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

Treasury Department : : : : : Bureau of Internal Revenue

Internal Revenue Bulletin

Cumulative Bulletin II-2

JULY–DECEMBER, 1923

SECTION OF STATISTICS
OFFICE OF THE SECRETARY
TREASURY DEPARTMENT

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

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

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Treasury Department : : : : : Bureau of Internal Revenue

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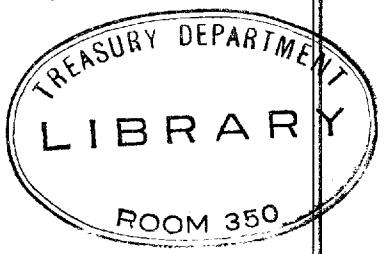

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The Internal Revenue Bulletin Service for 1924 will consist of weekly bulletins, quarterly digests, and semiannual cumulative bulletins.

The weekly bulletins will contain the rulings to be made public and all Internal Revenue Treasury Decisions. The quarterly digests, with the exception of the one to be published at the end of 1924, will contain digests of the rulings previously published in the weekly bulletins for 1924. The last digest for 1924 will also contain digests of the rulings published during 1922 and 1923. The semiannual cumulative bulletins will contain all new rulings published during the previous six months.

The complete Bulletin service may be obtained, on a subscription basis, from the Superintendent of Documents, Government Printing Office, Washington, D. C., for $2 per year.

New subscribers and others desiring to obtain the 1919, 1920, and 1921 Income Tax Service may do so from the Superintendent of Documents at prices as follows: Digest of Income Tax Rulings No. 19 (containing digests of all rulings appearing in Cumulative Bulletins 1 to 5, inclusive), 50 cents per copy; Cumulative Bulletins Nos. 1 to 5, containing in full all rulings published since April, 1919, to and including December, 1921, as follows: No. 1, 30 cents; No. 2, 25 cents; No. 3, 30 cents; No. 4, 30 cents; No. 5, 25 cents.

Persons desiring to obtain the one issue of Sales Tax Bulletin for 1920, Bulletin ST–1–20, and the Cumulative Bulletins for January–June and July–December, 1921, may procure them from the Superintendent of Documents at 15 cents and 5 cents each, respectively, per copy.

All inquiries in regard to these publications, as well as to the Internal Revenue Bulletin Service for 1922 and 1923, and subscriptions should be sent to the Superintendent of Documents, Government Printing Office, Washington, D. C.

INTRODUCTORY NOTES.

Internal Revenue Cumulative Bulletin II-2 contains in full the rulings of the Bureau of Internal Revenue relating to income, sales, estate, capital stock, and miscellaneous taxes, and miscellaneous rulings and Internal Revenue Treasury Decisions published in the weekly bulletins (Volume II, Nos. 13-39, inclusive) for the period July 2 to December 31, 1923. It should be retained, as its contents will not be reprinted in any subsequent volume.

The rulings are grouped under the sections of the Revenue Act of 1921 and the articles of the Regulations to which they relate, the number and class of each ruling being indicated by numerals and abbreviations. For example, $\frac{\text{I-22-313}}{\text{A. R. R. 933}}$ means Committee on Appeals and Review Recommendation 933, which is ruling 313 and was first published in Bulletin No. 22 of Volume I of the Internal Revenue Bulletin service.

ABBREVIATIONS.

The following abbreviations are used throughout the Bulletin:

A, B, C, etc.—The names of individuals.
A. R. M.—Committee on Appeals and Review memorandum.
A. R. R.—Committee on Appeals and Review recommendation.
C. B.—Cumulative Bulletin.
Ct. D.—Court decision.
C. S. T.—Capital-Stock Tax Division.
D. C.—Treasury Department circular.
E. T.—Estate Tax Division.
I. T.—Income Tax Unit.
M, N, X, Y, Z, etc.—The names of corporations, places, or businesses, according to content.
Mim.—Mimeographed letter.
MS.—Miscellaneous Division.
O. or L. O.—Solicitor's law opinion.
O. D.—Office decision.
Op. A. G.—Opinion of the Attorney General.
S. T.—Sales Tax Division.
S.—Solicitor's memorandum.
Sol. Op.—Solicitor's opinion.
T. B. M.—Advisory Tax Board memorandum.
T. B. R.—Advisory Tax Board recommendation.
T. D.—Treasury decision.
x and y are used to represent certain numbers, and when used with the word "dollars" represent sums of money.

For additional information which will be of assistance in the use of the Internal Revenue Bulletin service read the Introductory Notes to the latest Digest.

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INCOME TAX RULINGS.

TITLE I.—GENERAL DEFINITIONS.

SECTION 2.—GENERAL DEFINITIONS.

ARTICLE 1503: Association distinguished from partnership. II-15-979 A. R. R. 2773

REVENUE ACTS OF 1917 AND 1918.

The law of the State extended the life of a corporation whose charter had expired for a limited period, during which the organization is taxable as a corporation in the absence of evidence that the business was carried on as a partnership. The oral understanding among the stockholders as to unlimited liability, and to the effect that they would not transfer their shares pending the formation of a new corporation, is immaterial.

The Committee has considered the appeals of the M Company and of the N Company from the rulings of the Income Tax Unit with reference to the taxable status of the M Company for 1917 and 1918.

The main question involved in this appeal is whether the M Company was taxable as a corporation rather than as a partnership in 1917 and 1918. The contentions relating to the invested capital of the N Company, except in so far as affected by the determination of the main question, were not pressed at the oral hearing.

The M Company was organized as a corporation under the laws of the State of S in 1886. Its charter expired by statutory limitation in 1916, and upon receiving notice to that effect from the secretary of state the appellant filed a notice of dissolution with that officer. The business was continued without any other act of dissolution, however, until January, 1919, when the assets and business were transferred to the N Company, a new corporation organized by the stockholders of the original corporation. The old corporation filed returns for 1917, executed by its president and treasurer, and also filed a tentative return for 1918 as a corporation.

It is contended that upon the dissolution of the corporation under State law a partnership was organized under verbal agreement and that the partnership conducted the business until it was sold to the new corporation. There is no tangible evidence, however, that the business was carried on by a partnership. There was no formal partnership agreement nor any transfer of assets by the old corporation to the alleged partnership. There were a number of individuals whose shares in the business were represented by stock and who took no active part in the management of the business, which was in fact

carried on by the officers of the M Company. The law of the State extended the life of a corporation whose charter had expired for a limited period for the purpose of winding up the corporation, and prior to the determination of such period the old corporation transferred its assets to the new corporation.

The Committee is of the opinion that the M Company was taxable as a corporation in 1918 as well as in 1917 under section (1) of the Revenue Act of 1918 and articles 1502 and 1503 of Regulations 45 and of Regulations 62. The oral understanding among the stockholders as to unlimited liability and to the effect that they would not transfer their shares pending the formation of a new corporation is immaterial.

