

the contracting party in some part of whose territory such person was so domiciled or ordinarily resident shall allow against so much of its tax (as otherwise computed) as is attributable to that property a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed in the territory of the other contracting party as is attributable to such property; provided that this paragraph shall not apply as respects tax imposed by the United States solely by reason of a decedent's being its national which is attributable to property situated outside the United States.

(3) Where each contracting party imposes tax on property on the death of a person who at the time of his death was domiciled in some part of the United States and ordinarily resident in some part of the Union—

(a) in the case of any property which is deemed under paragraph (2) of Article III to be situated in the territory of one only of the contracting parties, the other contracting party shall allow against so much of its tax (as otherwise computed) as is attributable to that property a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed in the territory of the first mentioned contracting party as is attributable to such property;

(b) in the case of any other property each contracting party shall allow against so much of its tax (as otherwise computed) as is attributable to the property of a credit which bears the same proportion to the amount of its tax so attributable or to the amount of the other party's tax attributable to the same property, whichever is the less, as the former amount bears to the sum of both amounts.

(4) For the purposes of this article, the amount of the tax of a contracting party attributable to any property shall be ascertained after taking into account any credit, allowance or relief, or any remission or reduction of tax, otherwise than in respect of tax payable in the territory of the other contracting party.

(5) The allowance by the Union under this article of a credit for tax imposed in the United States in respect of any property shall be subject to the condition that no deduction in respect of the tax so imposed shall be made for the purpose of determining the amount of the estate on which tax is chargeable in the Union.

ARTICLE VI

(1) Any claim for a credit or for a refund of tax founded on the provisions of the present convention shall be made within six years from the date of the death of the decedent in respect of whose estate the claim is made, or, in the case of a reversionary interest where payment of tax is deferred until on or after the date on which the interest falls into possession, within six years from that date.

(2) Any such refund shall be made without payment of interest on the amount so refunded.

ARTICLE VII

With a view to the more effective imposition of the taxes to which the present convention relates, each of the contracting parties undertakes to furnish to the other contracting party such information in the matter of taxation, which the competent authority of the former contracting party has at his disposal or is in a position to obtain under the laws of that party, as may be of use to the competent authority of such other party in the assessment of the taxes to which the present convention relates and to lend assistance in the service of documents in connection therewith. Such information and correspondence relating to the subject matter of this article shall be exchanged between the competent authorities of the contracting parties in the ordinary course or on request.

ARTICLE VIII

(1) Each contracting party undertakes to lend assistance and support in the collection of the taxes to which the present convention relates, together with interest, costs, and additions to the taxes and fines not being of a penal character. The contracting party making such collections shall be responsible to the other contracting party for the sums thus collected.

(2) In the case of applications for enforcement of taxes, revenue claims of each of the contracting parties which have been finally determined shall be accepted for enforcement by the other contracting party and collected in the territory of that party in accordance with the laws applicable to the enforcement and collection of its own taxes.

(3) The application shall be accompanied by such documents as are required by the laws of the contracting party making the application to establish that the taxes have been finally determined.

(4) If the revenue claim has not been finally determined the contracting party to which application is made may, at the request of the other contracting party, take such measures of conservancy as are authorised by the revenue laws of the former party in relation to its own taxes.

ARTICLE IX

(1) In the administration of the provisions of the present convention relating to exchange of information, service of documents, and mutual assistance in collection of taxes, fees and costs incurred in the ordinary course shall be borne by the contracting party to which application is made but extraordinary costs incident to special forms of procedure shall be borne by the applying party.

(2) Documents and other communications or information contained therein, transmitted under the provisions of the present convention by one of the competent authorities to the other shall not be used by the latter except in the performance of his duty in the determination, assessment and collection of the taxes.

ARTICLE X

(1) Such regulations as may be necessary to interpret and carry out the provisions of the present convention may be prescribed by each of the contracting parties. With respect to the provisions of the present convention relating to exchange of information, service of documents and mutual assistance in the collection of taxes, the competent authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

(2) The competent authorities of the two contracting parties may communicate with each other directly for the purpose of giving effect to the provisions of the present convention.

ARTICLE XI

If any person liable for any of the taxes to which the present convention relates can show that double taxation has resulted or may result in respect of such taxes he shall be entitled to lodge a claim or protest with the contracting party of which he is a citizen or resident, or, if a corporation or other entity, with the contracting party in which created or organized. If the claim or protest should be deemed worthy of consideration, the competent authority of such party may consult with the competent authority of the other party to determine whether the alleged double taxation exists or may occur and if so whether it may be avoided in accordance with the terms of the present convention.

ARTICLE XII

The provisions of the present convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance now or hereafter accorded by the laws of one of the contracting parties in the determination of the tax imposed by such contracting party.

ARTICLE XIII

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) The present convention shall come into force on the date of exchange of instruments of ratification and shall be effective only as to—

(a) the estates of persons dying on or after such date; and

(b) the estate of any person dying before such date and after the 30th day of June, 1944, whose personal representative elects, in such manner as may be prescribed, that the provisions of the present convention shall be applied to such estate.

ARTICLE XIV

(1) The present convention shall remain in force for not less than three years after the date of its coming into force.

(2) If, not less than six months before the expiration of such period of three years, neither of the contracting parties shall have given to the other contracting party, through diplomatic channels, written notice of its intention to terminate the present convention, the convention shall remain in force after such period of three years until either of the contracting parties shall have given written notice of such intention, in which event the present convention shall not be effective as to the estates of persons dying on or after the date (not being earlier than the sixtieth day after the date of such notice) specified in such notice, or, if no date is specified, on or after the sixtieth day after the date of such notice.

IN WITNESS WHEREOF the above-mentioned plenipotentiaries have signed the present convention and have affixed thereto their seals.

DONE at Cape Town, in duplicate, in the English and Afrikaans languages, the tenth day of April, 1947.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:
T. HOLCOMB [SEAL]

FOR THE GOVERNMENT OF THE UNION OF SOUTH AFRICA:
J. C. SMUTS [SEAL]

SUPPLEMENTARY PROTOCOL

ARTICLE I

Article VIII of the convention signed April 10, 1947, relating to taxes on the estates of deceased persons, is amended by deleting paragraph (4) and substituting the following:—

"(4) The assistance provided for in this article shall not be accorded in respect of any citizen or national, or the estate of any citizen or national, of the contracting party to which application is made except where such citizen or national or estate is entitled to the allowance of a credit under Article V of the present convention."

ARTICLE II

1. This protocol shall be ratified and the instruments of ratification thereof shall be exchanged at Washington as soon as possible.

2. This protocol shall become effective and continue effective in accordance with Article XIII of the convention of April 10, 1947, and, in the event of termination of such convention, shall terminate simultaneously with such convention.

IN WITNESS WHEREOF the undersigned plenipotentiaries, being authorized thereto by their respective Governments, have signed this protocol and have affixed thereto their seals.

Done in duplicate, in the English and Afrikaans languages, at Pretoria this the fourteenth day of July, 1950.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:
[SEAL] BERNARD C. CONNELLY
Chargé d'Affaires ad interim of the United States of America.

FOR THE GOVERNMENT OF THE UNION OF SOUTH AFRICA:
[SEAL] P. O. SAUER
Minister of Transport of the Union of South Africa.

UNITED STATES-UNITED KINGDOM INCOME TAX SUPPLEMENTARY PROTOCOL

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 has the sole purpose of modifying the territorial-extension provisions of, and is to be regarded as an integral part of, the convention signed at Washington, D. C., on April 16, 1945, as modified by the supplementary protocol signed at Washington on June 6, 1946, C. B. 1947-1, 209. This supplementary protocol, signed at Washington on May 25, 1954, was approved for ratification by the United States Senate on August 20, 1954. It was ratified by the President on September 22, 1954, and by the United Kingdom on December 21, 1954. The instruments of ratification were exchanged at London on January 19, 1955, and the President proclaimed the supplementary protocol on January 28, 1955.

The supplementary protocol reads as follows:

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, have agreed as follows:

ARTICLE I

Paragraph (1) of Article XXII 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 is hereby amended to read as follows:

"(1) Either of the contracting parties may, at any time while the present convention continues in force, by a written notification given to the other contracting party through the diplomatic channel, declare its desire that the operation of the present convention, either in whole or in part or with such modifications as may be found necessary for special application in a particular case, shall extend to all or any of its territories for whose international relations it is responsible, which impose taxes substantially similar in character to those which are the subject of the present convention. When the other contracting party has, by a written communication through the diplomatic channel, signified to the first contracting party that such notification is accepted in respect of such territory or territories, the present convention, in whole or in part or with such modifications as may be found necessary for special application in a particular case, as specified in the notification, shall apply to the territory or territories named in the notification on and after the date or dates specified therein. None of the provisions of the present convention shall apply to any such territory in the absence of such acceptance in respect of that territory."

ARTICLE II

This supplementary Protocol, which shall be regarded as an integral part of the said Convention, shall be ratified and the instruments of ratification thereof shall be exchanged in London.

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 twenty-fifth day of May, 1954.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

[SEAL] JOHN FOSTER DULLES
Secretary of State of the United States of America

FOR THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND:

[SEAL] ROGER MAKINS
Her Majesty's Ambassador Extraordinary and Plenipotentiary at Washington

SUBPART B.—LEGISLATION

PUBLIC LAW 85-12

EIGHTY-FIFTH CONGRESS, MARCH 29, 1957

[H. R. 4090] [1]

An act to provide a fifteen-month extension of the existing corporate normal-tax rate and of certain excise-tax rates.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Tax Rate Extension Act of 1957".

SEC. 2. FIFTEEN-MONTH EXTENSION OF CORPORATE NORMAL-TAX RATE

Section 11(b) (relating to corporate normal tax), section 821(a)(1)(A) (relating to mutual insurance companies other than interinsurers), and section 821(b)(1) (relating to interinsurers) of the Internal Revenue Code of 1954 are amended as follows:

(1) By striking out "April 1, 1957" each place it appears and inserting in lieu thereof "July 1, 1958";

(2) By striking out "April 1, 1957" each place it apears and inserting in lieu thereof "July 1, 1958";

(3) By striking out "March 31, 1957" each place it appears and inserting in lieu thereof "June 30, 1958";

(4) By striking out "March 31, 1957" each place it appears and inserting in lieu thereof "June 30, 1958".

SEC. 3. FIFTEEN-MONTH EXTENSION OF CERTAIN EXCISE TAX RATES.

(a) EXTENSION OF RATES.—The following provisions of the Internal Revenue Code of 1954 are amended by striking out "April 1, 1957" each place it appears and inserting in lieu thereof "July 1, 1958"—

(1) section 4061 (relating to motor vehicles);

(2) section 5001(a)(1) (relating to distilled spirits);

(3) section 5001(a)(3) (relating to imported perfumes containing distilled spirits);

(4) section 5022 (relating to cordials and liqueurs containing wine);

(5) section 5041(b) (relating to wines);

(6) section 5051(a) (relating to beer); and

(7) section 5701(c)(1) (relating to cigarettes).

(b) TECHNICAL AMENDMENTS.—The following provisions of the Internal Revenue Code of 1954 are amended as follows:

(1) Section 5063 (relating to floor stocks refunds on distilled spirits, wines, cordials, and beer) is amended by striking out "April 1, 1957" each place it appears and inserting in lieu thereof "July 1, 1958", and by striking out "May 1, 1957" and inserting in lieu thereof "August 1, 1958".

[1] House Report No. 52, page 668 this Bulletin; Senate Report No. 183, page 671 this Bulletin.

(2) Section 5134(a)(3) (relating to drawback in the case of distilled spirits) is amended by striking out "March 31, 1957" and inserting in lieu thereof "June 30, 1958".

(3) Subsections (a) and (b) of section 5707 (relating to floor stocks refunds on cigarettes) are amended by striking out "April 1, 1957" each place it appears and inserting in lieu thereof "July 1, 1958", and by striking out "July 1, 1957" and inserting in lieu thereof "October 1, 1958".

(4) Section 6412(a)(1) (relating to floor stocks refunds on automobiles) is amended by striking out "April 1, 1957" each place it appears and inserting in lieu thereof "July 1, 1958", by striking out "July 1, 1957" and inserting in lieu thereof "October 1, 1958", and by striking out "August 10, 1957" each place it appears and inserting in lieu thereof "November 10, 1958".

Section 497 of the Revenue Act of 1951 (relating to refunds on articles from foreign trade zones), as amended, is amended by striking out "April 1, 1957" each place it appears and inserting in lieu thereof "July 1, 1958".

Approved March 29, 1957.

SUBPART C.—COMMITTEE REPORTS

[H. R. 4090] [1]

TAX RATE EXTENSION ACT OF 1957

[House of Representatives Report No. 52, Eighty-fifth Congress, First Session]

[February 7, 1957]

Mr. COOPER, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 4090]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 4090) to provide a 1-year extension of the existing corporate normal-tax rate and of certain excise-tax rates, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

H. R. 4090, as reported by your committee, provides for a 1-year extension of the present corporate income tax rate and the existing rates of certain excises. The rates of these taxes otherwise are scheduled for reduction on April 1, 1957.

The present 52 percent corporate income tax rate, without the 1-year extension provided in the bill, would revert to 47 percent as of the 1st of this April through a reduction in the normal tax rate from 30 percent to 25 percent. The excise tax rates, which without this bill also would be decreased this April, are those on alcoholic beverages, cigarettes, automobiles, and automobile parts and accessories. This bill does not affect excise tax rates which previously were scheduled for reduction this April, but as a result of the Highway Revenue Act of 1956 were extended (along with certain increases) until July 1, 1972. Tax rates previously in extension acts which were extended by the Highway Revenue Act of 1956 are those on gasoline, trucks and buses, and diesel and special motor fuels.

Your committee has agreed to the extension of the present corporate and excise tax rates because of their effect on the Federal budget in the fiscal year 1958. If these rates were not extended it is estimated that there would be a deficit in the fiscal year 1958 of about $500 million.

The President in his budget message after indicating that tax rates are still too high and that we should look forward to further tax reductions as soon as a sound budget policy permits went on to state:

> * * * However, the reduction of tax rates must give way under present circumstances to the cost of meeting our urgent national responsibilities.
>
> For the present, therefore, I ask for continuation for another year of the existing excise tax rates on tobacco, liquor, and automobiles, which, under present law, would be reduced next April 1. I must also recommend that the present corporate tax rates be continued for another year. It would be neither fair nor appropriate to allow excise and corporate tax reductions to be made at a time when a general tax reduction cannot be undertaken.

II. REVENUE AND BUDGET EFFECTS

The revenue effects of your committee's bill for the fiscal years 1957 and 1958, and also on a full year's basis, are shown in table 1. Only the extension of the excise taxes is expected to have any effect on budget receipts in the fiscal year 1957. Under existing law the excise tax reductions would be effective for April, May, and June in the fiscal year 1957, and the collections for the fiscal year 1957 would reflect most of the reductions for these months.

The reduction in corporate taxes under existing law will not be reflected in receipts in fiscal year 1957 because of the lag in corporate tax collections. Most of the revenue effect from extending the present corporate income tax beyond April 1, 1957, will be reflected in the fiscal year 1958, but some effect will carry over into the fiscal year 1959.

If the various excise-tax rates provided for in this bill were not extended until April 1, 1958, refunds of approximately $180 million would have to be paid to

[1] Public Law 85-12, p. 666, this Bulletin.

dealers with respect to their floor stocks, or inventories of taxed articles, on which the rates would be reduced. These refunds would have been paid in fiscal year 1958 if these excise tax rates were not extended; with the 1-year extension provided in this bill, expenditures for these floor-stock refunds will be postponed until the fiscal year 1959.

On a full year's basis the extension of the present corporate rate will increase revenues by $2,075 million and excise taxes by $900 million, making a total full-year effect under the bill of $2,975 million. This is somewhat smaller than the figure indicated in the Tax Rate Extension Act of 1956 because the Highway Revenue Act of 1956 has already extended beyond 1958 certain of the excises which were previously involved in the prior act.

Table 2 shows the effect of your committee's bill on the budgets for the fiscal years 1957 and 1958. Expenditures in the budget as presented by the President for the fiscal years 1957 and 1958 are estimated at $68.9 and $71.8 billion, respectively. Receipts for these years are estimated at $70.6 and $73.6 billion, respectively. These figures reflect a surplus of $1.7 billion in 1957 and $1.8 billion in 1958. As was indicated in table 1, if the present corporate income and excise tax rates were not extended, there would be a loss in revenue of $172 million in the fiscal year 1957 and $2,103 million in the fiscal year 1958. Moreover, if these rates were not extended, floor-stock refunds of above $180 million also would have to be paid during the fiscal year 1958. Thus, the failure to extend these rates would reduce the surplus in the fiscal year 1957 to about $1.5 billion and would result in a deficit of about $500 million in the fiscal year 1958.

TABLE 1.—*Estimated revenue gain from extension of existing corporate and excise tax rates*

[Extension from Apr. 1, 1957, to Apr. 1, 1958]

	Change in rate which would occur without bill	Estimated revenue gain (in millions of dollars)		
		Fiscal 1957	Fiscal 1958	Full-year effect
Corporation income tax	52 to 47 percent normal tax (reduced from 30 to 25 percent).	-----	1, 375	2, 075
Excises:				
Alcohol taxes:				
Distilled spirits	$10.50 to $9 per gallon	40	102	142
Beer	$9 to $8 per barrel	21	64	85
Wine	Various rates	3	7	10
Total, alcoholic beverages	-----	64	173	237
Tobacco taxes: Cigarettes (small).	$4 to $3.50 per 1,000	50	150	200
Manufacturers' excise taxes:				
Passenger cars	10 to 7 percent	51	354	405
Auto parts and accessories	8 to 5 percent	7	51	58
Total, manufacturers' excises.	-----	58	405	463
Total excises	-----	172	728	900
Total, corporate income tax and excises.	-----	172	2, 103	2, 975

NOTE.—Floor-stock refunds of about $180 million will be postponed from the fiscal year 1958 to the fiscal year 1959 by the extension of existing excise tax rates.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation

TABLE 2.—*Effect on the 1957 and 1958 budgets of allowing terminations of rates as scheduled Apr. 1, 1957*

	Fiscal year	
	1957	1958
Budget receipts	$70.6	$73.6
Budget expenditures	68.9	71.8
Budget surplus (+)	+1.7	+1.8
Effect of termination of corporate and excise rates:		
Decrease (−) in tax collection	−.2	−2.1
Payment of floor-stock refunds	-------	−.2
Budget surplus (+) or deficit (−) without extension of rates	+1.5	−.5

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

III. SUMMARY OF BILL

The first section of the bill indicates that this act is to be cited as the "Tax Rate Extension Act of 1957."

Section 2 of the bill extends for 1 year the present 52 percent corporate income tax rate which otherwise is due to revert to 47 percent as of April 1, 1957. The 5 percentage point reduction will occur in the 30 percent normal tax to which all corporate taxable income is subject. The 22 percent surtax, which applies only to income above $25,000, remains unchanged.

The rate extension provided by section 2 in the case of the corporate income tax makes the 52 percent rate applicable to taxable years beginning before April 1, 1958, and a 47 percent rate applicable with respect to taxable years beginning on or after this date. A proration formula, already in section 21 of the Internal Revenue Code, provides for corporations whose taxable years overlap April 1, 1958.

Section 2 extends the present corporate income tax rate not only for ordinary corporations but also for mutual insurance companies and interinsurers.

Section 3 of the bill extends for 1 year the present excise tax rates due to be automatically reduced as of April 1, 1957. These include the excise taxes on distilled spirits, beer, wine, cigarettes, passenger automobiles, and automobile parts and accessories. These excises are described more fully in table 3 which shows the unit of tax and the rates before and after April 1, 1958, under this bill.

TABLE 3.—*Excise tax rates extended until Apr. 1, 1958* [1]

	Unit of tax	Rate extended for period from Apr. 1, 1957, to Mar. 31, 1958	Rate to become effective Apr 1, 1958 [1]
Liquor taxes:			
Distilled spirits	Per proof gallon	$10.50	$9.
Beer	Per barrel	$9	$8.
Wine:			
Still wine:			
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents.
Containing 14 to 21 percent alcohol.	Per wine gallon	67 cents	60 cents.
Containing 21 to 24 percent alcohol.	Per wine gallon	$2.25	$2.
Containing more than 24 percent alcohol.	Per wine gallon	$10.50	$9.
Sparkling wines, liqueurs, cordials, etc.:			
Champagne or sparkling wine.	Per wine gallon	$3.40	$3.
Liqueurs, cordials, etc	Per wine gallon	$1.92	$1.60.
Artificially carbonated wines.	Per wine gallon	$2.40	$2.
Tobacco taxes: Cigarettes	Per 1,000	$4	$3.50.
Manufacturer's excises:			
Passenger cars	Manufacturers' sale price.	10 percent	7 percent.
Auto parts and accessories	Manufacturers' sale price.	8 percent	5 percent.

[1] These rates were increased by the Revenue Act of 1951 and the increases were scheduled to terminate on Apr. 1, 1954. The Excise Tax Reduction Act of 1954 extended these rate increases to Apr. 1, 1955, the Tax Rate Extension Act of 1955 extended these rate increases to Apr. 1, 1956, and the Tax Rate Extension Act of 1956 extended these rate increased to Apr. 1, 1957 The Highway Revenue Act of 1956, in addition to making certain increases, extended the taxes on gasoline, trucks, buses, and truck trailers, and diesel and special motor fuel taxes, which were in the prior extension acts, until July 1, 1972.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

In addition to extending the rates specified above, section 3 of the bill postpones for 1 more year the floor-stock refunds or credits presently effective with respect to stocks of various taxpaid products on hand on April 1, 1956. These floor-stock refunds are available in the case of distilled spirits, wines and beer, cigarettes and automobiles.

Section 3 also extends for 1 year the present drawback of $9.50 per proof gallon for distilled spirits used in the manufacture of medicines, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for beverage purposes. In conformance with the change in the distilled spirits tax, as of April 1, 1958, this drawback under the bill decreases to $8 per proof gallon in order to maintain a net tax of $1 per proof gallon on distilled spirits used for these purposes.

[H. R. 4090]

TAX RATE EXTENSION ACT OF 1957

[Senate Report No. 183, Eighty-fifth Congress, First Session, Calendar No. 178]

[March 25, 1957]

Mr. Byrd, from the Committee on Finance, submitted the following report [To accompany H. R. 4090]:

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[1] Public Law 85–12, p. 666, this Bulletin.

The Committee on Finance, to whom was referred the bill (H. R. 4090) to provide a 1-year extension of the existing corporate normal-tax rate and of certain existing excise-tax rates, having considered the same report favorably thereon with amendments and recommend that the bill do pass.

I. GENERAL STATEMENT

H. R. 4090, as reported by your committee, provides for an extension of the present corporate income tax rate and the existing rates of certain excises for 15 months, or until July 1, 1958. The rates of these taxes otherwise are scheduled for reduction on April 1, 1957.

The present 52 percent corporate income tax rate, without the extension provided in the bill, would revert to 47 percent as of the 1st of this April through a reduction in the normal tax rate from 30 to 25 percent. The excise tax rates, which without this bill also would be decreased this April, are those on alcoholic beverages, cigarettes, automobiles, and automobile parts and accessories. This bill does not affect excise tax rates which previously were scheduled for reduction this April, but as a result of the Highway Revenue Act of 1956 were extended (along with certain increases) until July 1, 1972. Tax rates previously in extension acts which were extended by the Highway Revenue Act of 1956 are those on gasoline, trucks and buses, and diesel and special motor fuels.

Your committee has agreed to the extension of the present corporate and excise tax rates because of their effect on the Federal budget in the fiscal year 1958. If these rates were not extended it is estimated that there would be a deficit in the fiscal year of about $500 million.

The President in his budget message after indicating that tax rates are still too high and that we should look forward to further tax reductions as soon as a sound budget policy permits went on to state:

> * * * However, the reduction of tax rates must give way under present circumstances to the cost of meeting our urgent national responsibilities.
>
> For the present, therefore, I ask for continuation for another year of the existing excise tax rates on tobacco, liquor, and automobiles, which, under present law, would be reduced next April 1. I must also recommend that the present corporate tax rates be continued for another year. It would be neither fair nor appropriate to allow excise and corporate tax reductions to be made at a time when a general tax reduction cannot be undertaken.

Your committee has amended the bill by extending the present rates for 15 months rather than for 12 months as provided in the House bill. This was done so that the new termination date for these corporate and excise rates would coincide with the close of the Government's fiscal year, and thus would parallel the appropriation acts. The Congress will be in a better position to review these tax rates concurrently with the appropriation bills next year.

II. REVENUE EFFECT

The revenue effects of your committee's bill for the fiscal years 1957 and 1958 are shown in table 1. Only the extension of the excise taxes is expected to have any effect on budget receipts in the fiscal year 1957. Under existing law the excise tax reductions would be effective for April, May and June in the fiscal year 1957, and the collections for the fiscal year 1957 would reflect most of the reductions for these months.

The reduction in corporate taxes under existing law would not be reflected in receipts in fiscal year 1957 because of the lag in corporate tax collections. About half of the revenue effect from extending the present corporate income tax beyond April 1, 1957, will be reflected in the fiscal year 1958, and the remaining effect will carry over into the fiscal year 1959.

If the various excise-tax rates provided for in this bill were not extended, refunds of approximately $180 million would have to be paid to dealers with respect to their floor stocks, or inventories of taxed articles, on which the rates would be reduced. These refunds would have been paid in fiscal year 1958 if these excise tax rates were not extended; with the 15 months extension provided in this bill, expenditures for these floor-stock refunds will be postponed until the fiscal year 1959.

TABLE 1.—*Estimated revenue gain from extension of existing corporate and excise tax rates*

[Extension from Apr. 1, 1957, to July 1, 1958]

	Change in rate which would occur without bill	Estimated revenue gain (in millions of dollars)	
		Fiscal year 1957	Fiscal year 1958
Corporation income tax	52 to 47 percent normal tax (reduced from 30 to 25 percent).		1,440
Excises:			
Alcohol taxes:			
Distilled spirits	$10.50 to $9 per gallon	40	142
Beer	$9 to $8 per barrel	21	85
Wine	Various rates	3	10
Total, alcoholic beverages		64	237
Tobacco taxes: Cigarettes (small).	$4 to $3.50 per 1,000	50	200
Manufacturers' excise taxes:			
Passenger cars	10 to 7 percent	51	405
Auto parts and accessories	8 to 5 percent	7	58
Total, manufacturers' excises.		58	463
Total excises		172	900
Total, corporate income tax and excises.		172	3,340

NOTE.—Floor-stock refunds of about $180 million will be postponed from the fiscal year 1958 to the fiscal year 1959 by the extension of existing excise tax rates.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation

The extension of the present corporate rate for the full 15 months will yield $2.6 billion of additional revenue, and the extension of the excise tax rates for 15 months will yield $1.1 billion, giving a total yield of $3.7 billion. About two-thirds of this revenue gain will be reflected in the budget receipts of the fiscal year 1958, while some will carry over into fiscal 1959.