The Committee therefore recommends that the action of the Income Tax Unit be sustained upon all points involved in these appeals.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1503: Association distinguished from partnership. II-23-1077 I. T. 1769

REVENUE ACTS OF 1917 AND 1918.

By the terms of an agreement under which a general banking business was carried on, the death of a member does not dissolve the organization. Each member was entitled to 1 vote for each share of stock held by him in the regular or special meetings of stockholders called by the president. The management of the organization was intrusted to the officers and directors elected annually by the members.

Held, that for income tax purposes the organization has the status of an association and is taxable as a corporation.

Inquiry is made whether the M Company should be classified as a partnership or as an organization taxable as a corporation for income tax purposes during 1917, 1918, 1919, and 1920.

Its business is described as an ordinary banking business. The terms of the instrument under which it was organized have been strictly adhered to in carrying on the business, with the exception that the provisions thereof pertaining to the issuance of evidence of the stockholders' interests in the organization in the form of certificates have not been carried out. This omission is of no importance. Evidence in the form of such certificates could have been issued at any time. Under such circumstances, the Bureau must be guided by the terms of the agreement in fixing the classification of the organization for income tax purposes.

The articles of association provide that the death of a member does not dissolve the organization. Therefore, it is apparent that an element vitally essential to the formation of a true partnership was intentionally omitted.

Under the terms of the instrument, each member was entitled to 1 vote for each share of stock held by him in the regular or special meetings of stockholders called by the president. The management of the organization was intrusted to the officers and directors elected annually by the members.

Held, that the M Company during the years in question did not have the status of a partnership for income tax purposes. It has been an organization created for the purpose of conducting its affairs under corporate methods. For income tax purposes it has had the status of an association, and as such it has been taxable as a corporation.

ARTICLE 1503: Association distinguished from partnership. II–23–1078 I. T. 1770

REVENUE ACT OF 1918.

The articles of agreement under which a bank was organized show that it conducted its business in an organized capacity; that it had capital stock divided into shares and that its net income was distributable among its stockholders upon the basis of the capital stock which each held. The articles provide, further, that if a stockholder wishes to sell or dispose of his stock he shall first offer it to the stockholders who desire to remain in the organization, and that if those stockholders or any of them refuse to purchase the stock the stockholder shall have the right to sell his stock to such person or persons outside of the membership of the association as may be acceptable to the majority of the remaining stockholders.

Held, that the taxpayer has the status of an association, and that its income should be taxed as the income of a corporation.

A bank made returns as a corporation for the years 1916, 1917, 1918, and 1919. The articles of agreement under which the bank was organized describe it as an association or firm, and show that it conducted its business in an organized capacity. They also show that it had capital stock divided into shares; that its net income was distributable among its stockholders upon the basis of the capital stock which each held; and that its business was conducted by officers without the active participation of all of the members as such. The articles provide, further, that if a stockholder wishes to sell or dispose of his stock he shall first offer it to the stockholders who desire to remain in the organization, and that if those stockholders or any of them refuse to purchase the stock the stockholder shall have the right to sell his stock to such person or persons outside of the membership of the association as may be acceptable to the majority of the remaining stockholders.

Upon the supposed authority of I. T. 1501 (C. B. I–2, p. 1) the bank rendered a return as a partnership.

Held, that as the taxpayer meets all of the requirements of articles 1502 and 1503 of Regulations 45, it has the status of an association, and that its income should be taxed as the income of a corporation.

The restriction placed upon a stockholder's right to transfer his stock which limits this right, so far as outsiders are concerned, to such persons as are acceptable to the remaining stockholders, does not bring the case within I. T. 1501. That decision is expressly limited to cases "Where other elements of a partnership relation are present" in addition to a restriction upon the right of a stockholder to transfer his share without the consent of the remaining stockholders.

ARTICLE 1503. Association distinguished from partnership.

(See A. R. R. 2503; sec. 214(a)4, 5, 6, art. 146.) Status of the M Bank for income tax purposes.

ARTICLE 1504: Association distinguished from trust. II–16–995 I. T. 1729

REVENUE ACT OF 1918.

The fact that the beneficiaries are in control of the trustees is not in itself sufficient to require the classification of an organization as an association. An organization to be so classified must also be quasi corporate in form; it must act or do business in an organized capacity.

In 1912, A, individually and as trustee of the M estate, and B and C, sons of A, each owning certain real and personal property, executed a trust agreement and conveyed and assigned such property to themselves as trustees with full power and authority to manage, lease, improve, and sell the property for the purposes enumerated in the instrument. The trust is to continue for the lives of certain persons in being and for 21 years thereafter. Upon the expiration of this period, the trustees are to distribute the property of the trust among the then living lineal descendants of B and C. An article of the agreement directs that one-fourth of the income be set aside and reinvested in real estate by the trustees. The remainder of the net income is directed to be distributed at regular intervals, one-third to A, one-third to B, and one-third to C. Upon the death of A, his share of the income is directed to be distributed to B and C.

Because of the fact that the life beneficiaries and the trustees are the same persons, it is contended that the beneficiaries are in control of the trust; that the trust is an association and as such subject to corporation income and profits taxes.

There is no quasi corporate form of organization. The trustees do not act as a board of directors; there are no officers, no certificates of stock or beneficial interest. No provision is made for annual or special meetings of the beneficiaries for the purpose of examining into the affairs of the trust or for electing or deposing trustees and officers. In short, the trust bears not the slightest resemblance to a corporation, and if it were not for the fact that the trustees and the beneficiaries are the same persons there would be no question but that the trust was nothing more than an ordinary trust.

There is language in article 1504 of Regulations 45 which, taken by itself, would seem to support the contention that any trust whose trustees are under the control of the beneficiaries is an association. Article 1504, however, should be read in connection with article 1502, which thus defines associations:

Associations and joint-stock companies include associations, common-law trusts, and organizations by whatever name known, *which act or do business in an organized capacity*, * * *.

The presence or absence of control over the trustees on the part of the beneficiaries is an important element in distinguishing between trusts and associations, but it is not the only point of distinction. While the absence of control will prevent the classification of a trust modeled along corporate lines as an association, the presence of

control over the trustees is not of itself sufficient to convert a trust into an association. Under the Bureau's rulings, in order to be classified as an association not only must the trust be one whose trustees are under the substantial control of the beneficiaries but the organization of the trust must also be quasi corporate in form.

ARTICLE 1504: Association distinguished from trust. II–34–1200
I. T. 1840

REVENUE ACTS OF 1918 AND 1921.

The only control over the trustees retained in the holders of beneficial interest under a trust agreement is the right of a majority in amount of the beneficial interest to remove any trustee, provided a cause therefor exists which would justify a court of equity to order such removal. The trustees do not own a majority of the certificates of beneficial interest.

The organization is taxable as a trust.