III. AMENDMENTS REJECTED BY THE COMMITTEE

Your committee is desirious of providing relief for small business but the amendments changing the corporate rates offered in the committee do not provide the desired result. Most small businesses are unincorporated, being partnerships or sole proprietorships. Only 10 to 15 percent of the total number of operating businesses are corporations. Your committee sees no justification for tax reduction which would benefit only this small corporate segment and thus discriminate against the many small business firms which are not incorporated. The committee has instructed its staff to repeat its suggestions for small business relief.

Our purpose here is to extend the corporate tax and the excise taxes, which expire on April 1, 1957 so as to prevent a deficit for the fiscal year 1958. If these taxes are not extended, there will be a deficit for the year 1958 in the amount of $500 million on the basis of the present budget.

There were two amendments offered in the committee to change the rates of the corporate tax. One was offered by the Senator from Arkansas, Mr. Fulbright, and the other by the Senator from Alabama, Mr. Sparkman. Three full days of hearings were held to consider the amendments.

Senator Fulbright's amendment retains the present method of levying corporate normal and surtax but substitutes for the present 30 percent normal tax rate a normal rate of 22 percent and for the present surtax rate of 22 percent a

surtax rate of 31 percent. The top normal and surtax rate under this amendment is thereby increased to 53 percent as compared to the 52 percent rate under existing law. This amendment, while reducing the tax on some corporations, will actually increase the tax on others.

Senator Sparkman's amendment provides a graduated tax rate on corporations ranging from 5 percent on taxable incomes not over $5,000 to 55 percent on incomes above $100,000. This amendment would undoubtedly cause many of the larger corporations to break up into small units in order to get the benefit of the lower bracket rates. If this were not done, an additional tax burden would be imposed on the small stockholders of large corporations. Aside from this fact, a graduated corporate tax will discourage the growth of small corporations. It will hurt many corporations desiring to expand and become larger.

The possible revenue effect of the proposed graduated rate amendment cannot be ignored. A revenue estimate was presented which seemed to indicate that the proposal would involve no loss in revenue to the Government. This estimate, however, was based on the assumption that there would be no change in the present corporate structure; that is, that there would be no change in the distribution of corporations by income classes. Your committee believes that this assumption is highly unrealistic. The proposed graduated corporate tax schedule, with an initial rate of 5 percent, would certainly offer an incentive for large corporations to split up and the result would be a serious loss in revenue.

It is argued that since there is a provision in the tax law which grants certain unincorporated enterprises the privilege of being taxed as corporations, any relief granted small corporations would also benefit unincorporated businesses as well. This provision was enacted in 1954 (sec. 1361 of the Internal Revenue Code of 1954) and the regulations on the section have not been issued. There are many problems involved, and corporate accounting may be required. If a partnership or sole proprietorship once elects to be taxed as a corporation, the election is irrevocable and the small firm would hesitate to make this irrevocable election, particularly when there is such uncertainty as to the provision. Your committee does not believe that section 1361 of the Internal Revenue Code, in its present form, offers any assurance that unincorporated businesses would gain the same benefits as corporations under the proposed changes in the corporate tax rates. It would seem unwise to force an unincorporated business to change its manner of doing business in an unincorporated form to gain the tax relief which these amendments would accord only to corporations.

Other amendments, in addition to the two relating to the corporate tax rates, were offered. Your committee feels that the additional amendments require further study. Immediate action on this bill is required since otherwise the excise tax rates involved would be reduced on April 1, 1957. The staff was instructed to give further study to these amendments and report to the Finance Committee.

IV. SUMMARY OF BILL

The first section of the bill indicates that this act is to be cited as the "Tax Rate Extension Act of 1957."

Section 2 of the bill extends for 15 months the present 52 percent corporate income tax rate which otherwise is due to revert to 47 percent as of April 1, 1957. The 5 percentage point reduction will occur in the 30 percent normal tax to which all corporate taxable income is subject. The 22 percent surtax, which applies only to income above $25,000, remains unchanged.

The rate extension provided by section 2 in the case of the corporate income tax makes the 52 percent rate applicable to taxable years beginning before July 1, 1958, and a 47 percent rate applicable with respect to taxable years beginning on or after this date. A proration formula, already in section 21 of the Internal Revenue Code, provides for corporations whose taxable years overlap July 1, 1958.

Section 2 extends the present corporate income tax rate not only for ordinary corporations but also for mutual insurance companies and interinsurers.

TABLE 2.—*Excise tax rates extended until July 1, 1958* [1]

	Unit of tax	Rate extended for period from Apr. 1, 1957, to July 1, 1958	Rate to become effective July 1, 1958 [1]
Liquor taxes:			
Distilled spirits	Per proof gallon	$10.50	$9.
Beer	Per barrel	$9	$8.
Wine:			
Still wine:			
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents.
Containing 14 to 21 percent alcohol.	Per wine gallon	67 cents	60 cents.
Containing 21 to 24 percent alcohol.	Per wine gallon	$2.25	$2.
Containing more than 24 percent alcohol.	Per wine gallon	$10.50	$9.
Sparkling wines, liqueurs, cordials, etc.:			
Champagne or sparkling wine.	Per wine gallon	$3.40	$3.
Liqueurs, cordials, etc	Per wine gallon	$1.92	$1.60.
Artificially carbonated wines.	Per wine gallon	$2.40	$2.
Tobacco taxes: Cigarettes	Per 1,000	$4	$3.50.
Manufacturer's excises:			
Passenger cars	Manufacturers' sale price.	10 percent	7 percent.
Auto parts and accessories	Manufacturers' sale price.	8 percent	5 percent.

[1] These rates were increased by the Revenue Act of 1951 and the increases were scheduled to terminate on Apr. 1, 1954. The Excise Tax Reduction Act of 1954 extended these rate increases to Apr. 1, 1955, the Tax Rate Extension Act of 1955 extended these rate increases to Apr. 1, 1956, and the Tax Rate Extension Act of 1956 extended these rate increased to Apr. 1, 1957. The Highway Revenue Act of 1596, in addition to making certain increases, extended the taxes on gasoline, trucks, buses, and truck trailers, and diesel and special motor fuel which were in the prior extension acts, until July 1, 1972.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

Section 3 of the bill extends for 15 months the present excise tax rates due to be automatically reduced as of April 1, 1957. These include the excise taxes on distilled spirits, beer, wine, cigarettes, passenger automobiles, and automobile parts and accessories. These excises are described more fully in table 2 which shows the unit of tax and the rates before and after July 1, 1958, under this bill.

In addition to extending the rates specified above, section 3 of the bill postpones for 1 more year the floor-stock refunds or credits presently effective with respect to stocks of various taxpaid products on hand on April 1, 1956. These floor-stock refunds are available in the case of distilled spirits, wines and beer, cigarettes and automobiles.

Section 3 also extends for 1 year the present drawback of $9.50 per proof gallon for distilled spirits used in the manufacture of medicines, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for beverage purposes. In conformance with the change in the distilled spirits tax, as of July 1, 1958, this drawback under the bill decreases to $8 per proof gallon in order to maintain a net tax of $1 per proof gallon on distilled spirits used for these purposes.

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

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PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

STATEMENT OF ORGANIZATION AND FUNCTIONS[1]

This material supersedes the statement on organization published at 11 F. R. 177A–22 as Part 600, Subparts A and B; Commissioner's Reorganization Order No. 15, except for paragraph 6 (18 F. R. 4033) [C. B. 1953–2, 505]; and Commissioner's Reorganization Order No. 16 (18 F. R. 4033).[2]

1112 *Service organization*—(1) The Internal Revenue Service is a component part of the Treasury Department. The Service is headed by the Commissioner of Internal Revenue who serves under the direction of the Secretary of the Treasury.

(2) The Internal Revenue Service consists of a National Office in Washington, D. C., and a field organization. The latter consists of nine Internal Revenue Regions, each headed by a Regional Commissioner who reports to the Assistant Commissioner (Operations), and 64 Internal Revenue Districts, each headed by a District Director who reports to a Regional Commissioner. In addition, there are in the field nine Regional Inspectors and nine Regional Counsel, who report to the Assistant Commissioner (Inspection) and the Chief Counsel, respectively, in Washington, D. C.

(3) In administering the alcohol and tobacco tax and appellate functions direct from the Regional Office, the Regional Commissioner maintains and supervises several branch offices. The Alcohol and Tobacco Tax branch offices are headed by Supervisors in Charge who report to the Assistant Regional Commissioner (Alcohol and Tobacco Tax). The Appellate branch offices are headed by Associate Chiefs or Assistant Chiefs, Appellate Division, who report to the Assistant Regional Commissioner (Appellate) who also carries the title of Chief, Appellate Division. The Regional Counsel also maintain and supervise branch offices.

(4) In each Internal Revenue District there are a number of local offices in communities where concentration of workload in audit, collection, or intelligence activities requires the assignment of personnel. There are some 900 local offices.

(5) Location of the Internal Revenue regional and district offices is given in Appendix A. The Alcohol and Tobacco Tax branch offices are shown in Appendix B; and the Appellate branch offices in Appendix C.

[1] 21 F. R. 10418.
[2] Not published in Bulletin.

APPENDIX A

INTERNAL REVENUE REGIONAL OFFICES

Atlanta, Ga., Peachtree-Baker Building, 275 Peachtree Street NE.
Boston, Mass., 55 Tremont Street.
Chicago, Ill., 17 North Dearborn Street.
Cincinnati, Ohio, Post Office Building.
Dallas, Tex., 1114 Commerce Street.
New York, N. Y., 90 Church Street.
Omaha, Nebr., 100 Elks Club Building.
Philadelphia, Pa., 1700 Widener Building.
San Francisco, Calif., Flood Building, 870 Market Street.

INTERNAL REVENUE DISTRICT OFFICES

Birmingham, Ala., 1531 Third Avenue, North.
Phoenix, Ariz., 140 West Monroe Street.
Little Rock, Ark., Post Office and Courthouse Building.
Los Angeles, Calif., U. S. Post Office and Courthouse.
San Francisco, Calif., 100 McAllister Street.
Denver, Colo., 165 New Customhouse.
Hartford, Conn., 460 Capitol Avenue.
Wilmington, Del., Post Office Building.
Jacksonville, Fla., U. S. Post Office Building.
Atlanta, Ga., Peachtree-Baker Building, 275 Peachtree Street.
Honolulu, Hawaii, Federal Building.
Boise, Idaho, 914 Jefferson Street.
Chicago, Ill., 22 West Madison Street.
Springfield, Ill., 621 East Adams Street.
Indianapolis, Ind., U. S. Post Office and Courthouse Building.
Des Moines, Iowa, Courthouse Building.
Wichita, Kans., 412 South Main Street.
Louisville, Ky., 313 Post Office Building.
New Orleans, La., Federal Building, 600 South Street.
Augusta, Maine, 221 State Street.
Baltimore, Md., Customhouse.
Boston, Mass., 174 Ipswich Street.
Detroit, Mich., New Federal Building, 231 West Lafayette Street.
St. Paul, Minn., 610 Post Office and Customhouse Building.
Jackson, Miss., Post Office and Courthouse.
Kansas City, Mo., U. S. Courthouse, 811 Grand Avenue.
St. Louis, Mo., 200 New Federal Building.
Helena, Mont., 209 Federal Building.
Omaha, Nebr., Federal Office Building, 15th and Dodge Street.
Reno, Nev., Post Office Building.
Portsmouth, N. H., 600 State Street.
Camden, N. J., Elks Building, Seventh and Cooper Streets.
Newark, N. J., Industrial Office Building, 1060 Broad Street.
Albuquerque, N. Mex., U. S. Courthouse.
Albany, N. Y., Post Office and Customhouse Building.
Brooklyn, N. Y., 210 Livingston Street.
Buffalo, N. Y., 34 West Mohawk Street, Corner Pearl Street.
New York, N. Y. (lower Manhattan), 245 West Houston Street.
New York, N. Y. (upper Manhattan), 484 Lexington Avenue.
Syracuse, N. Y., Chimes Building, 510 South Salina Street.
Greensboro, N. C., 320 South Ashe Street.
Fargo, N. Dak., Pioneer Mutual Life Building, 203 North 10th Street.
Cincinnati, Ohio, Post Office Building.
Cleveland, Ohio, 626 Huron Road.
Columbus, Ohio, 110 West Long Street.
Toledo, Ohio, U. S. Court and Customhouse.
Oklahoma City, Okla., Federal Building.
Portland, Oreg., 830 Northeast Holladay Street.
Philadelphia, Pa., U. S. Courthouse, Ninth and Chestnut Streets.
Pittsburgh, Pa., Post Office and Courthouse Building.

Scranton, Pa., Post Office and Courthouse Building.
Providence, R. I., 544 Elmwood Avenue.
Columbia, S. C., U. S. Courthouse Building, 1100 Laurel Street.
Aberdeen, S. Dak., Post Office and Courthouse Building.
Nashville, Tenn., 144 Federal Office Building.
Austin, Tex., 314 West 11th Street.
Dallas, Tex., 414 Lynch Building, 2101 Pacific Avenue.
Salt Lake City, Utah, U. S. Post Office and Courthouse.
Burlington, Vt., 80 St. Paul Street.
Richmond, Va., 415 Post Office Building.
Seattle, Wash., 109 Marion Street.
Parkersburg, W. Va., Fourth and Juliana Streets.
Milwaukee, Wis., Federal Building, room 208, 517 Wisconsin Avenue.
Cheyenne, Wyo., Federal Office Building.

APPENDIX B

Alcohol and Tobacco Tax Branch Offices

Location:	*Territory*
Birmingham, Ala., Post Office 320 Federal Bldg_____	Alabama.
Little Rock, Ark., room 65A, U. S. Post Office and Courthouse.	Arkansas.
*Los Angeles, Calif., room 850, Subway Terminal Bldg., 417 South Hill St.	Southern Judicial District of California, Arizona.
San Francisco, Calif, room 1109, 870 Market St_____	Northern Judicial District of California, Nevada, Utah.
*Denver, Colo., room 188, New Customhouse_____	Colorado, Wyoming.
Hartford, Conn., 209 Post Office Bldg_____	Connecticut, Rhode Island.
Jacksonville, Fla., 438 New Post Office Bldg., P. O. Box 4999.	Florida.
Atlanta, Ga., 721 Atlanta Journal Bldg., 10 Forsyth St. NW.	Georgia.
*Honolulu, Hawaii, room 562, Alexandria Young Bldg.	Hawaii.
Chicago, Ill., 17 North Dearborn St., Chicago 2, Ill___	Illinois.
*Louisville, Ky., 406 Federal Bldg_____	Kentucky.
*New Orleans, La., 436 Federal Office Bldg_____	Louisiana.
*Baltimore, Md., 501 Hamburger Bldg., 104 West Baltimore St.	Maryland, Delaware, District of Columbia.
Boston, Mass., 55 Tremont St_____	Massachusetts, Vermont, New Hampshire, Maine.
*Detroit, Mich., 38th floor, Cadillac Tower Bldg., 65 Cadillac Sq.	Michigan.
*St. Paul, Minn., 1033 New Post Office Bldg_____	Iowa, Minnesota, North Dakota, South Dakota.
Jackson. Miss., 141 East Amite St_____	Mississippi.
*Kansas City, Mo., room 2501 Federal Office Bldg___	Western Judicial District of Missouri, Kansas, Nebraska.
*St. Louis, Mo., 738 U. S. Custom and Courthouse___	Eastern Judicial District of Missouri.
*Newark, N. J., 1060 Broad St_____	New Jersey.
*Buffalo, N. Y., 314 U. S. Courthouse, Niagara Sq____	Northern and Western Judicial Districts of New York.
New York, N. Y., 641 Washington St_____	Southern and Eastern Judicial Districts of New York.
Charlotte, N. C., 228 Post Office Bldg_____	North Carolina.
Cleveland, Ohio, room 232, Standard Bldg., 1370 Ontario St.	Indiana, Ohio.

* Denotes combination regulatory and enforcement offices.

Location:	*Territory*
Oklahoma City, Okla., 114 North Broadway	Oklahoma.
Philadelphia, Pa., room 632, 6th floor, Widener Bldg., Juniper and Chestnut Sts.	Eastern and Middle Judicial Districts of Pennsylvania.
*Pittsburgh, Pa., 101 Balcony Fulton Bldg., 107 Sixth St.	Western Judicial District of Pennsylvania.
*San Juan, P. R.	Puerto Rico, Virgin Islands.
Columbia, S. C., 1321 Pendleton St	South Carolina.
Nashville, Tenn., 679 U. S. Courthouse, 801 Broad St.	Tennessee.
Dallas, Tex., room 615, Wholesale Merchants Bldg., 912 Commerce St.	Texas, New Mexico.
*Richmond, Va., 619 Parcel Post Bldg	Virginia.
*Seattle, Wash., 232 U. S. Courthouse, 6th and Madison Sts.	Washington, Oregon, Montana, Idaho, Alaska.
Charleston, W. Va., 318 Embleton Bldg., P. O. Box 2986.	West Virginia.
*Milwaukee, Wis., 560 Federal Bldg	Wisconsin.

*Denotes combination regulatory and enforcement offices.[3]

APPENDIX C

APPELLATE BRANCH OFFICES

Birmingham, Ala., third floor, Calder Building, 1724 Third Avenue, North.
Los Angeles, Calif., room 1250, Subway Terminal Building, 417 South Hill Street.
San Francisco, Calif., room 1010, Flood Building, 870 Market Street.
Denver, Colo., room 406, New Customhouse Building, 19th and California Streets.
New Haven 10, Conn., room 1205, 157 Church Street.
Washington, D. C., room 5559, Internal Revenue Building, 12th and Constitution Avenue NW.
Jacksonville, Fla., 405 Post Office and Courthouse Building.
Miami, Fla., 314 Plaza Building, 245 Southeast First Street.
Atlanta, Ga., Peachtree-Baker Building, 275 Peachtree Street NE.
Chicago, Ill., 17 North Dearborn.
Springfield, Ill., third floor, 618 East Washington.
Indianapolis, Ind., eighth floor, Century Building, 36 South Pennsylvania Street.
Wichita, Kans., Internal Revenue Building, 412 South Main Street.
Louisville, Ky., 410 Federal Building.
New Orleans, La., 444 Federal Office Building, 600 South Street.
Baltimore, Md., fourth floor, Hamburger Building, 104 West Baltimore Street.
Boston, Mass., 919 Houghton-Dutton Building, 55 Tremont Street.
Detroit, Mich., 900 Cadillac Tower.
St. Paul, Minn., W-1681, First National Bank Building, 332 Minnesota Street.
Kansas City, Mo., 1006 Federal Office Building, 911 Walnut Street.
St. Louis, Mo., 751 New Federal Building, 1114 Market Street.
Omaha, Nebr., 100 Elks Club Building, 108 South 18th Street.
Newark, N. J., room 6124, 1060 Broad Street.
Buffalo, N. Y., 330 U. S. Courthouse, Niagara Square.
New York, N. Y., 80 Lafayette Street.
Greensboro, N. C., fifth floor, 320 South Ashe Street.
Cincinnati, Ohio, fifth floor, Faller Building, 106 East Eighth Street.
Cleveland, Ohio, 410 Federal Reserve Bank Building.
Oklahoma City, Okla., 516 Oklahoma Natural Building, 401 North Harvey Street.
Portland, Oreg., room 207, 827 Northeast Oregon Street.
Philadelphia, Pa., 800 Widener Building.
Pittsburgh, Pa., 2304 Clark Building, Seventh and Liberty Avenue.
Columbia, S. C., 424 Palmetto State Life Building, 1310 Lady Street.
Nashville, Tenn., 654 New U. S. Courthouse Building, 801 Broadway.

[3] As added by 22 F. R. 245.

Dallas, Tex., room 520, 1114 Commerce Street.
Houston, Tex., 316 Federal Land Bank Building, 430 Lamar Street.
Salt Lake City, Utah, 504 Dooly Building, 109 West Second South.
Richmond, Va., room 300, 220 North First Street.
Seattle, Wash., 123 U. S. Courthouse Building.
Huntington, W. Va., Post Office Building, Ninth Street and Fifth Avenue.
Milwaukee, Wis., 530 Federal Building, 517 East Wisconsin Avenue.

1113 *National Office.*—

1113.1 *Mission.*—The mission of the National Office is to develop broad nationwide policies and programs for the administration of the internal revenue laws and related status, and to direct, guide, coordinate, and control the endeavors of the Internal Revenue Service.

1113.2 *Basic organization.*—The principal offices which form the National Office are: the Office of the Commissioner; the Office of the Assistant Commissioner (Operations); the Office of the Assistant Commissioner (Technical); the Office of the Assistant Commissioner (Inspection); and the Office of the Chief Counsel.

1113.3 *Office of the Commissioner.*—(1) The Commissioner of Internal Revenue, in conformity with policies and delegations of authority made by the Secretary of the Treasury, develops the policies and administers the activities of the Internal Revenue Service.

(2) The Office of the Commissioner consists of the Commissioner's immediate office, which includes the Deputy Commissioner and the Technical Advisor to the Commissioner; the office of Assistant to the Commissioner; the office of the Administrative Assistant to the Commissioner; the Fiscal Management Division; the Public Information Division; and the Director of Practice.

1113.31 *Deputy Commissioner.*—The Deputy Commissioner assists and acts for the Commissioner in planning, directing, coordinating and controlling the policies and programs and in giving [4] executive leadership to the activities of the Internal Revenue Service.

1113.32 *Technical Advisor.*—The Technical Advisor reviews and takes final action for the Commissioner on documents of a technical nature prepared for the Commissioner's signature or approval such as proposed regulations, reports on proposed legislation, rulings, correspondence authorizing or relating to litigation, compromises, and reports to the Joint Committee on Internal Revenue Taxation covering refunds or credits of any income, war profits, excess profits, estate, or gift taxes in excess of $100,000.

1113.33 *Assistant to the Commissioner.*—The Assistant to the Commissioner acts as the principal assistant to the Commissioner and Deputy Commissioner in the advance research and program and management planning activities of the Internal Revenue Service, and in the performance of related duties. These duties include long-range program planning to anticipate the course to be taken by the Service in view of economic and scientific developments; more immediate planning to recommend adjustments in program emphasis in view of changing legislation or circumstances; the handling of special problems and the making of related studies, such as the conduct of Service-wide surveys germane to important policy matters; the furnish-

[4] Originally published in 21. F. R. 10418 as "diverting." Correction appears in 22 F. R. 643.

ing of guidance and the coordination of management programs and projects having Service-wide application; the preparation of reports required by congressional committees, as assigned by the Commissioner or Deputy Commissioner, and the preparation of other reports and policy statements relating to revenue administration; the general coordination of congressional liaison matters; general direction of the system of operational reports of the entire Service; analysis of the status of the Service's operating programs and the preparation of reports thereon for the Commissioner and the Deputy Commissioner; and supervision of the statistical programs of the Service, including the review of statistical releases. He is responsible for and supervises the activities of the Planning Staff and the Statistics Division.

1113.331 *Planning Staff.*—The Planning Staff carries on the long-range planning essential to charting the future course of the Service in light of major economic and scientific developments; makes more immediate studies leading to recommendations for adjustments in program or program emphasis required by the enactment of new legislation or changed circumstances; assists in the solution of special problems such as problems of various tax associations and organizations; prepares official reports and statements reflecting the Service's accomplishments and position on various tax policy matters; participates in certain phases of legislation preparation and presentation of legislative proposals to the appropriate congressional groups; conducts continuing review and analysis of results of the Service's operating programs and prepares special reports thereon to the Commissioner and the Deputy Commissioner; reviews the Service's entire system of operating reports and develops plans for its revision and improvement; coordinates organization planning and advises and makes recommendations to the Commissioner thereon; furnishes guidance for and coordinates management programs and projects having Service-wide application; and administers the Service's internal management document system.

1113.332 [5] *Statistics Division.*—The Statistics Division conducts research and prepares statistics with respect to the operation of the income tax laws as required annually by the Internal Revenue Code to provide basic information for tax studies and legislation by the Congress and its committees, for administrative use by the Secretary of the Treasury and the Commissioner of Internal Revenue, and for the Federal benchmark statistical programs on income, wealth, and finance; develops, analyzes, and prepares other periodic and special reports on the operation of the Internal Revenue Service for management purposes; and performs other related research and statistical functions. The Division furnishes technical guidance and direction to all statistical programs of the Service, including the work performed for the Division in Service Centers. The Division consists of the Income, Finance, and Wealth Branch, the Program Analysis and Reports Branch, and the Operations Branch.

1113.3321 [5] *Income, Finance, and Wealth Branch.*—The Income, Finance, and Wealth Branch performs statistical and economic research with respect to the operation of the income tax laws as required by the Internal Revenue Code. It identifies and analyzes actual and prospective needs of users of income, wealth, and financial data re-

[5] As amended. 22 F. R. 4873.

ported on tax returns. The Branch plans, evaluates, and modifies these needs to develop an integrated statistical program. It translates that program into adequate specification for collection and compilation of the data. It interprets, analyzes, and presents the resulting statistics through publications of the Internal Revenue Service, such as the "Statistics of Income" series, and in consultation with appropriate policy and management officials.

1113.3322 [5] *Program Analysis and Reports Branch.*—The Program Analysis and Reports Branch performs statistical and economic research with respect to periodic and special reports on the operations of the Internal Revenue Service. It identifies and analyzes actual and prospective needs of management officials and others to provide a centralized or coordinated statistical reporting system for the Internal Revenue Service. The Branch evaluates and modifies these needs to develop an integrated statistical program to measure administrative accomplishments for management review and action. It translates that program into adequate specifications for collection and compilation of the data. It interprets, analyzes, and presents the resulting statistics through published reports and in consultation with appropriate policy and management officials. The Branch conducts research in and develops appropriate sampling, estimating and other statistical procedures and develops and establishes statistical procedures and develops and establishes statistical policies and standards.

1113.3323 [5] *Operations Branch.*—The Operations Branch translates the statistical specifications into operating procedures and produces the statistics required by the program of the Division. It conducts research in the development and adaptation of equipment and procedures to improve operations and evaluates the statistics produced in terms of specifications, costs, and procedures.

1113.34 *Administrative Assistant to the Commissioner.*—The Administrative Assistant to the Commisisoner acts as the principal assistant to the Commissioner and the Deputy Commissioner in planning and coordinating the functions of personnel management, training, procurement and supply of facilities, services and property, and printing and reproduction. He is responsible for the development and establishment of Service policies, procedures, and standards governing those functions. He supervises the Operating Facilities Division, Personnel Division, and Training Division.

1113.341 *Operating Facilities Division.*—The Operating Facilities Division develops, coordinates, and evaluates the policies and programs for providing essential operating facilities and administrative services and carries them out in the National Office, and exercises the authority to settle claims arising out of the activities of the Internal Revenue Service under the Federal Tort Claims Act. The Division is responsible for procurement and contracts, property and supply utilization, records management, document and physical security, printing and distribution and other similar administrative services. It develops the standards and procedures necessary for the effective performance of those functions throughout the Service. This Division consists of the following branches: Administrative Serv-

[5] As amended. 22 F. R. 4873.

ices Branch, Physical and Document Security Branch, Publications Branch, and Records Administration Branch.

1113.3411 *Administrative Services Branch.*—The Administrative Services Branch develops and coordinates the policies relating to an administrative services program for the Internal Revenue Service, involving the procurement and management of space, property, transportation and communications. It provides all administrative services for the National Office, and acts for the Internal Revenue Service in all liaison with Government regulatory agencies, such as General Services Administration, in coordinating and implementing Government-wide policies and procedures governing administrative services.

1113.3412 *Physical and Document Security Branch.* The Physical and Document Security Branch develops and coordinates the physical and document security program for the Internal Revenue Service, including civil defense, protection of documents and property, safety, and employee identification. It discharges the responsibilities of the Internal Revenue Service in connection with claims under the Federal Tort Claims Act.

1113.3413 *Publications Branch.*—The Publications Branch is responsible for the administration and execution of the Internal Revenue Service printing program; directs and plans the production, storage, distribution and standardization of Internal Revenue Service publications; develops policies, procedures and standards for Internal Revenue Service field printing establishments and contract field printing; and represents Internal Revenue Service in liaison with printing regulatory agencies in interpreting, coordinating and administering Government-wide printing and publication policies.

1113.3414 *Records Administration Branch.*—The Records Administration Branch develops and coordinates the policies, procedures, and standards for a Service-wide records management program. It coordinates the review and control of all Service forms, and represents Internal Revenue Service on records administration activities in all liaison with National Archives and Records Service of the General Services Administration and other Government agencies.

1113.342 *Personnel Division.*—The Personnel Division develops, coordinates, and evaluates the personnel policies and programs of the Service and carries them out in the National Office. The Division is responsible for the recruitment, placement, and evaluation of qualifications of employees, position classification and wage administration, employee incentives, performance rating, and employee discipline programs. It develops the standards and procedures necessary for the effective performance of these functions throughout the Service. It also carries out the personnel program for employees of the National Office. The Division consists of the following branches: Position Classification Branch, Placement Branch and Departmental Personnel Branch.

1113.3421 *Position Classification Branch.*—The Position Classification Branch develops and coordinates policies, programs and standards for the position classification and incentive awards programs. It classifies positions for which authority has not been delegated to Regional Commissioners or the Departmental Personnel Branch. The Branch processes contributions for incentive awards requiring Na-

tional Office approval. It prepares wage schedules for wage board jobs.

1113.3422 *Placement Branch.*—The Placement Branch develops and coordinates policies and programs relating to recruitment, placement, qualification standards, performance evaluation and separation of employees; management-employee relations; discipline, grievances, suspensions and appeals; rules of conduct; personnel records and files; leave, retirement, insurance and social security; and hours of duty. It provides services in processing, reviewing, and making recommendations in individual cases involving field positions which require the approval of the National Office or Treasury Department.

1113.3423 *Departmental Personnel Branch.*—The Department Personnel Branch is responsible for the operation of the personnel program to meet the needs of the National Office.

1113.343 *Training Division.*—The Training Division develops, coordinates, and evaluates the training policies and programs of the Service. The Division plans or assists in the planning of training activities and carries out the training program for employees of the National Office. It conducts or assists in the conduct of training of all types. The Division consists of two branches: Training Program Branch and Training Services Branch.

1113.3431 *Training Program Branch.*—The Training Program Branch develops, in cooperation with National Office and regional officials, training policies and program objectives for guidance of field and departmental training activities; provides staff leadership in determining training needs and recommending appropriate means of meeting these needs; evaluates effectiveness of field and departmental training administration; insures adequate uniformity and balance within established training programs; advises on training methods and techniques; prepares special reports; and compiles program information. It also carries out the executive development program at the national level and the training program for employees of the National Office.

1113.3432 *Training Services Branch.*—The Training Services Branch edits and coordinates the preparation and issuance of textual materials and training aids for national use in conducting special courses; issues syllabi, course outlines, conference leaders guides; distributes course materials; conducts correspondence courses on centralized basis; and provides clerical support for Division activities.

1113.35 *Fiscal Management Division.*—The Fiscal Management Officer serves as the chief advisor to the Commissioner, the Deputy Commissioner, and the principal assistants on all matters concerning budget and the fiscal management of funds appropriated for the administration of the Internal Revenue Service. He is responsible for the development and coordination of budgetary policies and programs. He develops and assists in the justification of the Service's budget; advises on its execution; establishes policies and procedures covering the accounting system for appropriated funds; and directs the budget and fiscal activities carried out at the National Office in connection with his responsibilities. The Division consists of two branches: Accounting Branch and Budget Branch.

1113.351 *Accounting Branch.*—The Accounting Branch develops, prescribes, and installs the Service's financial accounting system and the financial reporting system to produce timely and accurate data for budgetary and fiscal management purposes.

1113.352 *Budget Branch.*—The Budget Branch develops the Service's budget in conformance with the established overall program policies through consultation a nd cooperation with the responsible operating officials. It prescribes budget procedures and directs the preparation of budget estimates for the Service; participates in the development of standards for the measurement of work necessary in the justification of estimates or the evaluation of financial plans; prepares requests for the apportionment and reapportionment of appropriations; allots funds in accordance with the approved financial plan and properly authorized revisions thereof; and establishes the procedures, records and reports necessary to properly reflect the execution of the budget.

1113.36 *Public Information Division.*—The Public Information Division develops and coordinates the policies and program for providing information to the public to improve general knowledge and understanding of the Federal tax laws and their administration, and to increase voluntary compliance with the tax laws. This Division carries out the public information program at the National Office.

1113.37 *Director of Practice.*—The Director of Practice processes the applicants to practice before the Treasury Department, except those relating to customhouse brokers. He is also responsible for the consideration of and action upon charges that any enrolled person has violated any provision of the laws or regulations governing practice before the Department.

1113.4 *Office of Assistant Commissioner (Inspection).*—The Assistant Commissioner (Inspection) acts as the principal assistant to the Commissioner in planning and carrying out the inspection program of the Internal Revenue Service. This includes the independent review and appraisal of all Internal Revenue Service activities as a basis for protective and constructive service to management, and the carrying out of a program for assisting management to maintain the highest standards of honesty and integrity among its employees. The Assistant Commissioner (Inspection) plans and directs the inspection program at both the national and regional levels. At the National Office level he supervises two divisions: The Internal Audit Division and the Internal Security Division.

1113.41 *Internal Audit Division.*—The Internal Audit Division develops, coordinates, and controls the policies and programs for the internal audit of the Internal Revenue Service. The internal audit function provides an independent review and appraisal of all Internal Revenue Service operations. Its objectives are to assure that responsibilities at all organizational levels are properly and effectively discharged, and to provide a basis for constructive action by the Service officials involved. The internal audit programs include the systematic verification and analysis of operating policies, practices, and procedures as well as accounts, financial transactions, and reports. In addition, this Division conducts the internal audit of the National

Office and makes special studies and examinations as requested by the Commissioner or Deputy Commissioner.

1113.42 *Internal Security Division.*—The Internal Security Division develops, coordinates, and controls the internal security policies and programs of the Internal Revenue Service. The internal security program includes investigation of the conduct and character of employees and prospective employees of the Internal Revenue Service to provide management with the facts necessary to assure the highest standards of honesty, integrity, and security. The Division plans, and at the National Office level conducts, a program of formal investigations of accidents involving Revenue employees or property. This Division also carries out the internal security program at the National Office level, and makes such special investigations, studies and inquiries as required for the Commissioner, Office of the Secretary, and agencies outside the Revenue Service. The Division consists of three branches: Security Program Branch, Special Investigations Branch, and Departmental Investigations Branch.

113.421 *Security Program Branch.*—The Security Program Branch performs continuing research into investigative techniques, devises investigative methods and procedures, develops and maintains the internal security policy and procedural instructions, and maintains liaison with other enforcement and intelligence agencies. It reviews reports of investigations to evaluate methods employed, extent of coverage, and form and quality of reports and issues corrective instructions and develops criteria for standard practices. The Branch maintains a national file and control system for all investigations conducted under the internal security program.

1113.422 *Special Investigations Branch.*—The Special Investigations Branch conducts special investigations requiring control and direction at the national level to determine the facts of alleged or suspected situations potentially affecting the maintenance of public confidence in the integrity of the Service. It maintains liaison with regional internal security staffs to coordinate activities and secure uniform practices, and inspects performance and initiates corrective action.

1113.423 *Departmental Investigations Branch.*—The Departmental Investigations Branch conducts security and personnel type investigations of National Office personnel; investigations relating to specified and sensitive positions for appropriate security clearances; and, on assignment, investigations of personnel of other Treasury Department agencies.

1113.5 *Office of Assistant Commissioner (Operations).*—The Assistant Commissioner (Operations) acts as the principal assistant to the Commissioner in planning, managing, coordinating, and directing the operations programs of the Service. These include the collection of taxes, the audit and investigation of returns, criminal fraud and enrollment investigations, the administrative system of tax appeals, the administration of laws relating to alcohol, alcoholic beverages, tobacco and firearms, and the administration of U. S. internal revenue laws in all areas outside of the continental United States and the Territories of Alaska and Hawaii. The Assistant Commissioner (Operations) is responsible for and supervises the activities

of the Alcohol and Tobacco Tax Division, Appellate Division, Audit Division, Collection Division, Intelligence Division, and the International Operations Division of the National Office. In directing the operations programs, he supervises the Offices of Regional Commissioners and allocates funds and personnel made available for the operation of field installations among the offices of the field organization.

1113.51 *Alcohol and Tobacco Tax Division.*—The Alcohol and Tobacco Tax Division develops and evaluates policies and programs with respect to, and administers and enforces the internal revenue laws relating to industrial alcohol, alcoholic beverages, tobacco and tobacco products, certain firearms, tax laws, the Federal Alcohol Administration Act, the Liquor Enforcement Act of 1936 and related laws, and prepares rulings under these laws. This Division consists of four branches: Permissive Branch, Basic Permit and Trade Practice Branch, Enforcement Branch, and Tobacco Tax Branch.

1113.511 *Permissive Branch.*—The Permissive Branch develops and evaluates policies, programs, regulations and procedures for the administration of internal revenue laws relating to the lawful production, rectification, storage, packaging, tax payment, sale and use, of alcoholic beverage and nonbeverage products, and for the issuance of rulings on these matters. It is responsible for the development of programs, policies and methods governing on-premises supervision and control of industry operations with a view toward protecting the revenue.

1113.512 *Basic Permit and Trade Practice Branch.*—The Basic Permit and Trade Practice Branch develops and evaluates policies, programs, regulations and the procedures for administering the provisions of the Federal Alcohol Administration Act which includes the approval of labels, enforcement of regulations governing advertising and prohibitions against interlocking directorates, general trade practices and questions arising under the Twenty-First Amendment of the Constitution. This Branch also develops the policies and program relating to the issuance, suspension, revocation and annulment of basic permits.

1113.513 *Enforcement Branch.*—The Enforcement Branch develops and evaluates policies, programs, and procedures for the investigation, detection and prevention of violations of the internal revenue laws relating to liquors and tobacco, the National and Federal Firearms Acts, the Federal Alcohol Administration Act and the Liquor Enforcement Act of 1936.

1113.514 *Tobacco Tax Branch.*—The Tobacco Tax Branch develops and evaluates policies, programs, regulations and procedures for the administration of internal revenue laws relating to the manufacture, packaging, tax payment, removal, and sale of leaf and other forms of tobacco materials, tobacco products, and cigarette papers and tubes; and is responsible for the issuance of rulings on these matters.

1113.52 *Appellate Division.*—The Appellate Division develops policies, programs, and procedures relating to the disposition of all income, profits, estate, gift, excise (other than alcohol, tobacco, narcotics, firearms, and wagering), and employment tax cases, including administrative appeals on offers in compromise, and refund claims

and overassessment cases, in which the determination of a District Director has been protested, or determinations made the subject of a petition for review by the Tax Court; reviews and approves final closing agreements for past taxable years; and exercises executive direction of the Excess Profits Tax Council. The Division also is responsible for programs and procedures relating to the final review for the Commissioner in cases involving overassessments or overpayments in excess of $100,000 requiring review by the Chief Counsel or the Joint Committee on Internal Revenue Taxation. This Division consists of the Excess Profits Tax Council and four branches: Final Closing Agreement Branch, Settlement Analysis Branch, Operations Analysis Branch, and Special Services Branch.

1113.521 *Final Closing Agreement Branch.*—The Final Closing Agreement Branch reviews all cases involving closing agreements under section 7121 of the Internal Revenue Code of 1954 (and the corresponding provision of the 1939 Code) relating to the amount of tax liability for past years or specific matters involved in returns already filed in which a recommendation for acceptance of the agreement is made by a District Director or an Assistant Regional Commissioner (Appellate). It is responsible for the approval of the action recommended in such cases prior to formal acceptance by the Commissioner. The Branch also performs processing functions in cases involving final closing agreements relating to prospective transactions and other specific matters affecting returns to be filed.

1113.522 *Settlement Analysis Branch.*—This Branch examines selected cases closed in regional Appellate Divisions to: (a) Determine whether current Service policies and procedures are being consistently and uniformly followed, and to promote uniform treatment of technical issues; (b) develop factual data for the improvement, simplification, and standardization of regional operations; (c) disclose at their inception unusual types of cases, circumstances, or trends in order that policies may be developed in the early stages to meet new conditions; and (d) supply information that will be helpful in the planning and programming of regional Appellate activities.

113.523 *Operations Analysis Branch.*—The Operations Analysis Branch develops essential statistical management and planning information and prepares comparative and other reports from studies and analyses of regular and special statistical reports on the operations of the Regional Appellate Divisions. It designs new reports and makes studies of existing reports for the purpose of increasing effectiveness of and simplifying statistical reporting system.

1113.524 *Special Services Branch.*—The Special Services Branch furnishes specialized advice and assistance to the National Office and regional offices on highly complex engineering and valuation problems and furnishes expert witnesses in trials of tax cases.

1113.525 *Excess Profits Tax Council.*—The Excess Profits Tax Council exercises, for the Commissioner, final authority in respect to all issues arising under section 722 of the Internal Revenue Code of 1939. The Council issues rulings of general application relating to the administration and interpretation of section 722 and makes the final determination for the Commissioner with respect to the section 722 issues in each case in which a claim for relief has been filed under

that section, including cases in which a petition for review has been filed with the Tax Court.

1113.53 *Audit Division.*—The Audit Division develops, coordinates, and evaluates policies and programs for the examination of tax returns to establish the correct tax liabilities of taxpayers and for the conduct of assistance and educational activities to maintain the maximum possible level of voluntary compliance with the internal revenue laws. Its functions include programming with respect to the selection of returns for audit; the examination and investigation of such returns, the determination of tax liabilities, and penalties where applicable; the disposition of offers in compromise; and the maintenance of district and regional uniformity in technical and procedural areas. The Division consists of three branches; Audit Program Branch, Audit Operations Branch and Compromise Branch.

1113.531 *Audit Program Branch.*—(1) The Audit Program Branch plans and develops the nationwide audit program. It conducts continuing studies of audit policy and recommends policy changes, adjustments, and revisions to improve the audit program. It plans and develops systems, methods, and procedures for the effective performance of audit activities.

(2) The Branch evaluates performance of the audit program and the results obtained. To this end, it establishes standards for determining effectiveness of audit operations, and measures progress against these standards. It analyzes management reports and other activity reports, the results of which serve as a basis for program planning and policy determination.

1113.532 *Audit Operations Branch.*—The Audit Operations Branch performs all operating functions of the Division at the National Office level, except those relating to offers in compromise. It processes special feature cases, including those involving overassessments recommended for allowance by field offices which require approval by the National Office, Chief Counsel or the Joint Committee on Internal Revenue Taxation. It determines or recomputes the tax liabilities in special cases under consideration by the Chief Counsel or the Department of Justice. It computes the amount of adjustments to tax liabilities on which interest is to be restricted in World War II excess profits tax cases. The Audit Operations Branch also administers the publicity provisions of the law and regulations governing applications to inspect or receive copies of returns by congressional committees or other United States Government agencies and State governments and services requests for returns in the custody of the National Office. It administers the program for the exchange of data with foreign governments in the estate tax cases, and maintains donor card records in gift tax cases.

1113.533 *Compromise Branch.*—The Compromise Branch reviews cases involving offers in compromise of unpaid taxes in amounts of $5,000 or more recommended for acceptance by field offices prior to consideration by the Chief Counsel and the Commissioner, and provides technical assistance and advice to field offices on compromise cases. This Branch also conducts a continuing analysis of the condition and effectiveness of compromise programs in the field.

1113.54 *Collection Division.*—The Collection Division develops, coordinates and evaluates policies, programs and procedures for reve-

nue collection and accounting, including the collecting of delinquent accounts and the securing of delinquent returns. The Collection Division consists of four branches: Collection Analysis Branch, Collection Planning Branch, Collection Procedures Branch, and Collection Operations Branch. The Division has program responsibility for the Service Centers.

1113.541 *Collection Analysis Branch.*—The Collection Analysis Branch evaluates and guages the effectiveness of all collection programs and recommends improvements. This function includes the conduct of a program of on-site review of regional operations and developing and analyzing revenue, workload and productivity reports.

1113.542 *Collection Planning Branch.*—The Collection Planning Branch develops the collection, accounting and processing policies and programs. It analyzes new internal revenue legislation and regulations to determine their effect on present policies and programs. The Branch also confers with industry representatives and engineers on development, design, and application of electronic and mechanical accounting and processing equipment, and office systems and evaluates new office equipment, techniques, and mechanized systems with a view toward modernization, simplification and general improvement of collection operations. It supervises pilot tests of experimental or improved systems and mechanical equipment and participates in the installation of new types of equipment in district offices. The Branch also develops and recommends production programs to accomplish the completion of the annual workload efficiently, in planned sequence, and by pre-established dates.

1113.543 *Collection Procedures Branch.*—The Collection Procedures Branch develops and reviews systems, methods and procedures in all phases of collection activity relative to the receipt and processing of tax returns and payments, accounting for the internal revenue, collecting delinquent accounts, and securing delinquent returns.

1113.544 *Collection Operations Branch.*—The Collection Operations Branch processes all cases requiring approval of the Joint Committee on Internal Revenue Taxation: overassessments of $100,000 or more, adjustments of World War II excess profits tax, adjustments of postwar credit, administrative settlements by the Department of Justice, and all interim allowances in respect to overpayments of tax under section 22 (d) (6) of the 1939 Internal Revenue Code (LIFO). It makes interest computations and prepares assessments involved in these cases. The Branch also performs functions of the National Office relating to disposition of real property acquired by distraint sales, collection of tax by offset of taxpayers' claims filed with other governmental agencies, and offset of tax refunds against debts owing other governmental agencies.

1113.55 *Intelligence Division.*—The Intelligence Division develops and coordinates policies and programs for the conduct and report of investigations of alleged criminal tax law violations, including tax fraud (other than those relating to alcohol, tobacco and certain firearms taxes), racketeer and wagering tax investigations, investigations of applicants for enrollment or of charges against persons who are enrolled to practice before the Treasury Department, and such other special investigations as the Commissioner may direct.

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The Division has two branches, the Intelligence Program Branch and the Intelligence Investigations Branch.

1113.551 *Intelligence Program Branch.*—The Intelligence Program Branch develops, coordinates and evaluates the programs, policies and procedures, on a nationwide basis, for the conduct and report of investigations of alleged criminal tax law violations, including wagering tax violations, and the enrollment and miscellaneous investigative programs. It conducts continuing study of the reporting and investigative functions of the Intelligence Division, in the light of changing legislation and policies and technical and scientific aids in investigative work to improve effectiveness and insure a balanced enforcement effort. The Branch also initiates recommendations for changes in law and policy, operating instructions, guides, manuals and forms to improve intelligence operations. The Branch develops management reports to provide statistical data for evaluation, and receives and analyzes such data as reported. It represents the Director in matters concerning publicity relating to overall Intelligence activities.

1113.552 *Intelligence Investigations Branch.*—The Intelligence Investigations Branch analyzes selected final investigation reports of alleged criminal tax law violations, including tax fraud, and of enrollment cases to (a) obtain nationwide uniformity of application of procedures and recommendations with respect to prosecution and civil penalties; (b) record enforcement data; (c) identify areas in which the tax fraud program may be improved; and (d) aid the field in the proper disposition or settlement of cases. This Branch also analyzes selected enrollment reports for the general purposes enumerated above. This Branch coordinates investigational activities in selected tax fraud interregional cases or cases of national importance and may exercise direct control over cases which, because of their importance or nature, are investigated by special agents working under the direct supervision of the National Office. This Branch keeps field offices currently posted on changes in policies, court decisions, new investigative methods and techniques and tax law violation areas and evasion methods. It participates in the initiation of recommendations to change laws or policies with a view to improving operations. It develops official sources of information and receives and appropriately disposes of information recevied from informants and official sources regarding alleged violations of tax law (within Intelligence jurisdiction) and violations of enrollment regulations. This Branch works closely with the Intelligence Program Branch in the development of new and improved techniques, guides and operating instructions. It maintains such Intelligence records and files as are necessary to implement the program of the Intelligence Division and to prepare reports on status, progress and results of investigations.

1113.56 *International Operations Division.*—The International Operations Division administers the internal revenue laws (except those relating to alcohol, tobacco and firearms) in all areas of the world outside the continental United States except Alaska and the Territory of Hawaii. This includes the initiation and development of policies and programs designed to establish and maintain satisfactory levels of voluntary tax compliance among United States taxpayers abroad. The Division is responsible in its area of jurisdiction

for the determination of tax liability, the assessment of the correct liability, and the investigation of certain internal revenue tax laws (except those relating to alcohol, tobacco, and firearms); and the collection of internal revenue taxes. It coordinates with foreign governments tax cases involving specific issues with such governments and takes final approval action for the Service under tax treaty provisions. It acts as a service organization to other operational components of the Internal Revenue Service in conducting or coordinating investigations in, and obtaining information from, foreign countries and United States possessions; and coordinates and maintains close liaison with the State, Defense, Commerce and Interior Departments and other Federal agencies in all matters affecting Service operations abroad. The Division has three branches: Collection Activities, Field Operations, and Technical and Audit.

1113.561 *Collection Activities Branch.*—The Collection Activities Branch receives all tax returns and related work items accruing from the international program (except Puerto Rico and the Virgin Islands), including all alien returns and all withholding returns filed by agents making income payments to foreign addresses; processes such returns; accepts and deposits remittances received with all such returns; performs all accounting operations incident to the control of these returns, including the issuance of bills, processing of claims, scheduling of refunds and maintenance of general ledger; approves applications of nonresident taxpayers for extensions of time for filing returns and paying taxes; administers the provisions of tax treaties authorizing the automatic and other exchange of tax information between the United States and foreign countries; administers section 6316 of the 1954 Code authorizing, under certain conditions, the acceptance of foreign currencies in payment of United States tax liabilities; collects delinquent accounts of taxpayers residing abroad; also collects, under applicable provisions of certain tax treaties, delinquent taxes which aliens residing in the U. S. owe to a treaty country; develops, in conjunction with appropriate National Office personnel, policies and procedures relating to the collection of delinquent tax from citizens abroad and nonresident aliens; and maintains liaison with the State and Defense Departments and the Bureau of Accounts concerning collection matter.

1113.562 *Field Operations Branch.*—The Field Operations Branch coordinates the work programs and other activities of the foreign and Canal Zone posts, and the audit activities of the Puerto Rico Office; conducts investigations and holds necessary conferences abroad in the more difficult audit, delinquency and evasion cases, and in other cases requiring personal contact overseas; considers, and in appropriate instances takes final action on, cases having issues involving foreign governments; and plans programs and coordinates all other operational matters of the international program which must be performed by personnel assigned permanently or detailed temporarily to duty outside the continental United States, with the exception of Hawaii and Alaska.

1113.563 *Technical and Audit Branch.*—The Technical and Audit Branch provides guidance or takes final action on all technical matters

involving tax liability determinations under the income, estate, gift, and other provisions of the Internal Revenue Code, and under tax treaty provisions; audits returns and claims filed by nonresident citizens and aliens, except those requiring personal contact or field investigation abroad; coordinates all income tax returns filed or due to be filed by foreign corporations, and estate and gift tax returns filed by or for nonresident citizens and aliens, refers appropriate returns to district offices for necessary action, and in other cases, audits the returns; reviews and passes upon all reports involving tax determination, claims, offers in compromise, etc., originating in the Division; holds taxpayer conferences and considers protests; prepares statutory notices and issues determination and other letters to taxpayers; develops, in conjunction with other National Office personnel, legislative proposals, regulations, policies, procedures and forms affecting aliens and citizens abroad; and reviews proposed tax treaties.

1113.6 *Office of Assistant Commissioner (Technical).*—The Assistant Commissioner (Technical) acts as the principal assistant to the Commissioner in providing basic principles and rules for the application of the tax laws (other than alcohol, tobacco and certain firearms taxes). His duties include the preparation and issuance of rulings and advisory statements to the public and Revenue officials, the preparation of regulations and other tax guide materials, technical advice and assistance in the preparation and issuance of tax forms, the direction of programs for clarification and simplification of tax rules and the negotiation of tax treaties and agreements with foreign governments. He also is responsible for providing technical assistance in programs for legislative revision and providing other technical services required in connection with revenue administration. The Assistant Commissioner (Technical) is responsible for and supervises the activities of four divisions: International Tax Relations Division, Special Technical Services Division, Tax Rulings Division, and Technical Planning Division.

1113.61 *International Tax Relations Division.*—The International Tax Relations Division engages in the negotiation of tax treaties and agreements with foreign governments. It cooperates with the State Department and with congressional committees in procedures leading to the ratification of such treaties and agreements, and conducts programs for treaty administration and relations with foreign tax officials.