A conveyed to B and other trustees certain property consisting of promissory notes, mortgages, pledges, assignments, furniture and other personal property, to be converted into money and distributed among the beneficiaries under the trust, subject, however, to the power of the trustees in their uncontrolled discretion to defer and postpone such conversion and distribution for a period not exceeding 20 years from and after the death of the grantor. Pending final conversion and distribution of the property, trustees are directed to hold, manage, and control the same, to loan any or all funds from time to time in the hands of the trustees with or without security and to invest and reinvest the same, to collect and receive all income from the trust property, and at least once in each year to pay over and distribute all of the net income to and among the several beneficiaries according to their fractional interests in the trust. The trust is declared in favor and for the benefit of the grantor, A, and his assigns, to whom the trustees are directed to issue proper receipt certificates of beneficial interest. Provision is made for reasonable compensation for the services of the trustees. Any trustee may resign by written instrument executed in duplicate, duly witnessed, acknowledged, and delivered to his cotrustee and recorded with the original instrument, if the original be then recorded. Any trustee may at any time be removed by an instrument in writing signed in duplicate by the holder or holders of a majority in amount of beneficial interests, provided a cause therefor exists which would justify a court of equity to order such removal. Any vacancy in office of trustee, however occasioned, is to be filled by the remaining trustees by an instrument in writing signed by them in duplicate, witnessed, acknowledged, and assented to in writing by the holder or holders of a majority in amount of the beneficial interests under the trust.

The direction and control of the trust property appears to rest at all times with the trustees with the exception of the mandatory provision that all net income be distributed at least once a year. The only control over the trustees retained in the holders of beneficial interest under the trust is the right of a majority in amount of the beneficial interests to remove any trustee, provided a cause therefor exists which would justify a court of equity to order such removal.

The rule with respect to a trust of this character is that unless the power of removal is expressly reserved to the grantor, beneficiary, or other person, in the instrument itself, a court of equity alone may remove the trustee against his will. The court will remove the trustee upon notice to him and all other parties interested in the trust if the trustee is shown to have been guilty of such misconduct in office that the financial interests of the beneficiaries are endangered. The insertion of this provision in the trust instrument for the removal of trustees for cause does not, therefore, appear to vest in the beneficiaries any greater rights or authority than they would have in the absence of such a provision. The purpose of the provision would, therefore, seem to be solely to obviate the delays which might otherwise result through seeking the aid of a court of equity to accomplish the same object.

B, one of the trustees, in an affidavit states that A, the grantor, and relatives and close personal friends at this time own 72.10 per cent of the certificates of beneficial interest; that the five persons who are trustees own 10.86 per cent of such beneficial interest; and that the remaining 17.04 per cent is owned by employees. As it appears from B's affidavit that at no time since the creation of this trust have the trustees as such owned a majority of the beneficial interests under the trust, at no time have the trustees as beneficiaries been in control of the trust property.

It is held, therefore, that the agreement of ——, 1919, created a distributable trust within the purview of the Revenue Acts of 1918 and 1921, and that the net income of the trust is taxable to the holders of certificates of beneficial interest in their proportionate share, whether distributed to them or not, and should be so treated so long and for such periods only as the trustees as beneficiaries do not own a majority of the certificates of beneficial interest.

ARTICLE 1507: Joint ownership and joint adventure. II–35–1212 I. T. 1849

REVENUE ACTS OF 1917 AND 1918.

The sharing of losses by all the members is not a requirement of a partnership relation.

The question is raised whether the organization described below is a partnership.

The memorandum of agreement submitted by the taxpayer to show the organization of the company states in its first paragraph:

That A, B, and C do hereby agree to enter into a partnership for the purpose of conducting a —— business * * * under the firm name of A and Company, for and during the period of one year from ——, 1917, to ——, 1918. * * *

The agreement then provides that A shall furnish the capital necessary for the business; that B shall buy and sell the product handled, and keep up with the market "in such manner as the best interest of the business may demand"; that C shall buy and perform such other duties as the best interests of the business require; and that all parties shall give their exclusive attention to firm business. It then provides for the payment of expenses and salaries, and for a division of profits, — per cent to A, — per cent to B, and — per cent to C. Losses of

the business are to be borne by A. All checks, notes, or other evidences of indebtedness are to be signed by at least two members of the firm. All contracts are to be made in the firm name; and no partner shall use the firm name in indorsing negotiable paper, except on firm business. Throughout the agreement the terms "partner" and "partnership" are used to designate, respectively, the parties to it and the firm thereby organized.

Although courts and text-writers do not entirely agree upon a definition of a partnership, the definition contained in *Meehan* v. *Valentine* (1891) (145 U. S., 611, at 618) has been frequently adopted:

> The requisites of a partnership are that the parties must have joined together to carry on a trade or adventure for their common benefit, each contributing property or services, and having a community of interest in the profits. (*Ward* v. *Thompson*, 22 How., 330, 334.)

A similar conception is contained in section 6 of the uniform partnership act, adopted in a number of States:

> A partnership is an association of two or more persons to carry on as coowners a business for profit.

Mr. Mechem, in his Elements of Partnership (2d ed.), details the characteristics of a partnership thus (sec. 2):

> 1. It is an unincorporated association or legal relation.
> 2. It is created not by law but by the agreement of the parties.
> 3. It requires two or more competent parties.
> 4. It involves ordinarily the contribution by the members of money, property, skill, labor, credit, or the like, to constitute the capital, stock, or foundation of the business. * * * As will be seen hereafter, the several contributions need not all be of the same kind nor of the same amount or value. * * *
> 5. It contemplates the transaction of some lawful business, trade, or occupation, in which the parties are to be coowners and which they are to carry on as principals.
> 6. The purpose of the union is the pecuniary gain of the members.

The organization here in question seems to conform to these tests in all essential particulars. It is urged by the taxpayer, however, that inasmuch as the losses were not, as between the partners themselves, to be borne by two of the partners, the organization can not be treated as a partnership.

This question—whether it is a requisite of a partnership that losses be shared by all the partners—has been frequently dealt with by courts and text-writers. It will be observed that in none of the quoted tests of a partnership given *supra* is a sharing of losses mentioned as an essential element. Moreover, the authorities are substantially agreed that a sharing of losses is not indispensable to a partnership. Thus, in Mechem, Elements of Partnership, section 81, it is said:

> *Agreements to share profits with express stipulation against losses.*—Agreements are sometimes made by which, though all are to share in the profits, some of the parties are expressly to be protected against loss. Such an agreement may constitute a partnership if the other elements are present. It is lawful for the partners, as between themselves, to stipulate that one or more of them shall be indemnified against loss, though such a stipulation can not affect the liability of the partners so indemnified to third persons (citing cases).
>
> It is true that cases are sometimes found which declare that liability for losses as well as participation in the profits is indispensable to partnership (citing three Iowa cases); but the proposition that the partners may, so far as they themselves are concerned, agree that the partnership liability of one shall be borne by the other, is sustained by the weight of authority.