1113.62 *Special Technical Services Division.*—The Special Technical Services Division conducts a program of coordinated technical services which includes the preparation and issuance of replies to all communications which relate to general technical information, provides technical precedents and reference material, and conducts special studies of tax problems and initiates action on major issues in order to reduce areas of controversy, promote uniformity and establish policy guidance. It provides technical advice to District Directors' offices and taxpayers on engineering and valuation aspects of tax determinations. The Division conducts a program for the publication of precedent rulings, decisions and other statements in the Internal Revenue Bulletin. This Division consists of four branches: Technical Reference Branch, Technical Projects Branch, Engineering and Valuation Branch, and Bulletin Branch.

1113.621 *Technical Reference Branch.*—The Technical Reference Branch replies to communications which relate primarily to general technical information. It provides technical precedents and reference material, directs the flow of all technical inquiries and requests for rulings or advice to appropriate technical organization units and also controls the overall correspondence program of the Office of the Assistant Commissioner (Technical).

1113.622 *Technical Projects Branch.*—The Technical Projects Branch conducts special studies of technical tax problems for the purpose of issuing, clarifying, or revising comprehensive precedent or guide materials for the application of tax laws. It also determines and takes necessary action with respect to major issues in order to reduce areas of controversy, to promote uniformity and to establish policy guidance.

1113.623 *Bulletin Branch.*—The Bulletin Branch conducts the program for publication of precedent rulings, decisions, revenue procedures and other materials in the Internal Revenue Bulletin, which includes selection, analysis, correlation and preparation of such materials for publication.

1113.624 *Engineering and Valuation Branch.*—The Engineering and Valuation Branch provides expert advice and guidance on engineering and valuation matters which arise in the issuance of rulings, the drafting of regulations, and in the development of technical policy in general. The Branch renders technical advice and other assistance, by special assignment, to the Regional Commissioners and District Directors, provides instructions, procedures, and principles for the guidance of engineering personnel and others, and supplies expert advice in the litigation of cases.

1113.63 *Tax Rulings Division.*—The Tax Rulings Division prepares and issues rulings, advisory letters, and tax memorandums on income, excess profits, estate, gift, employment, and withholding taxes, and excise taxes (other than alcohol, tobacco and certain firearms taxes) for the guidance of taxpayers, Revenue employees, and others. This Division consists of seven branches: Corporation Tax Branch, Employment Tax Branch, Individual Income Tax Branch, Estate and Gift Tax Branch, Pensions and Exempt Organizations Branch, Excise Tax Branch, and Reorganization and Dividend Branch.

1113.631 *Corporation Tax Branch.*—The Corporation Tax Branch issues rulings with respect to the application of Federal income and profits taxes to corporation matters generally. It resolves issues applicable to both corporate and noncorporate taxpayers in the field of amortization of emergency and grain storage facilities (sections 168 and 169 of the Internal Revenue Code); mitigation of effect of renegotiation of war contracts or disallowance of reimbursement (section 1481 of the Internal Revenue Code); LIFO Inventory (section 472 of the Internal Revenue Code); and requests for permission for change in accounting periods and methods.

1113.632 *Employment Tax Branch.*—The Employment Tax Branch issues rulings with respect to the application of the tax imposed by the Federal Insurance Contributions Act, the Railroad Retirement Act, Federal Unemployment Tax Act, and the withholding provisions of the Federal income tax, all of which are included in

Chapters 21–25 inclusive of the Internal Revenue Code. It also issues rulings with respect to the provisions of section 1402 (c) of the Internal Revenue Code providing for certain specific exclusions from the term "trade or business" as defined for purposes of the Self-Employment Contributions Act.

1113.633 *Estate and Gift Tax Branch.*—The Estate and Gift Tax Branch issues rulings with respect to the application of Federal estate and gift taxes, related statutes, and estate and gift tax treaties as to donors and estates.

1113.634 *Excise Tax Branch.*—The Excise Tax Branch issues rulings with respect to all Federal excise taxes other than alcohol, tobacco, and certain firearms taxes. The excise taxes comprise a variety of taxes which may be identified generally as sales taxes imposed upon manufacturers, producers, or importers; sales taxes imposed upon retailers; documentary stamp taxes; admissions, cabaret, and dues taxes; transportation taxes; communications taxes; and miscellaneous excise, occupational, and regulatory taxes.

1113.635 *Individual Income Tax Branch.*—The Individual Income Tax Branch issues rulings with respect to the application of Federal income taxes and related statutes applicable to noncorporate taxpayers (including partnerships, estates and trusts).

1113.636 *Pensions and Exempt Organizations Branch.*—The Pensions and Exempt Organizations Branch issues rulings pertaining to employees' trusts and deferred compensation plans under sections 401 and 402 of the Code and the deductibility of contributions to such plans under section 404 of the Code. It issues rulings with respect to the exemption from tax under sections 501, 502, 521, and 522 of the Code, the taxation of unrelated business income and related matters. It prepares cumulative lists of exempt organizations.

1113.637 *Reorganization and Dividend Branch.*—The Reorganization and Dividend Branch issues rulings with respect to the determination of the taxable status of exchanges and distributions in connection with corporate reorganizations. The Branch also makes determinations with respect to the taxable status of ordinary, liquidating, and stock dividends. If determinations are made in taxability of dividend cases which affect taxpayers in more than one district it is the responsibility of the Branch to arrange for the furnishing of the advice to such districts.

1113.64 *Technical Planning Division.*—The Technical Planning Division conducts a program for issuance and revision of tax regulations, provides technical advice and assistance in the preparation and issuance of tax forms and instructions, develops recommendations for and provides analyses and technical assistance in connection with new or amendatory tax legislation, and provides related services. This Division consists of two branches: Technical Programming Branch and Technical Analysis Branch.

1113.641 *Technical Programming Branch.*—The Technical Programming Branch is responsible for planning the performance of the functions of the Internal Revenue Service with respect to legislation, regulations, and return forms and related instructions to the public. It develops, and keeps currently up-to-date with changing conditions, an overall program and detailed programs coordinated in these three

fields. Its representatives arrange and conduct public hearings on proposed regulations which are held as required by the Administrative Procedure Act. The Branch receives and coordinates the requests from the Secretary's staff and congressional committees for technical assistance on legislation and other matters over which the Division has jurisdiction.

1113.642 *Technical Analysis Branch.*—The Technical Analysis Branch conducts a continuing survey and analysis of areas involving tax abuses, inequities, and recurring controversy, and develops legislative suggestions or regulatory changes for the correction of such problems; prepares formal reports to the Secretary in connection with all pending legislation where the opinion of the Commissioner has been requested; prepares initial drafts of Treasury decisions and regulations; initiates and develops or revises the technical content of all tax return forms, instructions and related documents (other than those relating to alcohol and tobacco taxes); and performs other functions in connection with legislation, regulations, and forms, such as, upon request, supplying technical assistance to the Department, congressional committees, and drafting groups. Employees of the Branch participate in conferences under the Administrative Procedure Act and consider and reply to protests received thereunder.

1113.7 *Office of the Chief Counsel.*—The Chief Counsel, an Assistant General Counsel of the Treasury Department, serves as a member of the Commissioner's executive staff and as counsel and legal officer to the Commissioner on all matters pertaining to the administration and enforcement of the internal revenue laws and related statutes. The several Assistants Chief Counsel under his supervision are: Assistant Chief Counsel (Administration), Assistant Chief Counsel (Claims), Assistant Chief Counsel (Enforcement), Assistant Chief Counsel (Litigation), and Assistant Chief Counsel (Technical).

1113.71 *Assistant Chief Counsel (Administration).*—The Assistant Chief Counsel (Administration) supervises and coordinates all legal management work of the Chief Counsel's Office (the National Office and all field offices); establishes and maintains appropriate standards of professional competence by members of the legal staff of the office and evaluates their legal competence; analyzes the workload of the office, and determines the distribution of personnel available to handle the workload. He exercises general supervision of all matters relating to administration and management in the office of Chief Counsel. Unless the Chief Counsel otherwise designates, he performs the duties of the Chief Counsel during the absence of the Chief Counsel.

1113.72 *Assistant Chief Counsel (Claims).*—The Assistant Chief Counsel (Claims) exercises general supervision over the legal work involving the review of overpayments and overassessments in excess of $100,000; the collection and protection of tax claims and other rights and interest of the United States in proceedings under the Bankruptcy Act; the collection or protection of tax claims of the United States in proceedings in Federal or State receiverships or other insolvencies, assignments for the benefit of creditors, corporate dissolutions, and administration of estates of decedents; and the technical aspects of the general relief provisions of the World War II excess profits tax law and tax problems under provisions of law relating to national defense.

He supervises the work of the Claims Division and the Review Division.

1113.721 *Claims Division.*—The Claims Division supervises and coordinates legal work of Regional Counsel on civil advisory matters (except with respect to those matters specifically delegated to the Civil Division). It reviews certain offers in compromise (except those concerning alcohol, tobacco and firearms). It handles legal work concerning (a) cases under section 77, Chapter X and Chapter XII of the Bankruptcy Act, (b) claims or suits for refund of amounts paid as processing taxes, (c) penal compromises, and (d) the preparation of formal opinions on the above matters. In the cases listed above and in certain civil advisory cases the Claims Division prepares or reviews recommendations to the Department of Justice concerning questions of (a) certiorari, appeal and petition for review, (b) offers in settlement, and (c) waiver or release of a right to redeem under 28 U. S. C. 2410. Similarly, the Claims Division considers recommendations that the Commissioner authorize or sanction affirmative action in (a) insolvency cases (including decedents' estate proceedings), (b) suits for foreclosure of mortgages or other liens and suits to quiet title where the United States is named as a party defendant, and (c) cases involving appointment of a receiver in aid of foreclosure of Federal tax liens.

1113.722 *Review Division.*—The Review Division is responsible for the review of overassessments exceeding $100,000. In such cases, the allowance is reviewed by the Chief Counsel's office, either in the National Office or in the Regional Counsel offices. These cases include overassessments of income, excess profits, estate, gift, and miscellaneous taxes proposed for allowance; and allowances already made of tentative adjustments of income and excess profits taxes. Any deficiencies coupled with such tax reductions under review are likewise subject to review. In certain cases a report is prepared for the Joint Committee on Internal Revenue Taxation required by section 6405 of the Internal Revenue Code.

1113.73 *Assistant Chief Counsel (Enforcement).*—The Assistant Chief Counsel (Enforcement) exercises general supervision over the legal phases of the handling of criminal cases arising out of violations of laws administered by the Internal Revenue Service and legal work with respect to the administration of alcohol, tobacco and certain firearms tax laws, liquor traffic laws, the Federal Alcohol Administration Act, the Liquor Enforcement Act, and the Federal Firearms Acts. He approves for the Service recommendations to the Department of Justice respecting appeals of court decisions in criminal matters; decides whether the Department of Justice should be requested to reconsider any of its decisions against instituting criminal proceedings; and decides the disposition of the criminal aspects of cases wherein Regional Counsel is not in agreement with the Intelligence Division recommendation for criminal prosecution. He supervises the work of the Enforcement Division and the Alcohol and Tobacco Tax Legal Division.

1113.731 *Enforcement Division.*—The Enforcement Division handles and prepares for final decision those criminal tax cases referred to the Chief Counsel by Regional Counsel or by the National Office. The Division also maintains control records with respect to

cases processed in the offices of the Regional Counsel and maintains advisory and technical contact with the regional offices with respect to such cases. It considers cases in which the Regional Commissioner and the Director of the Intelligence Division of the Office of the Assistant Commissioner (Operations) do not concur in recommendations of Regional Counsel involving prosecution. The Division prepares acquiescence memorandums or protest letters on decisions by the Department of Justice or United States Attorneys against prosecution and recommendations to the Department of Justice respecting appeals of court decisions in criminal tax cases. It also prepares law opinions in cases involving penalties or other legal questions with respect to criminal cases or investigations as may be requested by the National Office of the Internal Revenue Service. The Division coordinates with the Department of Justice or interested branches of the Internal Revenue Service any questions involving investigations or actions respecting the civil aspects of pending criminal cases. It reviews and prepares for action enrollee and disbarment cases referred to the Chief Counsel by the Director of Practice, and represents the latter in the trial of cases before Hearing Examiners.

1113.732 *Alcohol and Tobacco Tax Legal Division.*—The Alcohol and Tobacco Tax Legal Division handles the legal work arising in connection with the administration of laws pertaining to alcohol and tobacco taxes and various regulatory laws pertaining to alcohol and firearms, enforcement of which is vested in the Internal Revenue Service, and handles the legal work arising from administrative claims against the United States and Service employees under the Federal Tort Claims Act arising out of acts of Service employees. It maintains general supervision over the legal work involving alcohol and tobacco taxes performed in the office of the Regional Counsel. It provides advisory service in the drafting and reviewing of alcohol and tobacco tax laws; and prepares or reviews regulations issued under the alcohol and tobacco tax laws, and rulings and opinions on alcohol and tobacco tax matters. The Division advises the Regional Counsel, when requested, concerning legal matters considered by them. It handles the legal work in connection with the appeal of cases to the Washington level, and refers cases, considered at the Washington level, to the Department of Justice for prosecution with necessary recommendation and information thereon.

1113.74 *Assistant Chief Counsel (Litigation).*—The Assistant Chief Counsel (Litigation) exercises general supervision over all civil tax litigation in the Federal courts and The Tax Court of the United States for the Internal Revenue Service (except with respect to those matters specifically delegated to the Assistant Chief Counsel (Claims); and approves for the Service recommendations of acquiescence or nonacquiescence in adverse decisions of the Tax Court and recommendations to the Department of Justice respecting appeals and petitions for certiorari from adverse decisions of any court. He supervises and coordinates the work of the Civil Division and the Appeals Division.

1113.741 *Civil Division.*—The Civil Division performs all necessary legal service on behalf of the Internal Revenue Service in connection with taxpayers' suits for refund of taxes (except alcohol and tobacco taxes). It determines and coordinates the legal position of

the Service in such suits and incorporates such determinations in recommendations to the Department of Justice with respect to the defense of such suits, the acceptance or rejection of settlement proposals, and appeals and petitions for certiorari from adverse court decisions. The Civil Division supervises and coordinates legal work of Regional Counsel on litigation (except types of cases within the jurisdiction of the Claims Division) involving the collection of taxes. It reviews and coordinates at the National level recommendations of Regional Counsel with respect to appeals and petitions for certiorari from adverse court decisions in such cases. The Civil Division performs all necessary legal services on behalf of the Service in connection with all civil litigation affecting the Service and not within the responsibility of any other Division or Regional Counsel.

1113.742 *Appeals Division.*—The Appeals Division develops policies, programs, and procedures relating to the disposition of tax cases pending in the Tax Court of the United States; supervises and coordinates the defense and settlement of such cases to assure uniform treatment of the tax laws in Tax Court cases; coordinates and reviews appellate matters prepared in the regional offices, including the review of briefs to be filed with the Tax Court and recommendations of field offices for acquiescence or non-acquiescence in adverse Tax Court decisions; prepares recommendations to the Department of Justice for the Commissioner's appeals to the Courts of Appeals and prepares petitions and records on review in such cases; makes recommendations to that Department regarding offers in compromise or settlement and prepares recommendations for or against filing petitions for writs of certiorari to the Supreme Court of the United States in such cases, It supervises and handles the trial of excess profits tax refund cases.

1113.75 *Assistant Chief Counsel (Technical).*—The Assistant Chief Counsel (Technical) exercises general supervision over the legal work involved in the preparation and revision of regulations and legislation, and in interpretative rulings and opinions with respect to laws administered by the Internal Revenue Service (except with respect to matters delegated to another Assistant Chief Counsel). He supervises the work of the Interpretative Division and the Legislation and Regulations Division.

1113.751 *Interpretative Division.*—The Interpretative Division reviews as to form and legality interpretations of internal revenue statutes and regulations and other law and legal materials bearing upon the administration of the Internal Revenue Service except those relating to: (a) Alcohol, alcoholic beverages, tobacco and firearms matters; (b) criminal tax investigations and prosecutions; and (c) the Bankruptcy Act and procedures for the protection of tax claims in receiverships and other insolvencies. The Division prepares formal opinions of the Chief Counsel in assisting him in carrying out his functions as legal advisor to the Commissioner. The Division is also responsible for the legal review of closing agreements.

1113.752 *Legislation and Regulations Division.*—The Legislation and Regulations Division, upon request, participates and provides technical assistance in the development and drafting of internal revenue legislation and reviews as to legal form and substance recommendations for new and amendatory legislation. The Division coop-

erates with the Technical Planning Division in the development of the Service's program for the preparation of new and revised regulations, including Treasury decisions, and in accordance with the approved program undertakes initial preparation of certain regulations, principally those involving questions of law or those requiring specialized knowledge available in the Division. It reviews as to legal form and substance all proposed regulations and Treasury decisions, except those pertaining to alcohol and tobacco tax matters. Representatives of the Division participate in public hearings on proposed regulations.

1114 *Office of Regional Commissioner.*—

1114.1 *Mission.*—The mission of the Office of Regional Commissioner is to execute the broad nation-wide policies and programs for the administration of the internal revenue laws, to carry out appellate and alcohol and tobacco tax programs at the regional level, and direct and coordinate the functions and activities of the district offices within the region.

1114.2 *Basic Organization.*—The principal organization components of the typical Office of the Regional Commissioner are the immediate office of the Regional Commissioner, the Administration Division, the Alcohol and Tobacco Tax Division, the Appellate Division, the Audit Division, the Collection Division and the Intelligence Division. An Assistant Regional Commissioner is at the head of each division.

1114.3 *Regional Commissioner.*—The Regional Commissioner administers within an assigned regional area the collection, audit, intelligence, appellate, alcohol and tobacco tax, and administration programs of the Internal Revenue Service. He carries out Service-wide policies and programs in conformity with delegations of authority and, in this connection, establishes regional standards and programs to assure proper and effective implementation of Service-wide policies and programs within his region. The Regional Commissioner supervises and coordinates the work of the staff of the regional office and the District Directors within his region to assure that work is processed in an orderly and timely manner, and that proper and equable emphasis is placed and directed toward the accomplishment of current program objectives. As the principal field official, he evaluates the effectiveness of Service policies and programs, and advises the National Office as to the need for revising such policies and programs to bring about improved operations or service.

1114.4 *Assistant Regional Commissioner (Administration).*—The Assistant Regional Commissioner (Administration) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the administrative activities of the Service under the jurisdiction of the Regional Commissioner to assure that administrative policies and programs are properly executed. In conformity with the administrative policies and programs established by the National Office, he develops regional standards and other measures necessary to implement most effectively the administrative program of the Service which includes budget and fiscal management, personnel administration, training, public information, property and records management, use of facilities, and printing and reproduction. He also coordinates

organization planning and advises and makes recommendations to the Regional Commissioner thereon; and furnishes guidance for and coordinates management programs. He provides the Regional Commissioner with results of evaluations and other information upon which to base his administration of the regional administrative programs and recommends improvements and adjustments therein needed to bring about and sustain a high level of performance in administrative activities within the region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of its administrative policies, programs, procedures and standards in terms of regional and district requirements, provides reports and factual information upon which the National Office can base its administrative policy and program considerations, and recommends appropriate action with respect to problems encountered in observing and evaluating administrative operations. Within the limits of his delegated authority, he provides the Regional Counsel and Regional Inspector with such administrative services as they may require in the performance of thier duties. He is responsible for and supervises the activities of four branches: Fiscal Management Branch, Operating Facilities Branch, Personnel Branch and Training Branch.

1114.41 *Fiscal Management Branch.*—The Fiscal Management Branch performs, coordinates and evaluates budgeting, administrative accounting and financial reporting (other than for revenue collections) for the region, including the preparation of the financial plan within over-all budget limitations, submission of budget data, allotment of funds, maintenance of accounts, preparation of payrolls and examination of vouchers. This Branch participates in long-range planning involving expenditures for personnel, equipment, administrative services, space and similar items.

1114.42 *Operating Facilities Branch.*—The Operating Facilities Branch coordinates, evaluates, and carries out regionwide administrative service activities. This includes such matters as procurement and contracts; space, property and supply utilization; records administration; physical and document security; printing and distribution; and other administrative services. It provides these facilities and services in the regional office. The Branch develops, within guidelines established by the National Office, standards and procedures covering space, property and communications; creation, preservation and disposition of records; production, storage and distribution of forms and publications initiated within the region and the distribution of National Office forms and publications; and civil defense, document and property security, safety and employee identification. It processes all claims arising within the region under the Federal Tort Claims Act. It represents the region in contacts with General Services Administration.

1114.43 *Personnel Branch.*—The Personnel Branch develops and evaluates the regional personnel program and standards relating to recruitment and selection, employee relations, disciplinary actions, performance evaluation, promotions, in-service placements, incentive awards, records, reports and other aspects of a complete personnel program, within the framework of broad policies, programs and procedures established by the National Office and conducts the personnel

program for the regional office. It conducts the position classification program for the region. This Branch represents the region in contacts with employee groups and the Regional Directors of the Civil Service Commission.

1114.44 *Training Branch.*—The Training Branch provides leadership and coordination to the regional training programs and evaluates and reports on all such programs. It coordinates the regional execution of nationwide training programs; gives advice on all training programs conducted within the region; and assists in their development from the standpoint of training techniques. It participates in and coordinates the development of regional training programs to meet training needs that cut across organizational lines, such as supervisory training and training in clerical skills.

1114.5 *Assistant Regional Commissioner (Alcohol and Tobacco Tax).*—The Assistant Regional Commissioner (Alcohol and Tobacco Tax) acts as the principal assistant to the Regional Commissioner in planning, directing, and coordinating the alcohol and tobacco tax activities of the Service under the jurisdiction of the Regional Commissioner for the execution of policies and programs established by the National Office. He is responsible to the Regional Commissioner for the administration and enforcement of internal revenue laws relating to alcohol, alcoholic beverages and products, and tobacco and tobacco products; and related laws, including the Federal Alcohol Administration Act, the National and Federal Firearms Acts and the Liquor Enforcement Act of 1936. This includes the supervision and control, under Federal laws, of units of the lawful liquor and tobacco industries located within the region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of its alcohol and tobacco tax policies, programs, procedures and standards in terms of regional requirements, provides reports and factual information upon which the National Office can base its alcohol and tobacco tax policy and program considerations and recommends action with respect to problems encountered in alcohol and tobacco tax operations. He supervises the activities of two branches, Enforcement Branch and Permissive Branch, and all branch offices located within the region.

1114.51 *Enforcement Branch.*—(1) The Enforcement Branch coordinates and evaluates the alcohol and tobacco tax enforcement activities, including those relating to retail liquor dealers, to assure that throughout the region the policies and programs are properly executed with equal emphasis and uniform effort and that the investigative work is pursued in an orderly and timely manner.

(2) In conformity with alcohol and tobacco tax enforcement policies and programs established by the National Office, it develops regional programs, standards and other measures necessary to implement most effectively the investigative program relating to violation of the internal revenue laws and other statutes relating to alcohol, alcoholic beverages and products, tobacco and tobacco products and firearms.

(3) The Branch also directs and performs investigations of all major criminal cases throughout the region and provides functional advice and guidance to branch offices on enforcement matters.

1114.52 *Permissive Branch.*—(1) The Permissive Branch coordinates and evaluates the alcohol and tobacco tax permissive activities to assure that throughout the region the policies and programs are properly executed with equal emphasis and uniform effort and that the work is processed in an orderly and timely manner.

(2) In conformity with alcohol and tobacco tax permissive policies and programs established by the National Office, it develops regional programs, standards and other measures necessary to implement most effectively the control and supervision of the legally qualified liquor and tobacco industries and permittees.

(3) In the area not serviced by branch offices (combination), the Branch serves as the point of official contact for advice and guidance to industry and provides functional advice and guidance to branch offices (combination) on permissive matters.

1114.53 *Branch offices.*—(1) Branch offices, headed by Supervisors in Charge, direct the permissive and/or enforcement activities within assigned areas of jurisdiction. Those that direct permissive and enforcement activities are known as Combination Offices and those that direct only enforcement activities are known as Enforcement Offices.

(2) In the regulatory or permissive field Combination Offices provide advice and guidance to the industry and supervise its operations through the direction and assignment of storekeeper-gaugers and inspectors. The activities of the industry supervised include production, storage, tax payment, disposition and use of alcoholic liquors and tobacco by qualified permittees and registrants.

(3) In the enforcement field all branch offices engage in the investigation, prevention, and detection of willful and/or fraudulent substantive violations of the internal revenue liquor and tobacco laws, the Federal Alcohol Administration Act, the Liquor Enforcement Act of 1936, the National and Federal Firearms Acts, the regulations promulgated thereunder and related statutes. This involves the apprehension of violators against such laws; the submission of evidence adduced to United States Attorneys for criminal prosecution and forfeiture action and/or to Regional Commissioner's office for administrative action; the seizure, custody, forfeiture and disposition of real and personal property; the enforcement of the laws and legulations for the control of the flow of raw materials intended for use in the illicit manufacture of distilled spirits; and the inspection of retail liquor dealer establishments.

1114.6 *Assistant Regional Commissioner (Appellate).*—The Assistant Regional Commissioner (Appellate) acts as the principal assistant to the Regional Commissioner in planning, directing, coordinating and evaluating the appellate activities of the Service under the jurisdiction of the Regional Commissioner within the broad framework of policies and programs established by the National Office. He is responsible to the Regional Commissioner for a program of hearing and undertaking final settlement of taxpayers' appeals from determinations of tax liability made by District Directors within the region involving income, profits, estate, gift, and employment taxes, and excise taxes except those imposed on alcohol, wagering, narcotics, firearms, and tobacco. He is responsible for a program of hearing and, with concurrence of Regional Counsel, undertaking final settlement

of cases docketed in the Tax Court; and for a program of final review for the Commissioner in cases involving overassessments or overpayments in excess of $100,000 requiring review by the Chief Counsel or the Joint Committee on Internal Revenue Taxation. His program includes the hearing of administrative appeals in cases involving offers in compromise. In that capacity, he represents the Commissioner of Internal Revenue and exercises the authority of his office pursuant to, and within the limits of, a delegation of authority from the Regional Commissioner. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of its appellate policies, programs, procedures, and standards in terms of regional requirements, provides reports and factual information upon which the National Office can base its appellate policy and program considerations, and recommends action with respect to problems encountered in appellate operations. He supervises the activities of all appellate branch offices in the region.

1114.61 *Appellate Branch Offices.*—The basic settlement work of the Appellate Division is performed in branch offices of the Division which are headed by Associate Chiefs or Assistant Chiefs who report to the Assistant Regional Commissioner (Appellate). The branch office conducts hearings and makes final determinations, within the limits of its delegated authority, on cases involving income, profits, estate, gift, and employment taxes and excise taxes, except those imposed on alcohol, wagering, narcotics, firearms and tobacco, in which taxpayers have requested appellate consideration. The branch office conducts hearings and, with the concurrence of the Regional Counsel, effects settlement of cases which have been docketed in the Tax Court. It makes the final review for the Commissioner in all cases involving overassessments or overpayments in excess of $100,000 which are subject to review by the Chief Counsel or the Joint Committee on Internal Revenue Taxation. The branch office considers protested offers in compromise and makes recommendations on final closing agreements.

1114.7 *Assistant Regional Commissioner (Audit).*—The Assistant Regional Commissioner (Audit) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the audit activities of the Service under the jurisdiction of the Regional Commissioner to assure that policies and programs are properly executed, that audit work is processed in an orderly and timely manner, that equal emphasis is placed and uniform effort directed toward the accomplishment of the current audit program objectives, and that required standards for audit uniformly are being maintained. In conformity with the audit policies and programs established by the National Office, he develops regional programs, standards, and other measures necessary to implement most effectively the audit program of the Service which includes the selection of returns for audit, their examination and investigation, the determination of tax liabilities and penalties where applicable, a regional review of selected cases closed by the district offices, the administrative disposition of offers in compromise, and tax assistance to taxpayers. He provides the Regional Commissioner with results of evaluation and other information upon which to base his administration of the regional audit program and recommends improvements and adjustments in audit operations needed to bring about and sustain a high level of performance within the

region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of its policies, programs, procedures and standards in terms of regional and district requirements, provides reports and factual information upon which the National Office can base its policy and program considerations, and recommends appropriate action with respect to problems encountered in observing and evaluating audit operations.

1114.8 *Assistant Regional Commissioner (Collection).*—The Assistant Regional Commissioner (Collection) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the collection activities of the Service under the jurisdiction of the Regional Commissioner to assure that policies and programs are properly executed, that collection work is processed in an orderly and timely manner, and that equal emphasis is placed and uniform effort directed toward the accomplishment of the current collection program objectives. In conformity with the collection policies and programs established by the National Office he develops regional programs, standards and other measures necessary to implement most effectively the program of the Service for the collection and accounting of revenue, including the collection of delinquent accounts and the securing of delinquent returns. He provides the Regional Commissioner with results of evaluations and other information upon which to base his administration of the regional collection program and recommends improvements and adjustments in collection operations needed to bring about and sustain a high level of performance within the region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of its collection policies, programs, procedures and standards in terms of regional and district requirements, provides reports and factual information upon which the National Office can base its collection policy and program considerations and recommends appropriate action with respect to problems encountered in observing and evaluating collection operations.

1114.9 *Assistant Regional Commissioner (Intelligence).*—The Assistant Regional Commissioner (Intelligence) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the intelligence activities of the Service under the jurisdiction of the Regional Commissioner to assure that policies and programs are properly executed, and that the intelligence work is processed in an orderly and timely manner. In conformity with the intelligence policies and programs established by the National Office he develops regional programs, standards and other measures necessary to implement most effectively the intelligence program of the Service which includes the investigation of alleged tax fraud, certain other civil and alleged criminal violations of tax laws (except alcohol, tobacco and certain firearms tax cases), applicants for enrollment, charges against persons who are enrolled to practice before the Treasury Department and such other special investigations as the Commissioner may direct. He provides the Regional Commissioner with results of evaluations and other information upon which to base his administration of the regional intelligence program and recommends improvements and adjustments in intelligence operations needed to bring about and sustain a high level of performance within the region.

Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of its intelligence policies, programs, procedures and standards in terms of regional and district requirements, provides reports and factual information upon which the National Office can base its intelligence policy and program considerations and recommends appropriate action with respect to problems encountered in observing and evaluating intelligence operations. He supervises the review of special agents' reports of investigation submitted by the district offices in the region, approves or disapproves recommendations for prosecution, and provides for conferences when required with taxpayers, their representatives, representatives of the Regional Counsel and the Appellate Division relative to cases investigated. (The Assistant Regional Commissioner (Intelligence), New York, additionally acts as the operating head of intelligence activities for the New York City area, directing intelligence activities within the territorial boundaries covered by the Upper and Lower Manhattan and Brooklyn District Offices.)

1114.91 *Review and Conference Staff.*—(1) The Review and Conference Staff plans and directs the critical review of district office reports pertaining to alleged criminal violations of the internal revenue laws, applicants for enrollment to practice before the Treasury Department, charges against persons enrolled to practice before the Treasury Department, which contain recommendations for criminal prosecution and/or ad valorem penalties for disciplinary action, to determine that the conclusions and recommendations are sound and conform to existing policies; and recommends to the Assistant Regional Commissioner (Intelligence) the action to be taken on each such report.

(2) The Staff post reviews selected nonprosecution case reports prepared at the district level and unnumbered case disposals to determine that an appropriate, uniform basis for disposal existed. Where deficiencies are disclosed through such activities, the Staff suggests corrective measures.

(3) Through continuing analysis of district office reports the Staff provides the Assistant Regional Commissioner (Intelligence) with information which will assist him in evaluating investigative techniques employed and the extent of procedural and technical uniformity in the intelligence activity throughout the region.

(4) The Staff consults with and advises intelligence personnel at regional and district office locations on difficult and unusual issues, interpretations of regulations, rulings, tax laws and court decision; also, as to the conduct of investigations, rules of evidence and Internal Revenue Service policies. The Staff undertakes special assignments and investigations as directed by the Assistant Regional Commissioner (Intelligence).

1115. *Office of Regional Inspector.*—There are nine Regional Inspectors, one in each internal revenue region. The Regional Inspector, who operates under the direct supervision of the Assistant Commissioner (Inspection), is responsible for the conduct throughout the region of both the internal audit and internal security programs.

1115.1 *Assistant Regional Inspector (Internal Audit).*—Under the supervision of the Regional Inspector, the Assistant Regional Inspec-

tor (Internal Audit) is responsible for the conduct of the internal audit program throughout the region. The internal audit, which includes verification of financial transactions and analyses of operating practices and procedures, serves as the basis for informing appropriate officials of the manner in which operations are being carried out and responsibilities are being discharged and as a basis for necessary changes in policies, practices and procedures.

1115.2 *Assistant Regional Inspector (Internal Security).*—Under the Regional Inspector, the Assistant Regional Inspector (Internal Security) conducts investigations of the conduct and character of employees and applicants for employment which provide management with a factual basis for making decisions. He also conducts formal investigations of accidents involving Revenue employees and property, plus special investigations, as directed by higher authority, for the Office of the Secretary and agencies outside the Service.

1116 *Office of Regional Counsel.*—There are nine Regional Counsels, one in each internal revenue region. The Regional Counsel, who operates under the Chief Counsel for the Internal Revenue Service, serves as the principal legal advisor to the Regional Commissioner, and directs a staff of attorneys engaged in furnishing legal advice and performing legal services connected with the appellate, enforcement, civil advisory and alcohol and tobacco tax programs. The Regional Counsel, with the concurrence of the Regional Commissioner, settles tax cases docketed in the Tax Court of the United States, and represents the Commissioner in the trial of such cases before the Tax Court.

1116.1 *Appellate matters.*—The Regional Counsel (or his delegate) furnishes legal advice to the Assistant Regional Commissioner (Appellate); represents the Commissioner in the trial of cases before the Tax Court and is responsible for answers, motions and stipulations with respect to all petitions in tax cases, and the preparation of briefs in such cases, recommends acquiescence or non-acquiescence and appeal from adverse decisions; considers and approves or disapproves, with the concurrence of the Appellate Division, the settlement of cases docketed in the Tax Court and considers and concurs with the Appellate Division, or disapproves, the elimination of the ad valorem fraud or negligence penalties in cases not docketed in the Tax Court and considers statutory notices of deficiences proposed by the Appellate Division prior to issuance. He is responsible for the legal review of cases considered by the Appellate Division involving overpayments, credits or abatements in excess of $100,000, and in certain cases prepares reports to the Joint Committee on Internal Revenue Taxation in overpayment cases when approved.

1116.2 *Enforcement matters.*—The Regional Counsel's office is responsible for the performance of legal services in the field in connection with criminal cases arising under the internal revenue laws. The office reviews recommendations of prosecution in criminal cases received in the field, and prepares and refers such cases (other than alcohol and tobacco tax cases) to the Department of Justice or, where authorized by the Department of Justice, directly to United States Attorneys, or, where prosecution is not deemed warranted, prepares criminal action memoranda setting forth the reasons against prose-

cution and closes such cases with the concurrence of the Assistant Regional Commissioner (Intelligence). On request, the office furnishes aid and assistance to United States Attorneys in criminal tax proceedings in the United States District Courts and Courts of Appeal.

1116.3 *Civil advisory matters.*—Each Regional Counsel through his civil advisory staff handles legal work with respect to (a) cases under the Bankruptcy Act (except railroad reorganizations, corporate reorganizations, and real property arrangements under Section 77, Chapter X and Chapter XII, respectively, of the Bankruptcy Act) and other insolvency cases including decedents' estate proceedings; (b) Federal tax liens in suits for foreclosure by mortgagees or other lienholders and in suits to quiet title; (c) applications filed for the discharge of property from Federal tax liens or for the release of such liens; (d) the review and handling of certain offers in compromise; (e) recommendations as to the taking of affirmative action, whether by way of a separate suit or intervention in pending proceedings (with the exception of alcohol, alcoholic beverages, tobacco and firearms matters not relating to proceedings under the Bankruptcy Act, liens, receiverships and other insolvencies); (f) the defense of injunction suits to restrain the assessment or collection of Federal taxes (except with respect to alcohol, alcoholic beverages, tobacco and firearms matters); and (g) the assessment and collection of taxes.

1116.4 *Alcohol and tobacco tax matters.*—The Regional Counsel's office gives legal advice on request to the Assistant Regional Commissioner (Alcohol and Tobacco Tax) and to his staff on administration and enforcement of the laws and regulations pertaining to liquor, tobacco and firearms. The office reviews and makes recommendations, upon request, regarding claims for refund, abatement and drawback of liquor, tobacco and firearms taxes, for the redemption of stamps, and for damages, and with respect to petitions for mitigation or remission of forfeiture, offers in compromise, and proposed tax assessments. Upon request, the office assists United States Attorneys by preparing libels of information, indictments, briefs, stipulations and other legal documents required in litigation, and by aiding in the prosecution and defense of suits. The office also handles the legal work in connection with administrative proceedings involving the issuance, suspension, revocation or annulment of liquor and tobacco permits, including the preparation of the necessary opinions, notices and pleadings and the presentation of the Government's case at both formal and informal hearings.

1117 *Service Centers.*—(1) There are three Internal Revenue Service Centers—designated as the Midwest Service Center, the Northeast Service Center and the Western Service Center. The Midwest Center, located at Kansas City, Missouri, services all district offices in the Omaha Region and the Chicago Region. The Northeast Center, located at Lawrence, Massachusetts, services all district offices in the Boston and New York Regions, the Camden and Newark Districts of the Philadelphia Region, and the Cleveland District in the Cincinnati Region. The Western Center, located at Ogden, Utah, services all district offices in the San Francisco Region except Honolulu.

(2) The policies governing and work programs performed in each service center are prescribed and assigned by the National Office.

(3) Each service center is headed by a Director who operates under the general direction of the Regional Commissioner in whose region the center is located. The Service Center Director is responsible to the National Office, through the Regional Commissioner, for implementing the programs assigned to the center. He is responsible for budget, fiscal and personnel operations of the center under policies and procedures of the Regional Commissioner. He also participates with the National Office, through the Regional Commissioner, in planning, coordinating and evaluating experimental projects to develop improved techniques and methods for processing tax returns. The Regional Commissioner, in turn, is responsible to the National Office for supervising the execution of the service center's program and for recommending adjustments to or modifications of the program. The Regional Commissioner also exercises general supervision over the activities of the Service Center Director in coordinating and maintaining liaison with the several Regional Commissioners, District Directors, and the National Office in carrying out the policies and programs prescribed for the centers by the National Office.

(4) In general, each service center performs the following operations:

(a) Processes Forms 1040A to and including preparation of taxpayer delinquent account assembly;

(b) Processes certain categories of Forms 1040, to and including preparation to taxpayer delinquent account assemblies;

(c) Processes Forms 1040ES through the issuance of all installment notices and the collating of remittance credits for matching purposes;

(d) Mathematical verification of full paid 1040 returns;

(e) Mailing of blank returns;

(f) Processing income information documents such as 1099's;

(g) Matching of W–2 statements (by Midwest Service Center only); and

(h) Any other programs assigned by the National Office.

(5) The district offices served by the service centers receive the returns filed by the taxpayers, deposit all remittances, and settle all questions about the returns (including notices of change of address) before sending the returns to the centers for processing. They also endorse all notices of tax due issued by the center on which payment is made, and send them to the center for posting. The center, in turn, lists the returns on assessment lists, sends out even notices to taxpayers, prepares check-issue cards for the Disbursing Office, sends out bills (first notices) on taxable-assessable and underpaid returns, prepares taxpayer delinquent account assemblies and unit ledger cards and turns over unpaid accounts to District Directors, all under proper memorandum accounting controls. These service center operations are performed in the name of the appropriate District Director.

1118 *Office of District Director.*—

1118.1 *Mission.*—The mission of the office of the District Director is to administer the internal revenue laws within an internal revenue district in conformance with the policies and programs of the National and regional offices.

1118.2 *Basic organization.*—The principal organizational components of the typical district office are the immediate office of the District

Director, the Audit Division, Collection Division, Intelligence Division and Administration Division.

1118.3 *District Director.*—The District Director administers within an internal revenue district, the collection, audit, intelligence and administrative programs of the Internal Revenue Service. He is responsible for the determination of tax liability, the assessment of such liability, the scheduling and certification of refunds, and the investigation of certain criminal and civil violations of internal revenue tax laws (except those relating to alcohol, tobacco and firearms). He is also responsible for the collection and deposit of all internal revenue taxes and the investigation of applications of agents and attorneys for admission to practice before the Treasury Department.

1118.4 *Audit Division.*—The Audit Division administers a district-wide audit program involving the selection and examination of all types of Federal tax returns (except those involving alcohol, tobacco, and firearms taxes), claims, offers in compromise, informants' claims for rewards, and related activities including the examination and approval of pension trust plans and the issuance of determination letters. The audit program involves the selective classification of returns for field and office audits, the conduct of informal conferences in cases involving disagreement between the internal revenue agents and taxpayers, participation with special agents of the Intelligence Division in the conduct of tax fraud investigations and a program of assistance to taxpayers during the annual filing period. The Audit Division consists of the Field Audit Branch, Office Audit Branch, Service Branch and the Review Staff.

1118.41 *Field Audit Branch.*—(1) The Field Audit Branch conducts field examinations relative to all types of taxes (except alcohol, tobacco, and firearms) to determine correct liabilities of taxpayers for tax and penalties, including the examination of claims for refund, credit or abatement, or for redemption of stamps. It also conducts field examinations of offers in compromise based on either doubt as to liability or inability to pay, and special field examinations as requested including joint examinations with special agents of the Intelligence Division where tax evasion may exist. The Branch processes informants' claims for reward making any necessary investigations and prepares reports on such claims, together with recommendations as to the amount of rewards.

(2) The Field Audit Branch holds informal conferences with taxpayers and their representatives, and prepares conference reports directing action to be taken by examining officers. It furnishes technical advice and assistance on pension trust plans, performs engineering and valuation work, prepares memoranda to accompany closing agreements and closing letters and releases in estate and gift tax cases, and recommends jeopardy assessments. The Branch furnishes information to the public on tax matters and assists taxpayers in preparing and filing tax returns and claims.

1118.42 *Office Audit Branch.*—(1) The Office Audit Branch conducts examinations through correspondence or interviews with taxpayers in offices of the Service relative to all types of taxes (except alcohol, tobacco and firearms) to determine correct liability of taxpayers for tax and penalties, and allowableness of claims for refund,

credit, or abatement, or for redemption of stamps, including claims for exemption from collecting admissions, transportation, and other excise taxes. It recommends jeopardy assessments.

(2) The Branch holds informal conferences with taxpayers and their representatives for the purpose of resolving disputed issues in unagreed cases. The Branch also furnishes information to the public on tax matters and assists taxpayers in preparing and filing tax returns and claims.

1118.43 *Review Staff.*—(1) The Review Staff reviews reports of examinations of all types of tax returns to verify the determination of liability made by the examining officer. It directs the issuance of preliminary notices of deficiency to taxpayers, and prepares Form 7900 letters to taxpayers covering deficiencies in bankruptcy and receivership cases which serve as a basis for assessment and filing of proof of claim by the Collection Division. It reviews protests filed in response to notices of deficiency and Form 7900 letters for proper form, compliance with existing requirements and for new issues or facts. It also prepares statutory notices of deficiency.

(2) The Staff is responsible for the control, management and review of offers in compromise, informants' claims for reward and the special procedures applicable in cases involving renegotiation. It maintains and controls the preliminary notice file, the statutory notice file, the file on cases suspended pending court or other decision (Form 1254), power of attorney file, fee statement file, and worthless stock and taxibility of dividend file, taking appropriate action as required. The Staff prepares the Management Information Reports for both agreed and unagreed cases.

(3) The Staff has primary responsibility within the district for maintaining quality standards in examinations and reports, and the technical accuracy of all matters subject to review. It issues correction memoranda in all cases or matters involving substantial error.

1118.44 *Service Branch.*—(1) The Service Branch performs clerical services for the Division necessary to the processing of returns, reports of examination, case files and correspondence. It maintains control of all returns and case files assigned to the Audit Division and of number assignments for Management Information Reports on audit cases. It types examining officers' reports, form letters, correspondence and other material as assigned and furnishes clerical, stenographic and typing assistance to all Division offices.

(2) The Service Branch also compiles detailed production statistics of the Audit Division.

1118.5 *Collection Division.*—The Collection Division collects, receipts for and deposits all tax payments. It receives, processes, and arithmetically verifies all tax returns and related documents, maintains taxpayers' accounts, conducts systematic investigations for delinquent returns and enforces the collection of delinquent accounts through seizure and sale, levy and other means. The Division also sells tax stamps, grants extensions of time for paying taxes or filing returns, makes certain penalty and interest determinations, schedules refunds, credits and abatements, and maintains custody of tax returns. The Collection Division consists of the Cashier Branch, Returns Processing Branch, Accounting Branch, and the Delinquent Accounts and Returns Branch.

1118.51 *Cashier Branch.*—(1) The Cashier Branch receives, safeguards and deposits all monies tendered in payment of taxes. It maintains the district's stock of internal revenue stamps and handles the sale and accounting of these stamps.

(2) The Branch receives and opens all mail, sorts therefrom returns, documents and correspondence with remittances, classifies such returns and documents by type of tax, and routes correspondence and documents to the appropriate branch. It prepares and maintains records necessary to the accounting for monies received and deposited. The Branch also receives returned remittances from the depositary bank and communicates with the taxpayers concerned in an effort to make collection to cover the returned remittances.

1118.52 *Returns Processing Branch.*—(1) The Returns Processing Branch processes all tax returns in preparation for assessment and collection or refunding. It requests additional information from taxpayers when necessary to complete returns. It computes interest on delinquent returns, and computes interest on taxable returns not fully paid. It determines amount of refund and interest due the taxpayer on all refundable returns.

(2) The Branch matches prepayment credits and associates information documents with tax returns in preparation for audit. It checks returns against available records to determine non-filing of returns and makes initial routine effort to secure delinquent returns.

(3) The Branch classifies, routes and controls mail received by the Collection Division; and answers routine correspondence through use of form letters and pattern paragraphs.

(4) It maintains lists of taxpayers and uses such lists for the mailing of blank tax forms and related documents in advance of filing periods and for establishing checks on delinquency. It is responsible for the filing and proper storage of all returns and the maintenance of the index card file cross-referencing the number assigned to a return with the name of the taxpayer.

1118.53 *Accounting Branch.*—(1) The Accounting Branch maintains all taxpayer accounts and required control and general ledgers and serves as the billing officer for the district. It prepares assessment lists; sets up taxpayer accounts and posts assessments, credits, abatements and refunds thereto; issues statements of tax due; prepares taxpayer delinquent account assemblies; issues installment notices of accounts and computes interest due on each account; and issues certified transcripts of taxpayer accounts upon request.

(2) The Branch prepares and controls tax transfer vouchers reflecting transfers of accounts to and from other districts. It prepares all necessary schedules to support general ledger accounts and submits refund schedules to the Disbursing Officer.

(3) The Branch performs various types of verification and control assignments such as the reconciliation of deposit and disbursing transactions received from Treasury units and prepares monthly Account Current for revenue receipts.

(4) The Branch receives, records and transmits claims for refund and abatement for all classes of tax.

1118.54 *Delinquent Accounts and Returns Branch.*—(1) The Delinquent Accounts and Returns Branch makes collections of delinquent accounts and conducts a continuing program for the securing of delinquent returns.

(2) The Branch safeguards the Government's interests through the filing of notices of tax liens, and enforces collection by the serving of levies, and seizure and sale of real and personal property. It recommends jeopardy assessment when deemed necessary to protect revenue, civil actions to secure payment, suits to enforce penalty for failure to honor levies, and penalty assessments as a means of collection or as a method of obtaining compliance with existing laws and regulations. The Branch recommends the issuance of certificates of discharge of property from the effects of tax liens and conducts the investigations necessary to support such recommendations.

(3) The Branch receives, acts on, and processes information pertinent to bankruptcies, receiverships, assignments, reorganizations, probate proceedings, bulk sales, gifts and prizes, and dissolutions and initiates investigations for securing delinquent returns where necessary. It canvasses the district for delinquent returns and serves summonses on taxpayers to produce books, documents, returns or other information where necessary to secure compliance with the requirements for filing returns.

(4) The Branch maintains control of payments received in insolvency, bankruptcy, and decedent cases and of surety bonds and other collateral posted as security for tax liability. It also maintains files and control records of property seized under distraint authority and takes appropriate action with respect to seized property to assure that proper legal action may be timely taken.

1118.6 *Intelligence Division.*—(1) The Intelligence Division investigates alleged criminal violations of the tax statutes, including racketeer and wagering tax cases, but excluding alcohol, tobacco and firearms tax cases. It conducts investigations of applicants who are seeking enrollment to practice before the Treasury Department and of charges against persons enrolled.

(2) The Division evaluates allegations and indications of tax law violations and determines investigations to be undertaken. It makes recommendations as to the disposition of cases investigated, including recommendations of criminal prosecution, and the assertion of civil penalties. It provides assistance to U. S. Attorneys and the Regional Counsel in the trial of cases. The Intelligence Division consists of groups of special agents.

1118.7 *Administration Division.*—The Administration Division provides the personnel, training, budget and fiscal, procurement and supply, records, and communications services and other administrative services, within the limitations of the District Director's delegated authority, necessary to the effective operation and management of the district office. It coordinates the district office management improvement and incentive awards programs and other special projects. The Administration Division consists of three branches where size of the district office warrants such a breakdown: Personnel Branch, Training Branch and Operating Facilities Branch.

1118.71 *Personnel Branch.*—The Personnel Branch performs the recruitment and placement functions at the district level, and conducts the district's employee relations program and incentive awards program. It processes personnel action documents in accordance with prescribed procedure and maintains all district personnel records.

1118.72 *Training Branch.*—The Training Branch provides leadership and coordination to the district training program. It coordinates the district execution of training programs; gives advice on all training programs conducted in the district office, and assists in their development from the standpoint of training techniques. It participates in and coordinates the development of district training programs to meet local training needs that cut across organizational lines. In addition, it evaluates and reports on all district training programs.

1118.73 [6] *Operating Facilities Branch.*—The Operating Facilities Branch provides the facilities and administrative services necessary to the efficient operation of the district office. The Branch carries out the space policies of the District Director and conducts periodic surveys to assure effective space utilization. It procures, requisitions, issues, and assures effective utilization of equipment, property and office supplies; maintains records on all equipment and property located within the district; and provides communications and duplicating services. The Branch also furnishes data necessary for the preparation of that portion of the district office budget estimates and financial plans which is concerned with funds required for materials and facilities in the district. As required for district management control, it maintains blotter type records of fund commitments for materials and facilities (object classes 03 through 09 as defined in Budget-Treasury Regulation No. 1). It administers document and property security and the safety programs in the district.

1118.8 *Local offices.*—(1) Local offices perform one or more of certain collection, audit and intelligence functions such as: The collection of delinquent accounts and the securing of delinquent returns; the receiving and deposit of monies tendered in payment of taxes; the examination of returns to determine correct liability of taxpayers for tax and penalties; the holding of informal conferences with taxpayers and their representatives regarding the determination of liability for tax and penalties; and the investigation of alleged criminal violation of the tax statutes.

(2) The administrative supervision of a local office is the responsibility of a representative designated by the District Director from among the personnel assigned to the local office. Technical supervision of the personnel at a local office is the responsibility of the group supervisor or group supervisors of whatever group or groups the employees are members.

Effective date: December 1, 1956.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

DEPARTMENT OF THE TREASURY
TREASURY DEPARTMENT ORDER NO. 150–45
COMMISSIONER OF INTERNAL REVENUE

Authorization to prescribe rules and regulations for enforcement of Federal Firearms Act.

The Commissioner of Internal Revenue is hereby authorized to prescribe all needful rules and regulations for the enforcement of the

[6] As amended. 22 F. R. 6434.

Federal Firearms Act (15 U. S. C. 18), subject to approval by the Secretary or his delegate.

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

April 22, 1957.

(Filed by the Division of the Federal Register on April 26, 1957, 8:50 a. m., and published in the issue of the Federal Register for April 27, 1957, 22 F. R. 3022.)

DEPARTMENT OF THE TREASURY
TREASURY DEPARTMENT ORDER NO. 170-3

Deputy to the Secretary establishment of position

There is hereby established in the Office of the Secretary the position of Deputy to the Secretary. By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950, the functions and responsibilities of the position, Special Assistant to the Secretary in Charge of Tax Policy, are hereby transferred to the position of Deputy to the Secretary.

This order amends Treasury Department Orders No. 148 (Revision No. 2), dated August 3, 1955, and No. 150-41, dated February 13, 1956 [C. B. 1956-1, 1009].

G. M. HUMPHREY,
Secretary of the Treasury.

January 9, 1957.

(Filed by the Division of the Federal Register on January 25, 1957, 8:46 a. m., and published in the issue of the Federal Register for January 26, 1957, 22 F. R. 523.)