Similar statements, with citations of court decisions, may be found in Lindley on Partnership (8th ed.), page 50; Bates, Law of Partnership, section 56; Parsons, Laws of Business (1920), page 200. For a decision to the same effect see *Camp* v. *Montgomery* (1885) (75 Ga., 795).

From the agreement submitted, it is reasonably clear that the parties intended to form a partnership, as they themselves state throughout that agreement. A sharing of losses by all the partners is not, according to the best authorities, indispensable to a partnership. The provisions that profits shall be shared on an agreed basis; that negotiable paper must be signed by at least two partners; and that no single partner shall use the firm name in indorsing negotiable paper, except on firm business, together with the broad delegation of authority to B and C to buy and sell and perform such duties as the best interests of the business might require, indicate that A was no longer to be sole proprietor of A and Company, but that he was to be merely a coowner of the business of that firm, as a partner of B and C. Moreover, the evidence in the case indicates that B and C conducted the business as coproprietors during extended absences of A. For all these reasons, it appears that the A Company was a partnership during the period in question.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 200.—DEFINITIONS.

ARTICLE 1523: Personal service corporation.

(See I. T. 1860; sec. 327, art. 901.) Card rate advertising agency.

SECTION 201.—DIVIDENDS.

ARTICLE 1541: Dividends.

(See I. T. 1740; sec. 213(a), art. 53.) Dividend declared out of surplus and applied against notes given by shareholders in a prior year in payment of stock.

ARTICLE 1541: Dividends. II-35-1213
I. T. 1850

REVENUE ACT OF 1921.

There was a merger in 1922 of two national banks, the M Bank, one of the constituent banks, continuing business under its charter, under the name of the O Bank. It was provided that the assets not required by the merger agreement to be transferred to the O Bank should be transferred before the date of the merger to separate trustees for the benefit of the respective shareholders. Each shareholder of the constituent banks had, after the merger, the same number of shares in the O Bank of the same par value as he had before.

The amounts distributed to the stockholders of the M Bank out of the assets transferred to the trustees are cash dividends, taxable to the extent of the earnings or profits accumulated since February 28, 1913. Solicitor's Opinion 115 (C. B. 5, p. 47) distinguished.

An agreement for the merger of the M Bank and the N Bank was signed by the boards of directors of the two banks, January —, 1921, and February —, 1921, respectively. Thereafter, on March —, 1921, an increase of $10x$ dollars in the capital stock of the M Bank was approved by the Comptroller. This stock was subscribed and paid for in cash at that time. Although it appears that an agreement for merger of the two banks was ratified by the shareholders on May —, 1921, no further steps seem to have been taken to effect the merger until August, 1922. At that time the directors of the two banks adopted a new agreement for the merger, which was ratified by the stockholders in September, 1922. The former agreement for merger was rescinded at the same time. The merger was actually effected as of November —, 1922.

By this last agreement it was provided that the two banks should be "consolidated," pursuant to the provisions of 40 Stat., 1043 (Comp. Stat., 1919, Suppl., sec. 9696a), under the charter of the M Bank, to be thereafter known as the O Bank; that this bank should have a capital stock of $60x$ dollars, divided into —— shares of $2y$ dollars each, and a surplus at the date of consolidation of $20x$ dollars. Each of the two merging banks was to contribute net assets above all liabilities equal to 50 per cent of the capital and surplus of the O Bank. The shares of capital stock of the latter bank were to be allotted to the stockholders of the original banks on the basis of one share of new stock for each share of the old. It was further agreed that:

Such assets of either association as it shall not carry into the consolidation, or shall not be necessary to make up its contribution to the capital and surplus, as aforesaid, shall be transferred by it, before the effective date of consolidation, to a trustee or trustees for the ultimate benefit of the shareholders * * *.

Out of these assets in the hands of the two groups of trustees, $12x$ dollars was to be set apart by each group to pay any loss suffered by the O Bank in the collection of named assets transferred to it by the respective banks, the balances after two years to be paid over on certain conditions to the O Bank as surplus.

Pursuant to the agreement, the M Bank transferred to its trustees bonds with a par value of $12x$ dollars and $18x$ dollars in cash. Likewise, it contributed to the O Bank assets in excess of liabilities representing $30x$ dollars capital stock and $10x$ dollars surplus as its share thereof. The N Bank transferred its assets similarly. Thereafter, the trustees of the M Bank made a distribution of y dollars per share to its shareholders, out of the fund of $18x$ dollars transferred to them for the shareholders' benefit.

The question submitted is the income tax liability of the shareholders of the M Bank for the amounts so received by them.

Although it is not clear what statutory provisions are relied upon in arriving at the conclusion that these amounts are not taxable, it is necessary to consider the application of subdivisions (c) and (e) of section 202, Revenue Act of 1921, in disposing of the case. The pertinent provisions thereof read (prior to the amendment of March 4, 1923):

(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation (however effected);

(e) * * * when property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess.

Before these sections can be applied, it must first be determined what the shareholders in the two original banks received in exchange for their shares therein. According to the terms of each of the agreements for "consolidation" of the banks, it was provided that the assets not required by the agreement to be transferred to the so-called "consolidated" bank should be transferred *before* the date of the merger to separate trustees for the benefit of the respective shareholders. A stockholder in the M Bank then acquired, by the terms of the agreements, a beneficial interest in this fund held by trustees prior to the time that any exchange of stock was effected. Later he exchanged his stock certificate in the M Bank for another certificate in the same bank under a different name. Granted that this transaction constituted an exchange of property, the exchange was of share for share, *not* of share for share plus money, for the O Bank, with which he exchanged stock, never owned the assets from which he received the cash distribution, and the stockholder had already become entitled to the money he received before any exchange of stock was made at all. Therefore paragraph (2) of subdivision (c) applies to the transaction, but not subdivision (e). Hence, no gain or loss is recognized at this time in the exchange of share for share. The distribution of money, however, was a dividend, under the provisions of section 201 (a), (b), and (c) in the absence of some special circumstances removing the case from their operation.

It is suggested that, in view of the increase of the capital stock of the M Bank by $10x$ dollars in March, 1921, the distribution of $10x$ dollars to the stockholders in November, 1922, should be treated as a stock dividend. It is difficult to see why the transaction should be treated in this way. Although it may be granted that in increasing the capital stock the directors and stockholders had in mind the prospective merger of the banks, the two transactions were entirely separate. The stock was increased more than a year and a half before the merger was effected; and the merger was ultimately effected under an entirely different agreement from that in process of adoption early in 1921, which was rescinded. There was nothing in the mere increase of the capital stock to require that the merger be consummated; the arrangements for merger evidently remained dormant

over a year after the stock increase, and might well have been abandoned entirely. Finally, there is no necessary relationship between the money paid in for the new stock issued in March, 1921, and that paid out by the trustees in November, 1922. It is stated that the surplus was over $10x$ dollars in March, 1921, and that a stock dividend of $10x$ dollars might have been declared. The fact is, however, that such a dividend was not declared, and that the $10x$ dollars received by the stockholders in November, 1922, came from the surplus in the hands of the trustees, whereas the $10x$ dollars paid in in March, 1921, went into capital, over which these trustees had no control.