DELEGATION ORDER NO. 4 (REVISED)

(Effective May 21, 1957)

Authority to issue summonses and to perform other functions

1. All the functions which Sections 7602, 7603, 7604 and 7605(a) of the Internal Revenue Code of 1954 specify shall be performed by the Secretary or his delegate are delegated to the following officers and employees of the Internal Revenue Service:

(*a*) Regional Commissioner and District Directors.

(*b*) Inspection: Assistant Commissioner; Director and Assistant Directors, Internal Security Division; Regional Inspectors; and all Internal Security Inspectors.

(*c*) Alcohol and Tobacco Tax: Assistant Regional Commissioners.

(*d*) Intelligence: Director; Assistant Director; Assistant Regional Commissioners; Executive Assistants to Assistant Regional Commissioners; Chiefs, Review and Conference Staff; Reviewer-Conferees; and all Chiefs and Assistant Chiefs of Divisions, Branches and Sections, Group Supervisors, and Special Agents, of the National, regional and district offices.

(*e*) International Operatons: Director; Assistant Director; Chiefs of Branches; Special Agents; Internal Revenue Agents; Estate Tax Examiners; and Officers in Charge.

(*f*) Collection: Chiefs and Assistant Chiefs of the Collection Divisions; Chiefs and Assistant Chiefs of the Delinquent Accounts and Returns Branches; Group Supervisors; and Collection Officers.

(*g*) Audit: Chiefs of Divisions and Branches; Group Supervisors; Internal Revenue Agents; and Estate Tax Examiners.

2. Each of the officers and employees referred to in paragraph 1 of this order may designate any other employee of the Internal Revenue Service as the individual before whom a person summoned pursuant to section 7602 of the Internal Revenue Code of 1954 shall appear. Any such other employee of the Internal Revenue Service, when so designated in a summons, is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records, or other data produced in compliance with the summons.

3. The authority herein delegated to issue a summons and the authority to enforce such summons as provided for in sections 7602 and 7604, respectively, of the Internal Revenue Code of 1954 may not be redelegated. The remaining authorities herein delegated may be redelegated only by the Assistant Commissioner (Inspection), each Regional Commissioner, each District Director of Internal Revenue and the Director of International Operations to officers and employees within their jurisdiction.

4. This Order supersedes Delegation Order No. 4 issued June 7, 1955 [C. B. 1955–2, 893].

RUSSELL C. HARRINGTON,
Commissioner.

(Filed by the Division of the Federal Register on June 3, 1957; 8:50 a. m., and published in the issue of the Federal Register for June 4, 1957, 22 F. R. 3894.)

DELEGATION ORDER NO. 37 (REVISED)

(Effective January 8, 1957)

Authority to administer oaths and to certify

The following officers and employees are hereby authorized to administer such oaths or affirmations and to certify to such papers as may be necessary under the internal revenue laws or regulations made thereunder:

(a) Assistant Commissioner (Inspection).

(b) Regional Commissioners and District Directors of Internal Revenue.

(c) Assistant Regional Commissioners (Intelligence); Executive Assistants to Assistant Regional Commissioners (Intelligence); Chiefs, Review and Conference Staff, Intelligence Division; and Reviewer Conferees, Intelligence Division.

(d) Assistant Regional Commissioners (Alcohol and Tobacco Tax); and Chiefs, Aides to Chiefs, Supervisors in Charge, Assistant

Supervisors in Charge, Special Investigators, Investigators, and Inspectors, Alcohol and Tobacco Tax Division.

(e) Officers and employees of the respective divisions of the Internal Revenue Service designated as follows:

(1) *International Operations Division.*—Director, Chiefs of Branches, Chiefs of Sections, Internal Revenue Agents, Estate Tax Examiners, Special Agents, Treasury Representatives (Taxation), Assistant Treasury Representatives (Taxation), Officers in Charge, and Special Procedures Officer.

(2) *Collection Division.*—Chiefs of the Collection Divisions, Chiefs of the Delinquent Accounts and Returns Branches, Group Supervisors, and Collection Officers.

(3) *Audit Division.*—Chiefs of Divisions and Branches, Group Supervisors, all Internal Revenue Agents, and Estate Tax Examiners.

(4) *Intelligence Division.*—Chief, Assistant Chiefs, Group Supervisors and all Special Agents.

(5) *Inspection.*—Director, Internal Security Division; Assistant Directors, Internal Security Division; Regional Inspectors; and all Internal Security Inspectors.

This Order supersedes Delegation Order No. 37 dated August 9, 1956, C. B. 1956–2, 1376.

RUSSELL C. HARRINGTON,
Commissioner.

(Filed by the Division of the Federal Register on January 17, 1957, 8:48 a. m., and published in the issue of the Federal Register for January 18, 1957, 22 F. R. 386.)

DELEGATION ORDER NO. 51[1]

(Effective May 21, 1957)

Authority to sign proofs of claim and other documents

The following officers are hereby authorized, to the extent District Directors are now authorized, to sign proofs of claim and other documents asserting obligations incurred under the internal revenue laws (including taxes, penalties and interest), in order to claim and collect such obligations in any proceeding under the Bankruptcy Act and any receivership, decedent's estate, corporate dissolution, or other insolvency proceeding:

1. Chief and Assistant Chief, Collection Division.
2. Chief and Assistant Chief, Delinquent Accounts and Returns Branch.
3. Chief, Special Procedures Section.

The authority herein delegated may not be redelegated.

RUSSELL C. HARRINGTON,
Commissioner.

(Filed by the Division of the Federal Register on June 3, 1957, 8:50 a. m., and published in the issue of the Federal Register for June 4, 1957, 22 F. R. 3895.)

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[1] Delegation Orders Nos. 45, 46, 47, 48, 49, and 50 were not published.

(Also Part I, Section 3401; 26 CFR 31.3401(a)-1.) Rev. Proc. 57-1

Conditions under which an employer-issued statement, showing an employee's sick pay excludable from gross income under section 105(d) of the Internal Revenue Code of 1954, may be attached by the employee to his individual income tax return in satisfaction of the Internal Revenue Service's instructions requiring the employee to attach a statement relating to excludable sick pay.

Revenue Procedure 56-17, C. B. 1956-1, 1042, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the conditions under which an employer-issued statement, showing an employee's sick pay excludable from gross income under section 105(d) of the Internal Revenue Code of 1954, may be attached by the employee to his individual income tax return in satisfaction of the Internal Revenue Service's instructions requiring the employee to attach a statement showing a computaion of excludable sick pay and indicating the periods of absence, nature of illness or injury, and whether he was hospitalized.

SEC. 2. BACKGROUND.

.01 Section 31.3401(a)-1(b)(8)(ii)(b) of the Employment Tax Regulations provides that withholding is not required with respect to any or all employees upon the amount of any wage continuation payment made to an employee directly by the employer for whom he performs services to the extent that such payment is excludable from the gross income of the employee under section 105(d) of the Code, provided the employer maintains certain records specified in the regulations.

.02 In Revenue Procedure 56-17, C. B. 1956-1, 1042, conditions are set forth under which employers may show separately on Form W-2, Withholding Tax Statement, the amount of any sick or injury payments excludable from gross income, under section 105(d) of the Code, which are made directly by them. However, in such cases, regardless of whether or not tax was withheld on such excludable amounts, employers must keep the records described by subdivisions (1) and (2) of section 31.3401(a)-1(b)(8)(ii)(b) of the Employment Tax Regulations. It is further stated therein that the fact that excludable sick pay may be reported separately on Form W-2 will not relieve the employee of the necessity of submitting the statement which is required to be attached to his individual income tax return showing the computation of excludable sick pay and indicating the period or periods of absence, nature of illness or injury, and whether he was hospitalized.

.03 Employers having in effect wage continuation plans have requested permission to issue to their employees statements of excludable sick pay which such employees could attach to their individual income tax returns in lieu of the presently prescribed statement. These employers point out that the determinations made by them of excludable sick pay are fully supported by the type of records specified in subdivisions (1) and (2) of section 31.3401(a)-1(b)(8)(ii)(b) of the Regulations. It was suggested that adoption of such a procedure would be mutually advantageous to both the employer and the Service.

SEC. 3. PROCEDURE.

.01 Employers having wage continuation plans who keep the records required by section 31.3401(a)–1(8)(ii)(b) of the Regulations may issue statements to their employees of excludable sick pay which, when attached to the employees' individual income tax returns, will satisfy the present requirements for a statement supporting the sick pay exclusion, provided the employer also complies with the following:

1. Assumes full responsibility for the accuracy of the sick pay figures furnished to its employees, and keeps the payroll records supporting such figures available for inspection by Internal Revenue Service personnel;

2. Lists the excludable sick pay in a separate block on the Forms W–2 furnished to the employees; (Listing on Forms W–2 for the year 1956 may be shown separately. See Rev. Proc. 56–17, *supra.* The Form W–2 for 1957 will specifically provide a separate block for this purpose adjacent to the block for total wages paid.) and

3. Executes and issues to each employee involved a statement in substantially the forms illustrated in subsection .02.

.02 Form of statement to be issued by employers.

STATEMENT TO SUPPORT EXCLUDABLE SICK PAY

(Name of employee)

(Address of employee)

On the 1956 withholding tax statement, Form W–2, furnished to you by this corporation, sick pay excludable under section 105(d) of the Internal Revenue Code of 1954 in the amount of $---------- is shown. If you claim this exclusion on your 1956 income tax return, the Internal Revenue Service instructions pertaining to the filing thereof require you to enclose with your return a detailed computation in support of such sick pay exclusion. However, in view of the payroll records maintained by us, we are authorized under Rev. Proc. 57–1, I. R. B. 1957–2, to advise you that this statement will satisfy the Service's instructions and that, when you file your return, you may attach this statement thereto in lieu of the detailed computation required by the Service's instructions.

I, the undersigned officer of the corporation, declare under the penalties of perjury that the excludable sick pay shown above is, to the best of my knowledge and belief, an accurate determination based upon the records of the corporation, which records are available for inspection by Internal Revenue personnel.

By----------
(Name of employer)

.03 The foregoing statement was designed for use by a corporate employer. Whenever this statement is used by a partnership or a sole proprietor, it should be appropriately modified.

SEC. 4. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure modifies Revenue Procedure 56–17, C. B. 1956–1, 1042, insofar as it relates to the statement to be furnished by employees in support of the sick pay exclusion.

26 CFR 601.310: Forms. Rev. Proc. 57-2
(Also Section 601.318.)
(Also Parts I and III–A, Section 7805.)

The format for alcohol and tobacco tax forms has been changed. As each form comes up for reprint or revision, it will be amended to conform to the new format except where it is deemed advisable to reprint a form without change. Where differences arise between existing terminology as to "part," "section," etc., appearing in current regulations and the terminology appearing on the form, the latter will prevail.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to inform users of alcohol and tobacco tax forms of a basic change in the format of forms used in connection with alcohol and tobacco tax matters.

SEC. 2. BACKGROUND.

A study of the various forms used in the Internal Revenue Service has disclosed some lack of uniformity in format as to forms used in the several divisions. Appropriate standards and guidelines have now been established for use in designing and simplifying forms used throughout the Internal Revenue Service.

SEC. 3 NATURE OF CHANGE.

.01 For a number of years, many of the forms used in connection with alcohol and tobacco tax matters were printed so that major divisions of a form were designated as parts, identified by Arabic numbers. Several of the alcohol and tobacco tax regulations still identify such divisions of forms as "part 1," "part 2," etc.

.02 The new format is a complete reversal of this arrangement since it designates major divisions as sections, identified by Roman numerals, and designates subordinate divisions as parts, identified by capital letters. The new format also provides for Arabic numbering of lines and for lower case lettering of columns.

SEC. 4. SCOPE.

Compliance with the new format is being achieved as rapidly as circumstances permit. Practically all of the new forms recently issued, and recent revisions of other forms, are in accordance with the new format. However, in many instances, it has not been possible to comply since many forms have not come up for reprint, and in other instances contemplated changes in the use of a form make it advisable to reprint without revision.

SEC. 5. EFFECT ON OTHER DOCUMENTS.

Where differences arise between existing terminology as to "part," "section," etc., appearing in current regulations, and the terminology appearing on the form, the latter will prevail. The language of the regulations will be amended.

SEC. 6. INQUIRIES.

Inquiries with respect to this Revenue Procedure should refer to the number thereof and should be directed to the appropriate Assistant Regional Commisioner, Alcohol and Tobacco Tax.

26 CFR 601.318: Forms.

For the change in format of alcohol and tobacco tax forms, see Rev. Proc. 57–2, page 723.

Rev. Proc. 57–3

Procedures relating to applications for renewal of enrollments to practice before the Treasury Department and conditions under which renewals will be issued.

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, for the renewal of enrollments to practice before the Treasury Department.

SEC. 2. BACKGROUND.

.01 Enrollment to practice before the Treasury Department is governed by Part 10, Title 31 of the Code of Federal Regulations, which is printed in Treasury Department Circular 230 (Revised), *supra*. On October 17, 1956, there was published in the Federal Register an amendment to section 10.6 of Title 31 CFR which revoked paragraph (e) thereof, and revised subdivision (d) thereof, to read as follows:

(d) *Expiration and renewal of enrollment cards.*—Every enrollment card issued after December 31, 1951, shall become void five years after the date of its issuance. A holder of a void card is not entitled to practice before the Treasury Department. Application for renewal of enrollment card may be made at any time during a twenty-four month period commencing twelve months before and ending twelve months after the expiration of an enrollment card. Such application shall be filed on Form 23A at such place or places as may be designated by the Director of Practice and there shall be annexed thereto the enrollment card last outstanding. Copies of Form 23A may be obtained from the Director of Practice and at the offices of district directors of internal revenue.

.02 Pursuant to the authority granted in the amendment above, the Director of Practice has designated the office of the District Director of Internal Revenue of the district, in which an applicant conducts his practice, as the place at which he must file his *renewal* application unless such place of practice is in the Brooklyn, or Upper Manhattan, or Lower Manhattan District, in which event his application must be filed at the Office of the Regional Commissioner of Internal Revenue, New York, New York. His renewal application for an enrollment card may be made by filing Form 23A, Application for Renewal of Enrollment Card, in duplicate, with the enrollment card last issued attached thereto. Where the applicant is unable to attach his card last issued, a detailed explanation of the reason for such inability should be attached to his renewal application.

.03 Applications for enrollment, as distinguished from reenrollment, must, as heretofore, be filed at the Office of the Director of Practice, Internal Revenue Building, Washington 25, D. C.

SEC. 3. REVIEW AND EVALUATION OF THE APPLICATION.

.01 Renewal applications will be reviewed and determinations made as to whether:

1. All question theron have been fully answered and the application has been duly executed; and

2. The enrollment card last issued is attached; and
3. The answers on the application are favorable to the applicant and no reasonable grounds are known to exist for questioning the truth thereof; and
4. The application is not a questionable one; and
5. The application has been submitted within the time limit specified in section 10.6(d) of Title 31 CFR, as amended.

.02 Where any question on the renewal application has not been fully answered or where such application has not been duly executed, the application will be returned to the applicant for completion and resubmission.

.03 Where the enrollment card last issued, or in lieu thereof an explanatory statement of the failure to submit the card is not attached, the applicant will be required to establish whether such failure is the result of mere oversight.

.04 Where the application has not been submitted within the time limit specified in section 10.6(d) of Title 31 CFR, as amended, the applicant will be required to file an original application, Form 23, Application for Admission to Practice Before the Treasury Department at the office of the Director of Practice.

SEC. 4. ISSUANCE OF RENEWAL CARD.

.01 A renewal card may be issued forthwith where there is a fulfillment of each of the conditions above specified in section 3.01.

.02 A renewal card may also be issued in those cases wherein the conditions set forth in section 3.01 hereof have been subsequently fulfilled, or, wherein any matter bearing unfavorably upon the applicant's eligibility has been resolved favorably.

SEC. 5. PROVISIONS AGAINST DISRUPTION OF ENROLLMENT.

.01 Where the card last issued has not expired and it is determined that a renewal card cannot be issued immediately, the unexpired card shall be returned to the applicant.

.02 An immediate investigation will be undertaken where an expired enrollment card is submitted and a renewal card cannot be issued immediately due to some derogatory information (other than the applicant's affirmative answer to question 1 or 2 on his application).

SEC. 6. WITHDRAWAL OF APPLICATION.

Any request to withdraw a renewal application must be in writing duly signed by the applicant. A renewal application once filed becomes an official record and cannot be returned to the applicant. Effect shall be given, however, to a request to withdraw by advising the applicant in writing that his request has been granted and noted upon the official records. After advising the applicant that the granting of his request to withdraw has been noted on the official records, further processing of his application will be suspended.

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26 CFR 601.602: Forms and instructions. (Also Part I, Section 6011.) Rev. Proc. 57-4

Substitutes for Form 1042S, U. S. Annual Information Statement of Income Paid During 1957 Subject to Chapter 3, Internal Revenue

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Code, 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.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the practice of the Internal Revenue Service relative to the acceptance of substitutes for Form 1042S, U. S. Annual Information Statement of Income Paid During 1957 Subject to Chapter 3, Internal Revenue Code, for filing purposes in lieu of the official form furnished by the Service.

SEC. 2. SPECIFICATIONS.

.01 Substitutes for Form 1042S may be privately printed with slight variations in format, and used without specific approval of the Internal Revenue Service if the conditions enumerated in below section 3 are met.

.02 The fourth copy of the form is included in the official assembly for the convenience of the withholding agent. Although there is no requirement that privately printed substitute forms include a fourth copy, withholding agents may find it desirable to make and retain such a copy.

SEC. 3. CONDITIONS.

.01 *Quality of paper.*—The substitute forms must be printed on paper 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.

02. *Typography.*—The type may not be smaller than the corresponding type on the official form and must be as nearly as possible of the same font.

.03 *Format.*—The substitute forms must provide spaces for all the items (numbered 1 to 11) that are provided on Form 1042S.

.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 to eight and one-half inches (exclusive of snap-stub), and in depth from three and one-third inches to three and two-third 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 *The Government Printing Office symbols.*—The Government Printing Office symbols must be omitted.

SEC. 4. ADDITIONAL INSTRUCTIONS.

.01 *Arrangement of assembly.*—The parts of the assembly shall be arranged as follows: Original and duplicate, "For Internal Revenue"; triplicate "For payee"; and the quadruplicate copy "For Withholding Agent".

.02 *Substitutes previously approved.*—Substitutes which furnish all information required on Form 1042S and which have been previously approved by the Internal Revenue Service will be accepted without further approval. Previously approved substitutes which do

not fully comply with specifications as to size will continue to be accepted for the present. A reasonable amount of time will be permitted for correction of any existing differences in size specifications.

SEC. 5. ALTERNATIVE METHODS.

.01 *Listing investment income for custodial accounts.*—Listing all investment income for one payee on one sheet will be permitted without prior approval, providing the following conditions are met:

a. Not more than one payee's income may be covered by one sheet. The payee's name and address must be listed at the top of each sheet.
b. All of the information required on Form 1042S must be furnished and the gross amount of income paid and the tax withheld must be indicated.
c. The name of the foreign country, the nature of the income, and the withholding rate must be clearly shown.
d. The total width of the sheet must not exceed eight and one-half inches.
e. The list shall be submitted to the Internal Revenue Service, in duplicate, and treated as a Form 1042S for summarizing and filing purposes.

.02 *Copy for payee.*—If complete information as to the amount of income paid and tax withheld has been furnished to the payee with the dividend check, or in any other manner, it will not be necessary to furnish the triplicate copy of Form 1042S to the payee.

SEC. 6. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

Proposed substitute forms which do not meet the conditions stated above should be forwarded by letter to the Director of International Operations, Internal Revenue Service, Attention IOD:C:CRP, Washington 25, D. C.

(Also Part I, Section 503.) Rev. Proc. 57–5

Procedures as to the issuance, by the National Office, of registered notification letters and the granting of conferences with respect to cases involving prohibited transactions within the contemplation of section 503(c) of the Internal Revenue Code of 1954.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth procedures as to the issuance, by the National Office, of registered notification letters and the granting of conferences with respect to cases involving prohibited transactions within the contemplation of section 503(c) of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

Section 503(a) of the Code denies exemption to organizations described in section 501(c)(3), except those excluded under subsection (b), and employees' trusts which are qualified under section 401(a), which engage in prohibited transactions as described in section 503(c) of the Code. If the prohibited transaction is entered into with the purpose of diverting corpus or income of the organization from its

exempt purposes, and such transaction involves a substantial part of the corpus or income of the organization, it loses its exempt status forthwith and no notice is required. In other cases, however, exemption is denied only for taxable years after the taxable year during which the Commissioner issues a notice by registered or certified mail addressed to the organization at its last known address.

SEC. 3. NOTIFICATION THROUGH NATIONAL OFFICE.

Information obtained, and facts developed, by District Directors' offices upon examination of tax returns or through other sources, with respect to prohibited transactions, will be forwarded to the National Office with appropriate recommendations. The National Office will consider such information, and other information coming directly to its attention, for the purpose of determining whether a prohibited transaction has been entered into and, if so, for the issuance of the notice.

SEC. 4. CONFERENCES.

.01 The organization involved may be granted a conference at the National Office, relative to a determination whether a prohibited transaction has been entered into, either before or after the issuance of the notice. A conference will usually be granted in advance of issuance of the notice where the case reaches the National Office during the early part of a taxable year and it appears that action can be completed before the close of such year. In other cases, a conference will be granted after the notice is issued and, if it is determined that the notice was issued in error, it will be rescinded as of the date of issuance. Where an organization is advised through a District Director's office that the case has been forwarded to the National Office for a determination whether a prohibited transaction has been entered into, it may make a written request for a conference and submit a brief or statement directly to the National Office after filing copies with the District Director and stating that such copies have been filed. Where an organization is not so advised through a District Director's office, it may be advised through the National Office that it may request a conference and submit a brief or statement. Such advice will be issued if, in the opinion of the National Office, it appears that action can be completed before the close of the taxable year in which the information was obtained. In other cases, where the notice is issued, the organization may then request a conference and submit a brief or statement.

.02 If a conference is requested, a time and place will be set and the organization advised. The organization may be represented by an officer, or trustee, or by a fully authorized regular employee, or by a person who is enrolled to practice before the Treasury Department and duly authorized to appear on its behalf. A determination will be made after consideration of all the facts presented, conferences, discussions, and briefs and statements submitted, and the organization will be notified by the National Office as to such determination.

SEC. 5. EFFECTIVE DATE.

This Revenue Procedure is effective immediately.

(Also Part I, Section 6501; 26 CFR 301.6501(c)-1) Rev. Proc. 57-6
(Also Part II, Section 275; Regulations 118, Section 39.275-1.)

It is the policy of the Internal Revenue Service to secure a consent, extending the statutory period of limitation upon assessment of income and profits tax, only in a case involving unusual circumstances. It is the purpose of the Service to keep to an absolute minimum the number of consents obtained from taxpayers.

The Internal Revenue Service has been asked to state its policy and issue a guide for taxpayers and practitioners regarding the circumstances under which the securing of a waiver or consent provided for by section 6501(c)(4) of the Internal Revenue Code of 1954, to extend the period of limitation upon assessment of income and profits tax, is appropriate.

It has been the long-established policy of the Service to secure a consent, extending the statutory period of limitation, only in a case involving unusual circumstances. An examining officer must have the approval of his group supervisor prior to requesting a consent. Approval will not be granted in any case where previous contact with the taxpayer has not been made, except where compelling reasons exist.

It is the policy and purpose of the Service to keep to an absolute minimum the number of consents obtained from taxpayers. The audit program of the Service is set up to obtain the completion of the examination of returns within the present statutory period of limitation wherever possible. Nevertheless, situations arise which make it impossible for the examining officers to complete some of their examinations within the statutory period. As an example, an issue involved in a particular taxpayer's case may be similar to an issue in litigation in the case of another taxpayer or the same issue may be pending decision by the courts with reference to some other year of the same taxpayer. Obviously, in an instance of this nature, the examination cannot be satisfactorily completed until such time as the court's decision has been rendered and the issue resolved.

Similarly, where disagreement exists regarding some complex or intricate question of fact or doubtful issues of law and sufficient time does not remain within the statutory period to permit the taxpayer to gather the necessary data to support his contentions and to avail himself of his conference and appellate rights, there is no alternative, in the interest of a practical administration of the tax laws, but to request a consent from the taxpayer, extending the statutory period of limitation, in order to arrive at an equitable solution to the problem involved.

Also, where a net operating loss is to be applied as a carry back, sufficient time may not remain to complete the necessary audit action within the regular period and, accordingly, an extension of the period of limitation is obtained, an action of mutual benefit to the taxpayer and the Government. In these examples, and in other instances, the possibility exists that an additional or renewal consent may be found necessary. However, it is the policy of the Service to restrict additional consents to such cases as where the circumstances are, ordinarily, beyond the control of the Service and a further extension is fully justi-

fied in the opinion of the supervisory officials concerned, after a thorough review of all the facts present in the case.

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26 CFR 601.318: Forms. Rev. Proc. 57-7
(Also Part I, Section 5741; Section 275.132.)

Form 2141, Record To Be Kept by Manufacturer of Tobacco, has been issued for use by manufacturers of tobacco beginning with records covering transactions on and after January 1, 1957.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the issuance of Form 2141, Record To Be Kept by Manufacturer of Tobacco, and to provide instructions and guidelines for the proper recording of the information required by section 275.132 of the Regulations relating to Manufactured Tobacco (Manufacturers, Importers, and Dealers).

SEC. 2. DESCRIPTION OF FORM 2141.

Form 2141 consists of a single sheet 21 by 16 inches perforated on a center fold line to make a double sheet 10½ by 16 inches. The form contains five sections, namely, section I, Account of Tobacco Materials Received; section II, Account of Tobacco Materials Shipped, Delivered, Lost, and Destroyed; section III, Account of Manufactured Tobacco; section IV, Account of Stamps; and section V, Account of Taxpaid Manufactured Tobacco Received. These are designed to record such operations and transactions for a period of one month.

SEC. 3. ISSUANCE.

Prior to January 1, 1957, each Assistant Regional Commissioner, Alchol and Tobacco Tax, will furnish an initial supply of six copies of Form 2141 to every tobacco manufacturer in his region. The form will be used by such manufacturers covering transactions on and after January 1, 1957.

SEC. 4. USE.

The headings of the accounts and columns and the footnotes on the form provide appropriate reference and general instructions to guide the manufacturer in recording the required information. However, additional instructions are furnished with respect to the recording of the following operations and transactions to insure a clear understanding of the major changes made in the record:

.01 *Receipt and disposition of tobacco materials.*—The receipt of tobacco materials into the factory and the subsequent shipment, delivery, loss, or destruction of such tobacco materials shall be recorded under only the two classifications of *unstemmed tobacco* (tobacco from which the stem or mid-rib has not been removed) and *other tobacco materials* (all other tobacco materials, including stems—if received or if shipped or delivered to manufacturers of tobacco products, dealers in tobacco materials, or for purposes other than fertilizers, insecticide, or nicotine—but not including waste). A separate entry shall be made in the record with respect to each receipt, shipment, or other disposition of tobacco materials.