It is also suggested that Solicitor's Opinion 115 (C. B. 5, p. 47) is controlling in the decision of this case. The facts of the case therein decided differ from this in that the contribution of each constituent bank to the consolidated bank was of a smaller amount of capital and surplus than each of the constituent banks then possessed; hence, the par value of shares being the same, each shareholder received a less number of shares in the consolidated bank than he previously had in the constituent bank. Thus there was held to be a liquidation of a portion of the old stock. In the instant case, each shareholder had, after the merger, the same number of shares of the same par value as he had before; and hence there was no such liquidation. Further, the provisions of section 201(c) of the Revenue Act of 1918 construed in that opinion are not repeated in the Revenue Act of 1921, whose provisions with reference to a gain or loss on a reorganization differ from those of the preceding Act. Finally, at least so far as the shareholders in the M Bank, whose liability is here in question, are concerned, it seems that article 1545 of Regulations 62 with reference to liquidation does not apply, since the M Bank continued in existence.

Accordingly, the amounts received by the stockholders of the M Bank are to be treated as dividends, and under the provisions of section 201 of the Revenue Act of 1921 these amounts are taxable as a dividend to the extent of the earnings or profits of the bank accumulated since February 28, 1913. Every distribution, for the purposes of this Act, is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913. If such earnings or profits have been distributed, a distribution of earnings or profits accrued prior to March 1, 1913, may be made tax free.

However, in the event of a sale or other disposition of his stock, the stockholder can not deduct any loss unless and then only to the extent that the cost or March 1, 1913, value thereof, whichever is used as the basis, exceeds the sum of (1) the amount realized from the sale or other disposition of the stock and (2) the aggregate amount of the distributions representing earnings or profits accrued prior to March 1, 1913, received by the stockholder. (See art. 1545, Regulations 62, and example thereunder.) Attention is also directed to articles 1561 and 1564 to 1569 of Regulations 62, in determining the gain or loss on the subsequent sale or other disposition of the stock.

ARTICLE 1543: Distribution out of earnings or profits accumulated prior to March 1, 1913. II–17–1016 T. D. 3499

REVENUE ACT OF 1921—DISTRIBUTION OUT OF EARNINGS OR PROFITS ACCUMULATED PRIOR TO MARCH 1, 1913.

Article 1543 of Regulations 62 amended; T. D. 3478[1] revoked and T. D. 3475[1] affirmed.

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

To collectors of internal revenue and others concerned:

Article 1543 of Regulations 62 is hereby amended to read as follows (the italic is not a part of the amended article, but is used to indicate the additions and changes made by the amendment):

ART. 1543. *Distribution out of earnings or profits accumulated prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase *in* value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition *prior to March 1, 1913*), is not a dividend within the meaning of the Act. The provisions of the preceding sentence shall be applied uniformly to cases arising under the Revenue Act of 1916, the Revenue Act of 1917, *and* the Revenue Act of 1918, as well as the Revenue Act of 1921. A corporation can not distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. *Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its stockholders the amount so received by it from such other corporation, the distribution by the "receiving" corporation to its stockholders is not a dividend within the meaning of the Act and is exempt from tax.*

In determining whether a dividend is out of earnings or profits accumulated *since February 28, 1913, or* prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

A distribution made by a corporation out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, is exempt from tax, even if in excess of the cost or other basis provided in articles 1561–1563 and 1568, of the stock on which declared. However, where any tax-free distribution out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, has been made, the distributee can not deduct any loss from the sale or other disposition of the stock unless, and then only to the extent that, the cost, or other basis, exceeds the sum of (1) the amount realized from the sale or other disposition of the stock, and (2) the aggregate amount of such distributions received by him thereon. *The provisions of this paragraph are also applicable to a distribution by a "receiving" corporation made under the conditions set forth in the first paragraph of this article, and to the distributees in deducting any loss from the sale or other disposition of stock in the "receiving" corporation.*

Example: A purchased certain stock subsequent to March 1, 1913, for $10,000 and received in 1921 a distribution thereon of $2,000, paid out of the earnings or profits of the corporation accumulated prior to March 1, 1913. This distribution does not constitute taxable income to A. If A subsequently sells the stock for $6,000, a deductible loss of $2,000 is sustained. If he sells the stock for $12,000, a taxable gain of $2,000 is realized. No gain or loss is recognized if he sells the stock for an amount ranging between $8,000 and $10,000.

[1] Not published in Bulletin service.

Under date of May 9, 1923, T. D. 3475 was approved, amending article 1543 of Regulations 62 to provide substantially as above set forth. On May 14, 1923, no cases having been closed on the basis of T. D. 3475, T. D. 3478 was issued, revoking T. D. 3475, and the question involved in the amendment was referred to the Attorney General for opinion. His opinion, dated June 21, 1923, has now been received, and is in entire accord with the amendment originally effected by T. D. 3475. Accordingly, T. D. 3478 is revoked, T. D. 3475 is approved, and article 1543 of Regulations 62 is amended to read as hereinabove provided.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 20, 1923.

S. P. GILBERT, JR.,
Acting Secretary of the Treasury.

ARTICLE 1543: Distribution out of earnings or profits accumulated prior to March 1, 1913. II-35-1214 I. T. 1851

REVENUE ACT OF 1917.

Where a corporation paid a dividend in January, 1917, out of its general surplus, no specific mention having been made in the resolution declaring the dividend as to the funds from which it was payable, and subsequently passed a resolution prior to August 6, 1917, directing that such dividend should be paid out of profits accrued prior to March 1, 1913, it is held that the dividend so paid is exempt from taxation, since it is established that the distribution was actually made from accumulations prior to March 1, 1913.

A taxpayer received certain dividends in January, 1917, from the M Company, in which he was a stockholder. These dividends he did not include in his income tax return for that year, relying upon a notice received from the company in the early part of 1918, stating that such dividends were paid out of earnings or profits accrued prior to March 1, 1913, and were tax exempt. The resolution of the company declaring such dividends did not specify the funds from which the dividends were to be paid, and at the time of payment no declaration or entry that they should be paid out of any particular surplus had been made, although both the earnings and profits of the company accrued prior to March 1, 1913, as well as the earnings and profits accrued subsequent thereto, were more than sufficient to pay the dividends. In June, 1917, and during the same taxable year, the board of directors of the company adopted a resolution declaring the January dividends to be paid out of the earnings or profits accrued prior to March 1, 1913, and they were so entered in the company's record of dividend disbursements. The question is thus raised whether the January dividends could by this subsequent action be allocated to the March 1, 1913, surplus of the company.

An additional tax has been assessed against the taxpayer on the ground that the January, 1917, dividends constituted taxable income to the stockholders for that year, and the dividends received by the taxpayer should have been included in his 1917 income tax return.

The pertinent provisions of the Act of September 8, 1916, as amended, and of Regulations 33 (revised), issued thereunder, are as follows:

SEC. 2. (a) * * * the net income of a taxable person shall include gains, profits, and income derived from * * * dividends * * *.

SEC. 31. (a) That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March 1, 1913 * * *.

(b) Any distribution made to the shareholders or members of a corporation * * * in the year 1917, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus * * *, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March 1, 1913, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March 1, 1913, has been made. *This subdivision shall not apply to any distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913.* [Italics not in the original.]

ART. 107. * * * The provisions of section 31, subdivision (b), do not apply to distributions made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913; that is to say, that such distributions will *not* be deemed to have been made out of the most recently accumulated surplus or profits, if at the time of distribution, before August 6, 1917, they were specifically declared to be out of accumulations prior to March 1, 1913.

Under the foregoing provisions, the dividends paid to the taxpayer in January, 1917, were taxable dividends, unless they constituted a distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913, in which event they were exempt from taxation, the rule that a corporation will be deemed to make all distributions from the most recently accumulated undivided profits or surplus not being applicable in such a case. It will be seen that two conditions must obtain to exempt from taxation a distribution of corporate earnings made in 1917: (1) The dividends must have been declared and paid to the stockholders prior to August 6, 1917, and (2) the distribution must have been out of earnings or profits actually on hand and accrued prior to March 1, 1913.

The dividends in question were without question declared and paid to the taxpayer prior to August 6, 1917, so that the only question to determine is from what earnings or profits was the distribution made. If it can be said that the distribution was, prior to August 6, 1917, from earnings or profits accrued prior to March 1, 1913, the dividends were exempt from taxation under the clear language of the statute.

Although a resolution declaring a dividend prior to August 6, 1917, may have directed that the dividend be paid from March 1, 1913, surplus, that would not be conclusive. The distribution could be from such surplus only if such a surplus actually existed, and the distribution was charged against that surplus. In other words, the facts are determinative of whether a distribution was made from March 1, 1913, surplus, and not the declaring resolution.

It is undisputed that the dividends in question were declared without any reference being made to the particular fund from which the distribution was to be made. Thereafter, in January, 1917, the dividends were paid out of general surplus of the corporation without being charged against any particular earnings or profits by book entry or otherwise. Clearly, at this time it remained undetermined out of what earnings or profits the January distribution was made.

However, on June —, 1917, and during the same taxable year the dividends were paid, the directors of the corporation adopted a blanket resolution directing that all dividends paid or declared during 1917, including the January dividends, be paid out of the earnings or profits of the company accrued prior to March 1, 1913, and, pursuant to that resolution, the January dividends were entered in the company's record of dividend disbursements against the March 1, 1913, surplus, an actually existing surplus. At this point, nearly two months prior to August 6, 1917, the distribution became one out of earnings or profits accrued prior to March 1, 1913. It is to be noted that the March 1, 1913, surplus, against which the January dividends were thus charged, had never heretofore been reduced or depleted through losses sustained or dividend or other payments made in the interim from March 1, 1913, to January, 1917, and, furthermore, that such surplus was not represented by fixed assets, the assets of the company, exclusive of fixed assets, having at all times been in excess of the amount of the March 1, 1913, surplus, and, in fact, of the entire undivided profits of the company. Such surplus was an actually existing and available surplus on June —, 1917, when the January dividends were charged against it. Not only, then, were the dividends paid to the stockholders but they were subsequently declared from, and the distribution was entered against, the March 1, 1913, surplus, all prior to August 6, 1917, and at a time when such surplus was available for distribution. Under these circumstances, it can make no difference that the corporation first paid the dividends and thereafter during the same taxable year and prior to August 6, 1917, determined from what particular earnings the distribution should be made. This merely accords with a general, customary practice followed by many corporations.

In Law Opinion 932 (C. B. 1, p. 16) it was said concerning the very situation presented by this case:

> If a corporation during the taxable year 1916 paid dividends without specifying whether they were declared from earnings accumulated before March 1, 1913, or from earnings accumulated thereafter, no reason appears why, under the terms of the Revenue Act of 1916, the corporation might not, during the taxable year, pass a resolution and adjust its accounts so as to indicate that the dividend was declared out of earnings accumulated prior to March 1, 1913. In such a case the stockholder would get the benefit of such action. * * *

It has been held in O. D. 655 (C. B. 3, p. 36) that:

> Where original entries on the books and records of a corporation show that a dividend paid prior to August 6, 1917, represented a distribution of earnings accumulated prior to March 1, 1913, the dividend is exempt from income tax even though it was not specifically stated in the resolution authorizing payment of the dividend that it was to be paid from such earnings.

Article 107, Regulations 33 (revised), hereinabove quoted, states in effect that distributions made prior to August 6, 1917, will not be deemed to have been made out of the most recently accumulated surplus or profits if at the time of distribution they were specifically declared to be out of accumulations prior to March 1, 1913. However, it does not unequivocally state that all distributions made prior to August 6, 1917, must at the time of distribution have been specifically declared to have been out of accumulations prior to March 1, 1913, in order to come within the exemption, if the fact that the distributions were actually made from accumulations prior to March

1, 1913, is otherwise established. The provision is not at all to the effect that all dividends not specifically declared at the time of distribution to be from profits accrued prior to March 1, 1913, will be deemed to have been paid out of the most recently accumulated surplus. It is recognized that, even if the only specific declaration that a distribution be made from earnings or profits accrued prior to March 1, 1913, is contained in the declaring resolution, adopted considerably prior to the time of distribution, or, even in the entire absence of a specific declaration, where original entries in the books of a corporation show that a distribution was from March 1, 1913, surplus, such distributions, if made prior to August 6, 1917, will not be deemed to have been from current earnings.

In view of the foregoing, it is held that the dividends received by the taxpayer in January, 1917, constituted part of a distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913, and were not taxable income to the taxpayer.

SECTION 202.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 1561: Basis for determining gain or loss from sale. II–16–996 T. D. 3496

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTIONS—LOSSES ON SALES OF PROPERTY ACQUIRED BEFORE MARCH 1, 1913.

The deductible loss for income tax purposes under the Revenue Act of 1918 in the case of property acquired prior to March 1, 1913, and sold subsequent thereto can never exceed the actual loss or excess of cost over sale price. The fact of actual loss must first be found and resort had to section 202 of the Act solely for the purpose of determining the deductible amount thereof.