.02 *Receipt of untaxpaid manufactured tobacco.*—The receipt of untaxpaid manufactured tobacco from another factory, in export warehouse, customs custody, and by withdrawal from the market,

shall be recorded as a combined single daily entry in section III of the form, in the column headed "Received Without Payment of Tax." However, with respect to such manufactured tobacco withdrawn from the market, the manufacturers should first determine the disposition to be made thereof and so record only that quantity of manufactured tobacco that is to be reworked, reconditioned, or reduced to materials. The quantity of manufactured tobacco which is reduced to materials shall then also be recorded in section III in the column headed "Reduced to Materials." The quantity of tobacco materials obtained from such reduction of manufactured tobacco shall then also be recorded in section I of the form.

.03 *Receipt of taxpaid manufactured tobacco.*—The receipt of taxpaid manufactured tobacco into the factory and the subsequent disposition of such manufactured tobacco shall be recorded in section V of the form. The manufactured tobacco to be recorded in this section includes the taxpaid tobacco received from another factory, and the taxpaid tobacco of the manufacturer which is returned to the factory, for reshipment in the same condition as received.

.04 *Loss and destruction of manufactured tobacco.*—The loss or destruction of manufactured tobacco which has been recorded as manufactured, or as recived without payment of tax, and which is lost or destroyed prior to removal from the factory, shall be recorded in section III of the form, in the column headed "Lost and Destroyed."

.05 *Loss, destruction, and mutiliation of stamps.*—The loss, destruction, or mutilation of stamps which have been recorded as received (including those affixed to packages which have not been removed from the factory) shall be recorded in section IV of the form, in the column headed "Lost, Destroyed, and Mutilated."

.06 *Reduction of manufactured tobacco to materials.*—The reduction to tobacco materials of manufactured tobacco which has been recorded as manufactured, or as recived without payment of tax, shall be recorded in section III of the form, in the column headed "Reduced to Materials."

SEC. 5. EFFECT ON OTHER DOCUMENTS.

.01 Section 9 of Revenue Procedure 55–11, C. B. 1955–2, 912, which established an interim procedure pending the issuance of Form 2141, will not be applicable as to records covering transactions on and after January 1, 1957.

.02 Section 3 of Revenue Procedure 56–3, C. B. 1956–1, 1018, is modified to refer to Form 2141, in line of Form 74, Book to be Kept by Manufacturers of Tobacco and Snuff, as to transactions on and after January 1, 1957.

.03 Revenue Ruling 56–76, C. B. 1956–1, 548, which prescribed a uniform procedure for the keeping of tobacco, cigar, and cigarette factory records, is hereby superseded as to manufactured tobacco records maintained on and after January 1, 1957.

SEC. 6. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.318: Forms. Rev. Proc. 57–8
(Also Part I, Section 5741; Section 270.142.)

Form 2142, Record to be Kept by Manufacturer of Large Cigars, and Form 2143, Record to be Kept by Manufacturer of Small Cigars and Large and Small Cigarettes, have been issued for use by manufacturers of cigars and cigarettes, beginning with records covering transactions on and after January 1, 1957.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the issuance of Form 2142, Record to be Kept by Manufacturers of Large Cigars, and Form 2143, Record to be Kept by Manufacturers of Small Cigars and Large and Small Cigarettes, and to provide instructions and guidelines for the proper recording of the information required by section 270.142 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers).

SEC. 2. DESCRIPTION OF FORMS 2142, 2142–A, AND 2143.

Form 2142 consists of a single sheet 21 by 16 inches perforated on a center fold line to make a double sheet 10½ by 16 inches. The form contains three sections, namely, section I, Account of Tobacco Materials Received; section II, Account of Tobacco Materials Shipped, Delivered, Lost, and Destroyed; and section III, Account of Large Cigars. These are designed to record such operations and transactions for a period of one month. A supplemental Form 2142–A, printed as a single sheet 10½ by 16 inches, containing section IV, Account of Stamps, and section V, Account of Taxpaid Large Cigars Received, is provided for use by a manufacturer of large cigars using stamps for taxpayment and by a manufacturer receiving into his factory taxpaid large cigars. Form 2143 is identical to Form 2142 in size and design, and contains five sections, namely, section I, Account of Tobacco Materials Received; section II, Account of Tobacco Materials Shipped, Delivered, Lost, and Destroyed; section III, Account of Small Cigars, Large Cigarettes, or Small Cigarettes; section IV, Account of Stamps; and section V, Account of Taxpaid Small Cigars, Large Cigarettes, or Small Cigarettes Received.

SEC. 3. ISSUANCE.

Each Assistant Regional Commissioner, Alcohol and Tobacco Tax, will furnish an initial supply of six copies of Form 2142 or Form 2143, as the case may be, to each manufacturer in his region for use to cover transactions on and after January 1, 1957.

SEC. 4. USE.

The headings of the accounts and columns and the footnotes on the forms provide appropriate reference and general instructions to guide the manufacturer in recording the required information. However, additional instructions are furnished with respect to the recording of the following operations and transactions to insure a clear understanding of the major changes made in the records:

.01 *Receipt and disposition of tobacco materials.*—The receipt of tobacco materials into the factory and the subsequent shipment, delivery, loss, or destruction of such tobacco materials shall be recorded under only the two classifications of *unstemmed tobacco* (tobacco from which the stem or mid-rib has not been

removed) and *other tobacco materials* (all other tobacco materials, including stems—if received or if shipped or delivered to manufacturers of tobacco products, dealers in tobacco materials, or for purposes other than fertilizer, insecticide, or nicotine—but not including waste). A separate entry shall be made in the record with respect to each receipt, shipment, or other disposition of tobacco materials.

.02 *Receipt of untaxpaid cigars and cigarettes.*—The receipt of untaxpaid cigars or cigarettes from another factory, an export warehouse, customs custody, and by withdrawal from the market, shall be recorded as a combined single daily entry in section III of the appropriate form, in the column headed "Received Without Payment of Tax." However, with respect to such cigars and cigarettes withdrawn from the market, the manufacturers should first determine the dispostion to be made thereof and so record only those cigars or cigarettes that are to be reworked, reconditioned, or reduced to materials. Those cigars or cigarettes which are reduced to materials shall then also be recorded in section III in the column headed "Reduced to Materials." The quantity of tobacco materials obtained from such reduction of sigars or cigarettes shall then also be recorded in section I of the appropriate form.

.03 *Receipt of taxpaid cigars and cigarettes.*—The receipt of taxpaid cigars or cigarettes into the factory and the subsequent disposition of such cigars or cigarettes shall be recorded in section V of the appropriate form. The cigars or cigarettes to be recorded in this section include those taxpaid cigars or cigarettes received from another factory, and those taxpaid cigars or cigarettes of the manufacturer which are returned to the factory, for reshipment in the same condition as received.

.04 *Loss and destruction of cigars and cigarettes.*—The loss or destruction of cigars or cigarettes which have been recorded as manufactured, or as received without payment of tax, and which are lost or destroyed prior to removal from the factory, shall be recorded in section III of the appropriate form, in the column headed "Lost and Destroyed."

.05 *Loss, destruction, and mutilation of stamps.*—The loss, destruction, or mutilation of stamps which have been recorded as received (including those affixed to packages which have not been removed from the factory) shall be recorded in section IV of the appropirate form, in the column headed "Lost, Destroyed, and Mutilated."

.06 *Reduction of cigars and cigarettes to materials.*—The reduction to tobacco materials of cigars or cigarettes which have been recorded as manufactured, or as received without payment of tax, shall be recorded in section III of the appropriate form, in the column headed "Reduced to Materials."

SEC. 5. EFFECT ON OTHER DOCUMENTS.

.01 Section 10 of Revenue Procedure 55–12, C. B. 1955–2, 914, which established an interim procedure pending the issuance of Forms 2142 and 2143, will not be applicable as to records maintained on and after January 1, 1957.

.02 Section 3 of Revenue Procedure 56–3, C. B. 1956–1, 1018, is modified to refer to Forms 2142 and 2143, in lieu of Form 73—Part 1, Book to be Kept by Manufacturers of Large Cigars, and Form 73—Part 2, Book for Use by Manufacturers of Small Cigarettes, Large Cigarettes, or Small Cigars, respectively, as to transactions on and after January 1, 1957.

.03 Revenue Ruling 56–76, C. B. 1956–1,548, which prescribed a uniform procedure for the keeping of tobacco, cigar and cigarette factory records, is hereby superseded as to cigar and cigarette records maintained on and after January 1, 1957.

SEC. 6. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.311: Imposition of taxes; regulations. (Also Part I, Section 7805; Sections 270.153 and 275.142.) — Rev. Proc. 57–9

Procedure is established with respect to the receipt into tobacco products factories of packages of taxpaid tobacco products, including such products received from another factory, for the purposes of reshipment in the same packages in which received, without reworking, reconditioning, or other rehandling.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish certain basic procedures to be followed by manufacturers of tobacco products in connection with the receipt of taxpaid tobacco products on and after January 1, 1957.

SEC. 2. PRODUCTS WHICH MAY BE RECEIVED.

The receipt into tobacco products factories of packages of tobacco products on which the tax has been paid, by stamps or by returns, is permissible, including such products received from another factory, for purposes of reshipment in the same packages in which received, without reworking, reconditioning, or other rehandling. However, a manufacturer may receive into his factory only the kind of product which he is authorized to produce in the factory. In this connection see Revenue Ruling 56–141, C. B. 1956–1, 543, relative to transfers of tobacco products from one factory to another.

SEC. 3. APPLICATION.

A manufacturer of tobacco products must, prior to receipt of taxpaid products into the bonded factory, make application to, and receive permission from, the Assistant Regional Commissioner, Alcohol and Tobacco Tax, for the region in which his factory is located, to do so. The application should show the name of the manufacturer of the product and the quantity, kind, and class designation (in the case of large cigars) of the tobacco product to be received into the bonded factory premises. Where it is decided to receive tobacco products into the bonded premises under a continuing arrangement, the Assistant Regional Commissioner may grant a blanket authority

upon proper application therefor. However, the manufacturer must furnish the information indicated above with respect to each lot or shipment received.

SEC. 4. IDENTIFICATION.

Such taxpaid tobacco products received must be stored, segregated, or labeled in such manner as to make them readily identifiable as taxpaid products received and they must be accessible for inspection by any internal revenue officer upon his request.

SEC. 5. ACCOUNTING.

In connection with the revenue accounting for taxpaid tobacco products received, the new records required to be kept by manufacturers of tobacco products, to be issued for use beginning January 1, 1957, will provide, in section V, a separate account for the recording of the receipt of taxpaid tobacco products and the subsequent disposition thereof. See in this connection Rev. Proc. 57–7, page 730, and Rev. Proc. 57–8, page 732. These records are Form 2141, Record to be Kept by Manufacturer of Tobacco, Forms 2142 and 2142–A, Record to be Kept by Manufacturer of Large Cigars, and Form 2143, Record to be Kept by Manufacturer of Small Cigars and Large and Small Cigarettes. No other debit or credit entry of such products, or of any stamps affixed to the packages of such products, shall be made in such forms with respect to taxpaid tobacco products so received or disposed of. Further, such products shall not be included in any inventory or report required to be made by the manufacturer.

SEC. 6. TAXPAID PRODUCTS RECEIVED TO BE REWORKED, RECONDITIONED, ETC.

The procedure set forth in section 5 hereof is not to be confused with the procedure to be followed with respect to tobacco products on which tax has been paid where such products are to be taken up in the factory records as untaxpaid products received because they are to be reworked, reconditioned, or otherwise rehandled, or claim is to be filed for refund of the original tax paid, since such products will not be entered in the separate account under section V of the revenue records referred to in section 5.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

The penultimate paragraph of Revenue Ruling 56–141, *supra*, is hereby superseded as to factory records maintained on and after January 1, 1957.

SEC. 8. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

(Also Part I, Section 167; 26 CFR 1.167(d)–1.) Rev. Proc. 57–10

Form to be used for executing agreements as to useful life, method and rate of depreciation of business property provided for by section 167(d) of the Internal Revenue Code of 1954 and the Income Tax Regulations thereunder. In addition, procedural instructions are also prescribed relative to entering into and modifying such agreements.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to prescribe the form to be used for executing agreements as to useful life, method and rate of depreciation of business property provided for by section 167(d) of the Internal Revenue Code of 1954 and the Income Tax Regulations thereunder. In addition, procedural instructions are also prescribed relative to entering into and modifying such agreements.

SEC. 2. APPLICATION FOR AGREEMENT.

.01 Action to initiate an agreement, Form 2271, Agreement as to Useful Life, Method and Rate of Depreciation of Property (see exhibit A), under section 167(d) of the Code will be taken by the taxpayer. The taxpayer should submit an application, prepared in accordance with section 1.167(d)–1 of the Income Tax Regulations, to the District Director of Internal Revenue for the district in which the taxpayer's return is required to be filed.

.02 If the taxpayer's request for an agreement does not conform substantially to the instructions in section 1.167(d)–1 of the Income Tax Regulations, he will be invited to resubmit the application in accordance with such regulations.

.03 If, on review of the application, it is determined that the taxpayer has provided the required data and that there are no statements or proposals which require investigation, the agreement and related schedules will be prepared in accordance with the instructions printed on the back of Form 2271. The application itself may be attached as schedules to, and made a part of, the agreement if it is suitable for this purpose.

.04 Before the agreement can be prepared, it may be found necessary to obtain additional information from the taxpayer or to make a field examination of the taxpayer's return or returns for the taxable year or years immediately preceding the first taxable year to be covered by the agreement. It may also be necessary to make a physical examination of the property covered by the application for an agreement.

.05 If the agreement is to provide for a method of depreciation different from that in use by the taxpayer prior to the effective date of the agreement, the permission of the Commissioner to make such change will be required. See section 1.167(e)–1 of the Income Tax Regulations.

SEC. 3. PREPARATION OF THE AGREEMENT, FORM 2271.

.01 After all necessary preliminary action has been taken, it will be the responsibility of the District Director to prepare Form 2271 and to attach thereto the copies of the required schedules.

.02 Upon completion of Form 2271, the original and all copies will be forwarded to the taxpayer for signature. The taxpayer will then return the original and all copies for the signature of the District Director.

.03 Two signed copies of Form 2271 will be returned to the taxpayer, one for filing with the return for the first taxable year affected by the agreement and the other for the taxpayer's files. The office in which the form was prepared will retain the original as a part of its records.

SEC. 4. PERIOD OF TIME COVERED BY THE AGREEMENT.

In neither section 167(d) of the Code nor the Income Tax Regulations thereunder is provision made for limiting the period covered by the agreement, except that such agreement shall be binding on both parties from the effective date until such time as facts and circumstances may be shown to exist which were not taken into account in making the agreement. However, an agreement may be made effective for a period less than the useful life of the property covered by the agreement. If the parties to the agreement wish to limit its effective period, the words "* * * and to subsequent taxable years * * *" appearing in the second paragraph of Form 2271 will be deleted and, in the space provided for the entry of the beginning date, there will also be inserted the ending date of the period to be covered by the agreement.

SEC. 5. COMBINED ASSET ACCOUNTS.

Section 1.167(a)-7 of the Income Tax Regulations provide that depreciable property may be accounted for by the taxpayer by treating each individual item separately or by combining two or more assets into a single account. An agreement on Form 2271 may be entered into with respect to any of the combined asset accounts described in the regulations, or with respect to such other types of depreciation accounts as have been established by the taxpayer.

SEC. 6. PROPERTY ACQUIRED SUBSEQUENT TO AGREEMENT.

The provisions of an agreement on Form 2271 shall not be extended to depreciable property acquired subsequent to the date the agreement was entered into. However, if subsequently acquired property having the same characteristics as the property covered by the agreement is depreciated by the taxpayer consistently with the rates, method and useful life stated in the agreement, the effect will be to minimize subsequent adjustments to such acquisitions.

SEC. 7. FACTS AND CIRCUMSTANCES JUSTIFYING MODIFICATION OF AN AGREEMENT.

In the course of examinations undertaken after the effective date of an agreement, the Internal Revenue Service will give careful attention to physical assets, asset accounts and depreciation reserve accounts and to any facts or circumstances which were not taken into account at the time of making the agreement. However, modification or cancellation of an existing agreement will not be proposed by the Internal Revenue Service unless there is a clear and convincing basis for a modification. Procedure with respect to modification as set forth in section 1.167(d)-1 of the regulations will be followed in all cases.

SEC. 8. EXISTING AGREEMENTS.

Existing agreements entered into between the taxpayer and the Internal Revenue Service in accordance with procedures established prior to the effective date of the 1954 Code provisions will be continued in effect, except that such agreements will have no application to property described in section 167(c) of the 1954 Code if the taxpayer desires to compute the allowance for depreciation with respect to such property in accordance with a method of rate of depreciation permitted by section 167(b)(2), (3), or (4) of the Code.

SEC. 9. INQUIRIES.

Inquiries relating to this Revenue Procedure may be addressed to the appropriate office of the District Director of Internal Revenue.

EXHIBIT A

FORM 2271 DEC. 1956	U. S. TREASURY DEPARTMENT—INTERNAL REVENUE SERVICE **AGREEMENT AS TO USEFUL LIFE METHOD AND RATE OF DEPRECIATION OF PROPERTY** *(See instructions on reverse)*

THIS AGREEMENT is made in quadruplicate under and in pursuance of section 167(d) of the Internal Revenue Code of 1954, by and between

Name of taxpayer

Address from which return will be filed

and the Commissioner of Internal Revenue, by his authorized delegate.

The parties hereto mutually agree that the estimated remaining useful life, method and rate of depreciation of the property or properties shown and described in the schedule or schedules (consisting of_____pages) attached to and made a part of this agreement, shall be applicable to the taxable year beginning on_____and to subsequent taxable years, and shall be binding on the parties until such time as one of the parties hereto establishes facts and circumstances which were not taken into account in the adoption of this agreement, and which justify a modification hereof. Any change in the agreed estimated remaining useful life, method or rate specified in the schedules made a part of this agreement shall not be effective for taxable years before the taxable year in which notice is sent by registered mail by the party to the agreement proposing the change to the other party. It is understood that this agreement does not bind the parties as to the basis of properties shown for information purposes in the attached schedules.

EFFECTIVE DATE OF THIS AGREEMENT		
SIGNATURE OF TAXPAYER	DATE	CORPORATE SEAL
BY	DATE	
ACCEPTED FOR THE COMMISSIONER OF INTERNAL REVENUE BY	DATE	
TITLE		

26 CFR 601.318: Forms. Rev. Proc. 57-11
(Also Part I, Sections 5721, 5722.)

Manufacturers of tobacco products will, as of January 1, 1957, show all tobacco materials under only the classifications of *unstemmed tobacco* and *other tobacco materials* on all their inventories and reports.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to furnish instructions relative to the manner of reporting tobacco materials by manufacturers of tobacco products in their inventories and reports, after January 1, 1957.

SEC. 2. INVENTORY, FORM 2130 OR 2131.

In any inventory required to be made after January 1, 1957, on Form 2130, Inventory—Manufacturer of Tobacco, or Form 2131, Inventory—Manufacturer of Cigars and Cigarettes, manufacturers of tobacco products shall show all tobacco materials under only the two classifications of *unstemmed tobacco* (tobacco from which the stem or mid-rib has not been removed) and *other tobacco materials* (all other tobacco materials, including stems if received or intended for use in manufacture, but not including waste).

SEC. 3. MONTHLY REPORT, FORM 2134 OR 2136.

Beginning with the report for the month of January, 1957, manufacturers of tobacco products shall show in the report, Form 2134, Monthly Report—Manufacturer of Tobacco, or Form 2136, Monthly Report—Manufacturer of Cigars and Cigarettes, as the case may be, all tobacco materials under only the two classifications of *unstemmed tobacco* (tobacco from which the stem or mid-rib has not been removed) and *other tobacco materials* (all other tobacco materials, including stems if received or if shipped or delivered to manufacturers of tobacco products, dealers in tobacco materials, or for purposes other than fertilizer, insecticide, or nicotine, but not including waste).

SEC. 4. MODIFICATION OF PRESENT FORMS.

Until the inventory and the report forms are revised, manufacturers of tobacco products should appropriately modify section I of such forms to show only the two classifications of *unstemmed tobacco* and *other tobacco materials.*

SEC. 5. INTERNAL REVENUE RECORDS OF MANUFACTURERS.

This manner of reporting tobacco materials is consistent with the way manufacturers will record tobacco materials in the new internal revenue records, Form 2141, Record To Be Kept by Manufacturer of Tobacco, Form 2142, Record To Be Kept by Manufacturer of Large Cigars, and Form 2143, Record To Be Kept by Manufacturer of Small Cigars and Large and Small Cigarettes, which will be issued for use beginning January 1, 1957.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

.01 The instructions contained in paragraph three of Revenue Procedure 56-3, C. B. 1956-1, 1018, are not applicable as to inventories submitted on and after January 1, 1957.

.02 The provision of Revenue Ruling 56–74, C. B. 1956–1, 541, requiring transactions in tobacco materials to be reported under the classifications of unstemmed and stemmed leaf tobacco, is hereby modified to require such reporting under the classifications of *unstemmed tobacco* and *other tobacco materials* as to reports submitted on and after January 1, 1957.

SEC. 7. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.602: Forms and instructions. Rev. Proc. 57–12
(Also Part I, Section 5632; 301.6532–1.)

A taxpayer may execute a waiver, Form 2297, Waiver of Registered Mail Notification of Claim Disallowance, of the requirement that a registered notice of disallowance of a claim be issued where and agreement is secured at the conclusion of an investigation or conference. A taxpayer may, however, request the opportunity to execute the waiver at any time prior to issuance of the registered notice.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to prescribe Form 2297, Waiver of Registered Mail Notification of Claim Disallowance, which is to be used where a taxpayer expresses his willingness to execute a waiver of the requirement that a notice of disallowance of a claim for refund be sent to him by registered mail.

SEC 2. AUTHORITY.

Section 6532(a)(1) of the Internal Revenue Code of 1954 states in part that no suit or proceeding for recovery of an internal revenue tax, penalty, or other sum shall be begun more than two years after the date of issuance by a District Director of Internal Revenue or an Assistant Regional Commissioner of a registered notice of disallowance of the part of the claim to which the suit of proceeding relates. Section 6532(a)(3) provides that if a taxpayer files a written waiver of the requirement that he be mailed a notice of disallowance, the two-year period referred to shall begin on the date the waiver is filed. This Revenue Procedure is applicable only with respect to income, estate, gift, employment and excise taxes (other than alcohol, tobacco and certain other excise taxes prescribed by Subtitle E) imposed by the Internal Revenue Code of 1954.

SEC 3. PROCEDURE.

.01 If, in a case involving the disallowance in full or in part of a claim for refund, an agreement is signed at the conclusion of the examining officer's investigation of the claim or at a subsequent informal conference, the taxpayer will be asked to execute the waiver. If an agreement is reached in a claim disallowance case after consideration in the Appellate Division, the waiver will be offered for the taxpayer's signature at that time

.02 A taxpayer may, at any time prior to the issuance of a notice of claim disallowance by registered mail, execute the waiver with respect to any claim for refund which has been filed.

SEC. 4. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Operations), for the attention of O. A. PPr.

(Also Part I, Section 1441; 26 CFR 1.1441-1.) Rev. Proc. 57-13

Procedures to be followed in order for an employer to refund tax withheld from wages paid to a nonresident alien employee.

Rev. Rul. 54-584, C. B. 1954-2, 212, amplified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedure whereby an employer may refund tax withheld from wages paid to a nonresident alien employee in accordance with the requirements enumerated in Revenue Ruling 54-584, C. B. 1954-2, 212.

SEC. 2. BACKGROUND.

Revenue Ruling 54-584, *supra*, holds that the tax withheld from wages paid to a nonresident alien employee, under the provisions of section 143(b) of the Internal Revenue Code of 1939 (corresponding to section 1441 of the 1954 Code), which has not yet been paid to the District Director of Internal Revenue as required by section 143(c) of the 1939 Code, may be refunded direct to such nonresident alien employee by his employer upon receipt of satisfactory evidence that the employee has filed an appropriate income tax return and paid the amount of tax, if any, due thereon without claiming credit for such tax withheld; or, the excess of the tax withheld over the amount due on the return may be refunded if the employee has not paid the amount of tax due. In order for the employee to obtain a refund of the tax withheld, the Revenue Ruling requires that he must:

(1) Secure his employer's agreement to refund the tax withheld directly to him and obtain from his employer, in addition to his agreement to make such refund, a sworn statement showing the amounts of wages paid and tax withheld.

(2) File the appropriate income tax return, together with the statement obtained from the employer, with the appropriate District Director of Internal Revenue.

(3) Secure a receipt or statement from the District Director that will satisfactorily indicate to his employer that returns were properly filed and that:

(a) The amount of the tax liability shown on the return was paid in full without claiming credit for the tax withheld under section 143(b) of the 1939 Code, or

(b) Where such liability was not paid, credit only in the amount equal to the tax liability shown on the return was claimed, or

(c) The return filed disclosed no tax liability and no credit claimed for tax withheld, and that

(d) A refund of withheld tax in a stated amount may be made directly to the employee.

(4) Furnish to the employer the receipt or statement from the District Director.

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SEC. 3. DEFINITIONS.

.01 The "amounts of wages paid" means the amounts paid for services, allowances for travel and subsistence, and any other amounts paid, to the extent such amounts constitute gross income from sources within the United States and are not specifically exempted by any provision of the Code.

0.2 The "appropriate income tax return" normally means Form 1040C, "U. S. Departing Alien Income Tax Return." If an income tax return should have been filed for a prior year, Form 1040B, "U. S. Nonresident Alien Income Tax Return," will also be required. Where a nonresident alien had no taxable income from United States sources, Form 2063, "U. S. Departing Alien Income Tax Statement," will be required in lieu of Form 1040C.

.03 The "appropriate District Director of Internal Revenue" means the District Director who issues the Certificate of Compliance required by section 6851(d) and (e) of the 1954 Code, and who normally is located in the district in which the nonresident alien is employed or where the employer's principal office is located. Frequently, however, the Certificate of Compliance is obtained from the District Director located in or near the city of embarkation.

SEC. 4. PRESCRIBED FORMS.

For the purposes of the "agreement" to be obtained from the employer and the "receipt or statement" from the District Director no prescribed form has been made and none is available. However, they should be the equivalent in form and content to the exhibits made a part hereof.

Exhibit "A".—Employer's Refund Agreement and Statement of Wages Paid and Tax Withheld.

Exhibit "B".—Statement Authorizing Refund of Income Tax Withheld from Nonresident Alien Employee.

SEC. 5. EMPLOYERS REPORT ON REFUND OF TAX WITHHELD.

.01 The amount of tax originally withheld under section 1441 of the 1954 Code and subsequently refunded or released, in accordance with Revenue Ruling 54–584, *supra*, shall be reported in item 9 of Form 1042S, "U. S. Annual Information Statement Of Income Paid During 1957 Subject to Chapter 3, Internal Revenue Code."

.02 A brief statement relative to the release of tax withheld, using the reverse side of the Form 1042S, if additional space is necessary, or a copy of Exhibit "B" should be included with the Form 1042S.

.03 While the gross amount of income paid shall be reported by the employer on Form 1042, "U. S. Annual Return of Income Tax to be Paid at Source," only the net amount of tax withheld shall be reported under the heading "Amount of Tax Withheld" and remitted with the return.

SEC. 6. PROCEDURE FOR CORRECTING ERROR IN REPORTING AND REMITTING TAX WITHHELD.

.01 The types of errors commonly made in reporting tax withheld and requiring correction are as follows:

1. Tax withheld from nonresident alien, under section 1441 of the 1954 Code, is reported and paid by means of Form 941, "Em-

ployer's Quarterly Federal Tax Return," instead of Form 1042 as required.

2. Tax is erroneously withheld from nonresident alien employee under section 3402 of the 1954 Code instead of section 1441 as required; withheld amount is remitted with the employer's quarterly return Form 941 before discovery of the error.

.02 Erroneous amounts paid on Form 941 should be adjusted on the next quarterly return on that form filed after discovery of the error, in accordance with the regulations and instructions pertaining to such form.

.03 The gross amount of income paid and the net amount of tax withheld from the nonresident alien employee, under the provisions of section 1441 of the 1954 Code, shall then be reported on the annual return, Form 1042, and the tax, if any, paid as if the error had not occurred.

SEC. 7. Revenue Ruling 54–584, supra, is hereby amplified.

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EXHIBIT "A"

EMPLOYER'S REFUND AGREEMENT AND STATEMENT OF WAGES PAID AND TAX WITHHELD

(In accordance with the provisions of Revenue Ruling 54–584, C. B. 1954–2, 212.)

District Director of Internal Revenue (Date issued)
(address)

Dear Sir:

This is to _____, has paid to _____
(employer's name and address) (nonresident alien
_____, a citizen of _____,
employee's name and address) (country of alien's citizenship)
classified as a nonresident alien, for services rendered and/or subsistence during the calendar year 19____ through _____,
(final date of employment)
the amount of $_____ from which tax has been withheld in the amount of $_____.

Upon receipt of the proper authorization from your office, we agree to refund the excess of the tax withheld over the amount of tax due on the appropriate income tax return for the year 19____, filed by the above-named employee.

_____
(Name of employer)

By: _____
(Signature of authorized officer)
Title

Subscribed and sworn to before me
this _____ day of_____, 19____.

_____
Notary Public

EXHIBIT "B"

STATEMENT AUTHORIZING REFUND OF INCOME TAX WITHHELD FROM NONRESIDENT ALIEN EMPLOYEE

(In accordance with the provisions of Revenue Ruling 54-584, C.B. 1954-2, 212.)

(Name and address of employer)

This is to certify:

1. That an income tax return (or returns) for the taxable year (years) 19__, based on your Refund Agreement and Statement of Wages Paid and Tax Withheld executed by you (date of employer's refund agreement), has been filed by the employee named in item 3 below.

2. That (Check one of the following)

☐ a. Full tax liability was paid without claiming credit on the return for any tax withheld.

☐ b. Credit for income tax withheld from wages was claimed only to the extent of the tax liability amounting to $_____, as computed on the return(s) filed.

☐ c. The return filed disclosed no tax liability and no credit was claimed on the return for income tax withheld.

3. That you may release (refund) directly to (name of employee) income tax withheld from wages in the amount of $_____.

(Signature)

District Director of Internal Revenue

By_____

Title_____

Date:_____19____

(Official stamp)

26 CFR 601.602: Forms and instructions. (Also Part 1, Section 1402; 1.1402(a)-1.)

Rev. Proc. 57-14

Use of Form 2190, Change In Method of Computing Net Farm Earnings From Self-Employment, in lieu of amended returns in certain cases, in order to effect a change in election with respect to the alternative methods provided in section 1402 of the Self-Employment Contributions Act of 1954, for computing net farm earnings from self-employment.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to introduce Form 2190, Change In Method of Computing Net Farm Earnings From Self-Employment. Under certain circumstances, this form will be used in lieu of the filing of an amended return and, when executed by the taxpayer will constitute a valid election or revocation of the election to report net earnings from farm self-employment under the optional method provided in section 1402(a) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

SEC. 2. BACKGROUND.

.01 Section 1.1402(a)-1(d)(5) of the Income Tax Regulations provides, in part, that subsequent to the filing of the original return, the election (or revocation of the election previously made on such return)

to report net farm earnings from self-employment under the optional method may be made within the period prescribed by section 6501 of the Code and the regulations thereunder for the assessment of the tax for such taxable year "by filing an amended return (or such other form as may be prescribed for such use)."

.02 The Social Security Administration has advised the Internal Revenue Service that when claims for social security benefits are filed by self-employed farmers, in many cases it has been found upon examination by that agency that the net farm earnings from self-employment would have been larger if the alternative method of computing net earnings had been used. In a significant number of instances, it is evident that the taxpayers would also benefit materially from the standpoint of social security benefits. In these cases, the Administration advises the taxpayers accordingly and further action on the benefit claims is then withheld pending the filing of amended returns and presentation of evidence by the taxpayers that amended returns have been filed.

SEC. 3. USE OF FORM 2190.

.01 In order to simplify this procedure and enable the Social Security Administration to adjudicate the claims for benefits immediately, Form 2190 has been designed for use in lieu of an amended return to effect such election or revocation of an election. The Administration, in connection with the examinations conducted by that agency after the filing of claims for social security benefits, will make the Form available to taxpayers who are eligible to use the optional method for the particular year or years under consideration. Form 2190 will be used only under those circumstances. Other taxpayers must file amended returns with the District Director of Internal Revenue to effect a change in the election made on their original return.

.02 When executed by the taxpayer, Form 2190 will be transmitted by the Administration to the Internal Revenue Service.

SEC. 4. EFFECTIVE DATE.

This Revenue Procedure is effective with respect to returns filed for taxable years ending after 1954.

(Also Part I, Sections 6033; 26 CFR 1.6033–1.) Rev. Proc. 57–15

Procedure for filing Form 990–P, U. S. Return Of Employees' Trust Described In Section 401(a) And Exempt Under Section 501(a) of the Internal Revenue Code of 1954, by trustees of exempt employees' trusts which invest wholly or partially in insurance company contracts.

Advice has been requested as to the procedure for filing Form 990–P, "U. S. Return of Employees' Trust Described In Section 401(a) And Exempt Under Section 501(a) of the Internal Revenue Code of 1954," by trustees of exempt employees' trusts which invest wholly or partially in insurance company contracts.

Trustees of exempt employees' trusts need furnish only the information called for on the first page of Form 990–P in cases where the employer has filed the information required by section 1.404(a)–2 of the Income Tax Regulations, provided that the trust files with its

return on Form 990–P a copy of the notification from the employer that he has furnished such information or a copy of a statement by the employer that he will complete the filing of the required information within 12 months after the close of the taxable year. See Section 1.6033–1 of the Income Tax Regulations; General Instructions, item 1, page 2, Form 990–P, and the note following such instructions on page 2.

In other cases, that is, where the trustee is required to complete pages two and three of Form 990–P, a trust which invests wholly or partially in insurance company contracts must fill out all of the applicable items in the schedules on those two pages, with the following information respecting the investments in insurance contracts:

STATEMENT OF RECEIPTS AND DISBURSEMENTS (PAGE 2)

1. Do not include in Receipts any "Dividends" or other items credited by the insurer which are not received in cash but are merely used as credits against premiums due.
2. Show under Disbursements the net premiums paid to each insurer and the name of the insurer to which each amount is applicable. The lines in item 22 may be used for this purpose.
3. Do not include in Distributions the amounts which are distributed to employees or other beneficiaries directly by the insurer.

SCHEDULE A.—BALANCE SHEETS

1. The amount of equities in insurance company contracts held by the trust need not be shown under Assets, except that in the case of deposit administration contracts, the balance to the credit of the trustee in the deposit account held by the insurer should be shown, together with the name of the insurer. In the case of other insurance company contracts, only the name or names of the insurer or insurers need be shown.
2. Where the amount of equities under insurance company contracts are not shown in accordance with the foregoing, the return should indicate that item 10, "Total Assets," is understated and that there is a corresponding understatement in "Total liabilities and surplus."

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26 CFR 601.305: Offers in compromise. Rev. Proc. 57–16
(Also Part III, Section 7122;
Section 194.251.)

A copy of the abstract and statement relating to an accepted offer in compromise of a liquor bottle refilling violation will be available for public inspection in the office of the Assistant Regional Commissioner, Alcoholic and Tobacco Tax, and in the office of the District Director of Internal Revenue.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to advise that a copy of the abstract and statement relating to an accepted offer in compromise of a liquor bottle refilling violation will be available for public inspection both in the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, and in the office of the District Director of Internal Revenue.

SEC. 2. BACKGROUND.

.01. For each offer in compromise submitted and accepted on and after December 21, 1956, pursuant to section 7122 of the Internal Revenue Code of 1954, in any case arising under sections 5641 and 5643 of the Code, relating to refilling of liquor bottles, a copy of the abstract and statement relating to the offer shall be available for inspection for a period of one year in the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, accepting the offer, as authorized in Delegation Order No. 44, C. B. 1956–2, 1378. For the convenience of those interested, such abstracts and statements will also be made available in the office of the appropriate District Director of Internal Revenue.

.02. Section 7122 of the 1954 Code provides, in part, that the Secretary or his delegate may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense.

.03. Section 5641 of the 1954 Code makes provision for penalty and forfeiture for wilful violation of the regulations prescribed under section 5214 relating to the traffic in containers of distilled spirits, and section 5643 thereof makes similar provision with respect to the reuse of stamps or bottles, tampering, and unlawful removal of the distilled spirits bottled in bond. Section 194.251 of the Regulations relating to Liquor Dealers provides that no liquor bottle or other authorized container shall be reused for the packaging of distilled spirits, nor shall the original contents, or any portion thereof, remaining in a liquor bottle or other authorized container, be increased by the addition of any substance. Section 175.121 of the Regulations relating to the Traffic in Containers of Distilled Spirits contains similar provisions.

SEC. 3. INSTRUCTIONS.

For each offer in compromise submitted and accepted on and after December 21, 1956, pursuant to section 7122 of the Internal Revenue Code of 1954, in any case arising under sections 5641 and 5643 thereof, relating to the refilling of liquor bottles, a copy of the abstract and statement relating to the offer shall be available for public inspection for a period of one year in the office of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, accepting the offer. For the convenience of those interested, a copy of the abstract and statement will similarly be available for public inspection in the office of the District Director of Internal Revenue for the district in which the violation occurred.

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26 CFR 601.310: Forms. Rev. Proc. 57–17
(Also Part III–A, Section 5415; Section 245.226.)

Brewers will show on Form 103, Brewer's Monthly Report of Operations, the serial numbers of Forms 2034, Beer Tax Return, filed to cover taxable removals during the period covered by the Form 103.

SECTION 1. PURPOSE.

The purposes of this Revenue Procedure are to inform brewers of the revision of Form 103, Brewer's Monthly Report of Operations, to per-

mit the showing of the serial numbers of Forms 2034, Beer Tax Return, filed to cover taxable removals during the period covered, and to provide interim instructions to be followed in preparing reports on the January 1957 revision of Form 103.

SEC. 2. BACKGROUND.

The 1955 edition of the Beer Regulations required that brewers prepare Forms 2034 in quadruplicate so that a copy of each day's return could, for audit purposes, be accumulated and forwarded to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, at the end of the month with Form 103. The 1957 edition of such regulations relieves brewers of this requirement. However, it is desirable that there be restored a definite tie-in between the taxable quantities reported on Form 103 and the Forms 2034 relating thereto. It has been determined that the serial numbers of Forms 2034 will satisfactorily serve this purpose. Accordingly, the Form 103 has been revised to provide for the showing of the serial numbers in section I, above line 1 of column (a).

SEC. 3. METHOD OF REPORTING SERIAL NUMBERS.

Until the new revised Form 103 is available, it will be necessary for brewers to make a special entry on the current revision of the form reading "Forms 2034, Ser. Nos. —— to ——, incl." Such special entry should be made in the blank space in column (a) immediately below section I title.

SEC. 4. 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.

(Also Part I, Section 167;
26 CFR 1.167(a)-1.)

Rev. Proc. 57-18

Where the facts in the case furnish a clear and convincing basis for a depreciation adjustment, such adjustment will be made even though a depreciation deduction claimed in a previous return had been accepted without change.

Rev. Ruls. 90 and 91, C. B. 1953-1, 43-44, clarified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to correct an erroneous interpretation of the policy set forth in Revenue Rulings 90 and 91, C. B. 1953-1, 43 and 44, with respect to the adjustment of depreciation deductions.

SEC. 2. BACKGROUND.

.01 Revenue Ruling 90, *supra*, provided that, in order to reduce controversies over depreciation deductions, it will be the policy of the Internal Revenue Service generally not to disturb depreciation deductions taken by a taxpayer nor will Service personnel propose adjustments to such deductions unless there is a clear and convincing basis for a change. Revenue Ruling 91, *supra*, furnished guidance in the application of Revenue Ruling 90.

.02 The declaration of policy announced in these Revenue Rulings has been interpreted by some to mean that acceptance of depreciation claimed by a taxpayer in any taxable year precludes adjustment to the depreciation claimed in subsequent years.

SEC. 3. STATEMENT OF POLICY.

It is the position of the Service, that if the facts in the case currently under examination furnish a clear and convincing basis for a depreciation adjustment, such adjustment will be made even though a depreciation deduction claimed in a previous return had been accepted without change upon examination.

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26 CFR 601.310: Forms. Rev. Proc. 57-19
(Also Section 5367; Section 240.900.)

Proprietors of bonded wine cellars will show on Form 702, Monthly Report of Wine Cellar Operations, the serial numbers of Forms 2050, Wine Tax Return, filed to cover taxable removals of wine during the period covered by the Form 702.

SECTION 1. PURPOSE.

The purposes of this Revenue Procedure are to inform proprietors of bonded wine cellars of the planned revision of Form 702, Monthly Report of Wine Cellar Operations, to permit the showing of the serial numbers of Forms 2050, Wine Tax Return, filed to cover taxable removals during the period covered, and to provide interim instructions to be followed in preparing reports on the January 1955 revision of Form 702.

SEC. 2. BACKGROUND.

Auditors in regional offices have found it an advantage to have a definite tie-in between the tax account on Form 702 and the Forms 2050 relating thereto. It has been determined that the serial numbers of Forms 2050 will satisfactorily serve this purpose. Accordingly, Form 702 will be revised to provide for the showing of the serial numbers in a suitable space on the form.

SEC. 3. INTERIM METHOD OF REPORTING SERIAL NUMBERS.

Until the new revised Form 702 is available, it will be necessary for proprietors to make a special entry on the current revision of Form 702, in part I, immediately above the word "Item," which is the heading of the first column. Such special entry will read "Forms 2050, Ser. Nos. _____ to _____, incl." This method of reporting should commence with the report for March 1957.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to the number thereof and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

26 CFR 601.318: Forms. (Also Part I, Section 7805; Sections 270.153 and 275.142.)

Rev. Proc. 57–20

Taxpaid tobacco products of a kind other than produced at a particular tobacco factory may now be received on such factory premises. It will no longer be necessary that the Assistant Regional Commissioner, Alcohol and Tobacco Tax, be furnished information as to each lot or shipment of tobacco products to be received where blanket authority has been granted for the receipt of such products at a factory.

Revenue Procedure 57–9, page 734 of this Bulletin, modified.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to advise manufacturers of tobacco products that they may now receive on the bonded premises of their factories taxpaid tobacco products of a kind other than that produced therein, and that where they have been granted blanket authority to receive taxpaid tobacco products it will no longer be necessary to furnish the Assistant Regional Commissioner, Alcohol and Tobacco Tax, information with respect to each lot or shipment to be received.

SEC. 2. BACKGROUND.

The procedure for the receipt of taxpaid tobacco products on the bonded premises of a tobacco factory is contained in Revenue Procedure 57–9, page 734 of this Bulletin. Such Revenue Procedure restricts the receipt of taxpaid tobacco products to the kind produced at the receiving factory and provides for the issuance of blanket authority to receive such products provided the Assistant Regional Commissioner is furnished certain information with respect to each lot or shipment to be received.

SEC. 3. CHANGES IN PROCEDURE.

A manufacturer of tobacco products may now receive taxpaid tobacco products of a kind other than that produced by him into the bonded premises of his factory. Blanket authority may still be obtained for the receipt of tobacco products, but it will no longer be necessary for the manufacturer receiving such products to submit to the Assistant Regional Commissioner the information required by Revenue Procedure 57–9, *supra*, as to each lot or shipment to be received.

SEC. 4. STORAGE AND ACCOUNTING.

All taxpaid tobacco products received, whether or not of the kind produced at the factory, are to be stored, segregated, or earmarked in such a manner as to make them readily identifiable, as taxpaid products received, for inspection and accounting purposes.

SEC. 5. RECORDS.

When taxpaid tobacco products of the kind produced in the factory are received, the manufacturer will continue to record the receipt and subsequent disposition of such products in section V of the record required to be kept on Form 2141, Record to be Kept by Manufacturer of Tobacco, Form 2142–A, Record to be Kept by Manufacturer of Large Cigars, or Form 2143, Record to be Kept by Manufacturer of

Small Cigars and Large and Small Cigarettes, as the case may be. On the other hand, with respect to taxpaid tobacco products received of a kind other than that produced in the receiving factory, no entries of such products will be required in the revenue record of the factory, since such products will be readily distinguishable from the product manufactured in the factory.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 57–9, *supra*, is hereby modified.

SEC. 7. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.301: Imposition of taxes, qualification requirements, and regulations.
(Also Part III–A, Section 5331; Section 182.140.)

Rev. Proc. 57–21

Original and renewal permits to use specially denatured alcohol may be issued to include all articles or preparations covered by Forms 1479–A, Formula for Preparations Made with Specially Denatured Alcohol, approved during the period covered by the permit.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide instructions for the issuance of an original or renewal permit on Form 1481, Permit to Use Specially Denatured Alcohol, to include all articles or preparations covered by Forms 1479–A, Formula or Preparation Made with Specially Denatured Alcohol, approved during the period covered by the permit.

SEC. 2. BACKGROUND.

When a new article or preparation was to be manufactured pursuant to approved Form 1479–A, it has been necessary, under the procedures, which have been followed with respect to basic permits for the use of specially denatured alcohol, for the permittee to submit application on Form 1479, Application for Permit to Use Specially Denatured Alcohol, for the amendment of the basic permit to include the new article or preparation. As a result of studies in regional offices and the National Office, it has been determined that a simplified procedure can be established within the scope of present regulations whereby an applicant or a permittee can submit an application, Form 1479, for an original or renewal permit to include all articles or preparations covered by Forms 1479–A approved during the period covered by the permit. This would permit the manufacture of additional articles or preparations approved on Form 1479–A during the period covered by the permit without the necessity for an amendment of the Form 1481.

SEC. 3. PREPARATION OF APPLICATION FOR PERMIT TO USE SPECIALLY DENATURED ALCOHOL.

Applicants or permittees desiring to prepare an application, Form 1479, to include all articles or preparations covered by Forms 1479–A approved during the period covered by the permit will enter or determine that there is entered in the space headed "Article or Preparation to be Manufactured," the sentence "The articles and preparations are those listed in this application and those covered by Forms 1479–A approved during the period covered by the permit."

SEC. 4. PROCEDURE WITH RESPECT TO AMENDED BASIC PERMITS.

For procedure, similar to that outlined above, with respect to the issuance of amended basic permits to use specially denatured alcohol, see Revenue Procedure No. 56–7, C. B. 1956–1, 1023.

SEC. 5. INQUIRIES.

Inquiries in regard to this Revenue Procedure should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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26 CFR 601.310: Forms. Rev. Proc. 57–22
(Also Part III–A, Section 5114;
Section 225.1121.)

Instructions with respect to reporting removals, losses, and tax gallons on Form 52C, Monthly Report—Internal Revenue Bonded Warehouse.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to insure uniform reporting on Form 52 C, Monthly Report—Internal Revenue Bonded Warehouse, as to removals, losses, destruction, and tax gallons.

SEC. 2. BULK REMOVALS.

All spirits removed by the warehouseman, except spirits which have been bottled in bond, should be reported on line 1, "Bulk removals." This includes transfers in bond, as well as withdrawals after taxpayment or without payment of tax.

SEC. 3. REMOVALS IN CASES.

All bottled-in-bond spirits removed by the warehouseman should be reported on line 2, "Removals in cases." This includes transfers in bond, as well as withdrawals after taxpayment or without payment of tax of bottled-in-bond spirits.

SEC. 4. LOSSES, DESTRUCTION, ETC.

Losses of untaxpaid spirits by theft, casualty, or voluntary destruction should be reported on line 3, and an explanation of the entry should be given under the heading "Remarks" appearing immediately below line 4 of Form 52 C.

SEC. 5. TAX GALLONS TO BE REPORTED.

The tax gallons reported in column (b) should reflect the gauge gallons reported on withdrawal papers, whether withdrawn on the original gauge or after regauge.

SEC. 6. INQUIRIES.

Inquiries regarding this Revenue Procedure should refer to the number thereof and should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax.

(Also Part II, Section 22(b)) Rev. Proc. 57-23

Procedures in connection with claims for refund involving the exclusion from gross income of amounts received through accident and health insurance as compensation for personal injuries or sickness, under the provisions of section 22(b)(5) of the 1939 Code, as a result of the decision in *Gordon P. Haynes et ux* v. *United States*.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the policy and procedure of the Internal Revenue Service in connection with claims for refund involving the exclusion from gross income of sickness disability payments under section 22(b)(5) of the Internal Revenue Code of 1939.

SEC. 2. BACKGROUND.

The Supreme Court of the United States has held, in the case of *Gordon P. Haynes, et ux* v. *United States*, 353 U. S. 81, Ct. D. 1805, page 499, this Bulletin, that an employee may exclude from his gross income as "health insurance," sickness disability benefits received during 1949 under his employer's plan even though the plan did not contain features present in normal commercial insurance. The payment of premiums in a fixed amount at regular intervals is not a necessary element of insurance, nor is there any necessity for a definite fund to be set aside to meet the insurer's obligations. The legislative history does not indicate that Congress intended to restrict the exemption to conventional modes of insurance and not to include employer disability plans. Thus, amounts received by employees as sickness disability payments under a company "plan" are excludable from gross income as proceeds of health insurance under the provisions of section 22(b)(5) of the Internal Revenue Code of 1939. The court pointed out that in the case of *Arnold W. Epmeier* v. *United States*, 199 Fed. (2d) 508, disability payments under a similar plan were held to be not taxable.

SEC. 3. STATEMENT OF POLICY.

.01. The decision of the Supreme Court of the United States in the *Haynes* case is broad enough to control the characterization as health insurance of payments made under all company "plans" similar to those considered in that case.

.02 It is the position of the Internal Revenue Service that an employee may exclude from his gross income as "health insurance" sickness disability benefits received under his employer's "plan" for such payments even though the "plan" did not contain features present in normal commercial insurance.

.03 A large number of returns filed in such cases involve a deduction claimed for medical expenses under the provisions of section 23(x) of the 1939 Code, the amount of which is dependent upon and

controlled by the amount of the adjusted gross income reflected in the return. Thus, any decrease in the amount of the adjusted gross income will, by reason of the application of the five percent limitation required by section 23(x) of the Code, result in an increase in the amount of the allowable medical expense deduction. It is also the position of the Service that, due to the close relationship between the adjusted gross income and the allowable medical expense deduction, that portion of the overassessment resulting from the increase of the allowable medical expense in these situations is covered by implication in any claim for refund based upon the exclusion of sickness disability payments.

SEC. 4. PROCEDURE.

.01 Inasmuch as the period for filing suit might expire in the near future, top priority will be given (1) to requests for the reopening of claims of this type heretofore rejected by the issuance of registered notices of disallowance and (2) to cases where the statutory period has been extended under the provisions of section 3774(b)(2) of the 1939 Code. Section 3772(a)(2) of the 1939 Code provides that any suit or proceeding based upon refund claims must be begun before the expiration of two years from the date of mailing by registered mail by the Commissioner to the taxpayer of a notice of disallowance of the part of the claim to which such suit or proceeding relates.

.02 Certain field offices have designed claim withdrawal forms which have been executed by taxpayers in response to suggestions from such offices, and some claims have been rejected by means other than by the issuance of a registered notice of disallowance. Inasmuch as registered notices of disallowance were not issued in these cases, claims in this category will be regarded by the Revenue Service as original claims and processed without regard to such prior rejection or request for the withdrawal thereof.

ANNOUNCEMENT OF THE DISBARMENT AND SUSPENSION OF ATTORNEYS AND AGENTS FROM PRACTICE BEFORE THE TREASURY DEPARTMENT

Under section 261, Title 5 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from further practice before the Treasury Department any person, agent, or attorney shown to be incompetent, disreputable, or who refuses to comply with rules and regulations governing the recognition of agents, attorneys, or other persons representing clients before the Treasury Department, or who in any manner has wilfully and knowingly deceived, misled, or threatened any client or prospective client by word, circular, letter, or advertisement. Enrolled persons are prohibited in any Treasury Department matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any person disbarred or under suspension from practice before the Treasury Department. To enable enrolled persons to identify such disbarred or suspended persons, the Internal Revenue Service will announce in the Internal Revenue Bulletin the names and addresses of persons who have been disbarred or suspended from such practice, their designation as attorney, agent, or other representative, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletins at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for a period of 2 months for each agent and attorney so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

The following persons, after due notice and opportunity of hearings, have been disbarred from further practice before the Treasury Department:

Name	Address	Designation	Date of disbarment
Harry J. Alker, Jr.	Philadelphia, Penna.	Attorney	February 28, 1956.
John W. Ward	1235 Lafayette Bldg., Detroit 26, Mich.	Attorney	January 4, 1957.

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