2. LOSSES—COST LESS THAN MARCH 1, 1913, VALUE.

The deductible loss in the case of property acquired prior to March 1, 1913, and sold after that date at a price less than the cost thereof, the cost being less than the value on March 1, 1913, is the difference between the cost and sale price and not the difference between March 1, 1913, value and sale price.

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

To collectors of internal revenue and others concerned:

The attached decision of the United States District Court for the Eastern District of Pennsylvania in the case of *Charles H. Ludington* v. *McCaughn, collector*, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 11, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES, EASTERN DISTRICT OF PENNSYLVANIA.

Charles H. Ludington, plaintiff, v. *Blakely D. McCaughn, Collector of Internal Revenue, defendant.*

[June 15, 1923.]

McKEEHAN, District Judge:

The plaintiff sues to recover $3,094, the amount of an additional income tax assessed against him for the calendar year 1919 and paid under protest. Prior to March 1, 1913, he purchased certain securities for $32,500 and sold them in 1919 for $3,866.91. Thus the difference between the cost and the selling price, the actual loss, was $28,633.09. The selling price, however, was $33.183.09 less than the market price of the securities on March 1, 1913. In his income return, the plaintiff claimed the latter sum as a deduction, and the Commissioner reduced the amount of the deduction to the actual loss, thereby increasing the plaintiff's tax by $3,094.

The plaintiff stands upon the letter of section 202 of the Revenue Act of 1918 (approved February 24, 1919, 40 Stat., 1060-1067) and insists that, if it means what it says, he is entitled to the deduction he claimed. This section provides:

"SEC. 202(a). That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; * * *"

This provision, standing alone, gives color to the plaintiff's contention, but not when considered in relation to the sixteenth amendment and in relation to other provisions of the Act. The grant of power extended only to the taxation of actual income. The Act intended to tax only actual income, which means actual gross income less the deductions specified in the Act. Included in gross income are "gains, profits whether real or personal." And among the deductions allowed are "losses sustained during the calendar year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business." The adoption of the sixteenth amendment was proclaimed by the Secretary of State on February 25, 1913, and in order that gains and losses that had accrued prior to that time should be excluded in the computation of "income," the market price as of March 1, 1913, was selected as the basis for computing gains and losses as to property acquired prior thereto. In other words, the Act was to operate only on gains and losses accruing subsequent to the adoption of the amendment. But in selecting this method of accomplishing the result, Congress did not intend to impose a tax on a mere fictitious or paper profit, or to permit the deduction of a mere fictitious or paper loss. Only actual gains are taxed; only actual losses are deductible. The intent and purposes of section 202 is this—that where a part but not all of an actual gain accrues after March 1, 1913, only so much as accrues after that date is income, and where a part but not all of an actual loss accrues after March 1, 1913, only so much as accrues after that date is deductible. It is a limitation upon the amount of gains that are taxed and of losses that are deductible. Given an actual gain or loss, the market value on March 1, 1913, was selected as a reasonable criterion for determining how much, if any, of the gain or loss accrued subsequent to the adoption of the amendment.

In *Walsh* v. *Brewster* (255 U. S., 536), one of the transactions before the court involved securities that Walsh purchased in 1902 and 1903 for $231,300 and sold in 1916 for $276,150, an actual gain of $44,850. Their market value on March 1, 1913, however, was only $164,480, and the collector assessed the tax upon $111,670, being the difference between that market value and the selling price. The decision was that the assessment was illegal and that Walsh was taxable only on his actual gain of $44,850. Another transaction involved in the Walsh case was the purchase of securities in 1899 for $191,000 and their sale in 1916 for the same amount. Their market value on March 1, 1913, however, was only $151,854. The decision was that a tax assessed on the difference between that amount and the selling price was illegal, no actual gain having been realized. In *Goodrich* v. *Edwards* (255 U. S., 527), one of the transactions

had reference to securities that had been purchased in 1912 for $500 and sold in 1916 for $13,931.22. The market value on March 1, 1913, was $695. Thus there was an actual gain of $13,431.22, but only $13,236.22 of it had accrued subsequent to March 1, 1913. The decision was that the tax was properly assessed on the latter amount. The other transaction involved in the Goodrich case was a block of securities purchased in 1912 for $291,600 and sold in 1916 for $269,346, an actual loss of $22,254. The market value on March 1, 1913, however, was only $148,635, so that the taxpayer had a paper profit of $120,711 on the basis of March 1, 1913, value. The decision was that an actual loss having been sustained, a tax assessed upon the paper profit was illegal. Whether the taxpayer could have claimed a deduction for his actual loss of $22,254 was not before the court and was not decided.

The questions decided in these cases had to do with gains, not losses, and the cases arose under the income tax law of 1916. But the provisions of that Act on this question differed only in arrangement and not in substance with the Act of 1918. Section 2(c) of the Act of 1916 provided that "for the purpose of ascertaining the gain derived from the sale" of property acquired prior to March 1, 1913, the fair market price as of that date "shall be the basis for determining the amount of such gain derived," and section 5, in dealing with allowable deductions, provided that "for the purpose of ascertaining the loss sustained from the sale" of property acquired before March 1, 1913, the fair market price as of that date "shall be the basis for determining the amount of such loss sustained." Thus, under the Act of 1916, losses were to be computed in the same way as gains, and these provisions were substantially reenacted in section 202 of the Act of 1918. So I think that the Supreme Court's construction of the computation of "gains" applies equally to the computation of "losses" under the Act of 1918.

The plaintiff, therefore, was not entitled to a deduction in excess of his actual loss, and the additional tax of $3,094 was properly assessed. Judgment may be entered for the defendant.

ARTICLE 1561: Basis for determining gain or loss from sale. II–17–1017 A. R. R. 2771

REVENUE ACT OF 1918.

> Book values of stock are no more than evidential, and may not be accepted as conclusive evidence of the fair market value of the stock at March 1, 1913, except in the absence of any other acceptable evidence which will reasonably and adequately indicate what the fair market value was on that date. They may be disregarded, if the fair market value of the shares can be established by sales in sufficient quantities, in a free and open market.

The Committee has carefully considered the appeal of A from the action of the Income Tax Unit in holding that the March 1, 1913, value of certain shares of preferred and common stock of the M Company was not in excess of $.317x$ dollars per share and $.113x$ dollars per share, respectively, for the purpose of computing the gain derived from the sale of this stock in 1915.

The sole point at issue in the instant case is the determination of the March 1, 1913, value of $2.02y$ shares of common and $1.81y$ shares of preferred stock of the M Company, held by the appellant on that date and sold during the year 1915, in order that the gain realized through the sale of this stock may be correctly determined. The remaining $.34y$ shares of common and $.024y$ shares of preferred, sold in 1915, were purchased subsequent to March 1, 1913, at $.16x$ and $.36x$ dollars per share, respectively, and under the statute the cost of

these .364y shares is the basis for the determination of any gain derived through their sale.

It is not altogether clear what method was used by the appellant in computing the gain derived from the sale in 1915 of these 2.36y shares of common and 1.834y shares of preferred stock, and reported as income in the amount of 230.05x dollars in the return for that year. A revenue agent who examined the books of the appellant for the purpose of ascertaining the correct tax liability for 1915 computed the profit on the sale of these shares to be 630.52x dollars, using as a basis for such computation a March 1, 1913, value of .317x dollars per share for the preferred and .113x dollars for the common for those shares acquired prior to March 1, 1913, and cost for such shares as were purchased subsequent to that date. After reviewing this report of the examining officer, the Income Tax Unit requested that officer to ascertain from sales of M Company stock by other stockholders on or about March 1, 1913, the market value of this stock on that date. To this request the revenue agent replied "that no sales of this stock appear to have been made by any stockholder of this company on or about that date, as the —— Stock Exchange has no record of any sales made at that time," but called the attention of the Unit to the fact that the returns of six other stockholders of the M Company, who had sold part of their holdings, had been adjusted on the same basis as was used in the instant case.

The appellant takes exception to the March 1, 1913, value of this stock used by the revenue agent in computing the gain derived from the sale thereof in 1915, for the following reasons quoted from his brief:

1. The stock of the M Company in 1913 was closely held and there were no sales of stock from which its market value can fairly be determined.

2. In the absence of such sales the Department has indicated by its rules for the valuing of stock for the capital-stock tax (see Regulations No. 50, article 102) and for the estate tax (see Regulations No. 37, article 15) the procedure to be followed. These rules indicate clearly that in the absence of evidence by sales to determine market value the value of the stock is to be determined (1) by the "reconstructed book value" of the corporation, or by "the excess of the assets of the corporation over its liabilities," and (2) by the average earnings of the corporation for the five preceding years.

A balance sheet of the M Company as of March 31, 1913, has been submitted, which shows a net worth of 16,864.48x dollars, which, when divided by the total number of shares outstanding on that date, shows a book value for each share of preferred and common stock of .47x dollars, which appellant contends should be accepted as the March 1, 1913, value for the purpose of computing the gain on the sale of this stock.

In support of the contention that the book value of .47x dollars per share should be accepted as the March 1, 1913, value, appellant submits a statement of the earnings of the M Company for the years 1908 to 1912, inclusive. This statement shows the earnings of the company dropped from 2,622.93x dollars in 1910 to 243.05x dollars in 1911, while a loss of 437.5x dollars was sustained in 1912, and a further loss in 1913. Commenting upon this statement of earnings, appellant states:

While it is true that there was a falling off of earnings in 1911 and a deficit in 1912, it is well known that the prosperity of the —— business is subject to rapid fluctuations. The decline in earnings in 1911 and the loss shown

in 1912 was due largely to the fact that the company was manufacturing a heavy high priced article and at that period the competition of lower priced and much improved medium priced articles was severely felt. In the spring of 1913 the company found itself amply financed and the management considered its prospects to be excellent. The company was one of the oldest and best known in the country in the manufacture of these articles and it enjoyed at that time a large measure of good will and a splendid position in the business. It is true that in 1913 the country entered on a new period of business depression and the company was not immediately successful in adapting its product to the changed conditions in the trade, so that the business of 1913 showed a loss.

Examination of the record develops the following facts: On January —, 1913, the company sold $18y$ shares of common for cash at $.333x$ dollars per share, of which appellant purchased $.66y$ shares. On June —, 1913, appellant sold $.003y$ shares of common at $.113x$ dollars per share, and on July —, 1913, purchased $.34y$ shares of common at $.16x$ dollars per share. Preferred stock was sold by appellant on dates and in amounts as follows: April —, 1913, $.059y$ shares; April —, 1913, $.096y$ shares; June —, 1913, $.003y$ shares; July —, 1913, $.009y$ shares; and September —, 1913, $.001y$ shares, all at $.317x$ dollars per share. In addition to these, it is noted that several shares of preferred were sold by the company to employees at or about March 1, 1913, at $.317x$ dollars per share.

After thorough consideration of all the evidence presented, both written and oral, the Committee has reached the conclusion that the fair market value of the stock of the M Company on March 1, 1913, was not in excess of $.333x$ dollars per share of common and $.317x$ dollars per share of preferred. The Committee does not believe that the book value of stock at March 1, 1913, should be accepted as conclusive evidence of the fair market value of the stock at that date, except in the absence of any other acceptable evidence which will reasonably and adequately indicate what the fair market value was on that date. Book values are no more than evidential, and should be disregarded if the fair market value of the shares can be established by sales in sufficient quantities in a free and open market. It is very evident from the facts above recorded that in no instance was the book value of this stock even a fair criterion of its fair market value as established by the several sales, nor vice versa. It should be noted further that the excessive book value is represented by accretions prior to 1912; that the profits of 1911 fell off 90 per cent from the three preceding years, while in 1912 the company sustained a substantial loss, amounting to $437.5x$ dollars, and during the first three months of 1913 the net worth of the company was decreased in the amount of $334.74x$ dollars, all of which are factors underlying valuations. On January —, 1913, as heretofore noted, there was sold for cash, at $.333x$ dollars per share, $18y$ shares of common, while the preferred shares were sold during all of 1913 by appellant and the M Company at $.317x$ dollars per share. The close approximation in the value of shares of the two classes at or about March 1, 1913, is indicated also by the fact that stockholders on January —, 1913, exchanged $30y$ shares of common for an equivalent number of preferred shares of an equal par value. The premises considered, the Committee believes the use of the March 1, 1913, values of the common and preferred stock of the M Company herein determined for the purpose of computing gain on the sale by appellant in 1915 of

stock of that company, namely, .317x dollars per share for the preferred and .333x dollars per share for the common, will result in an adjustment which will be equitable to both the Government and the appellant.

Accordingly, it is recommended that the action of the Income Tax Unit be modified as herein indicated, and that the appeal be denied in part and sustained in part.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1561: Basis for determining gain or loss from sale. II–20–1050 I. T. 1753

REVENUE ACT OF 1918.

In determining the gain or loss from the sale of the assets of a corporation bought at a foreclosure sale by a trust organized by a bondholders' committee for the benefit of the bondholders, the cost is held to be the actual value of the bonds when acquired by it. This value is not the face value of the bonds but the actual market value thereof, determined on the basis of actual sales, or bona fide offers, or if there were none, then in the light of all available evidence as of the date of their acquisition by the committee.

The M Company owned certain real estate and issued 100x dollars of stock and 100x dollars of bonds. In 1912, owing to financial difficulties, the stockholders and debenture holders were asked to deposit the securities with a committee which was empowered to formulate a plan of reorganization. A reorganization plan was submitted by the committee and declared effective in ——, 1913. Under the plan, 100x dollars of preferred stock was authorized in exchange for the debenture bonds on even terms. First-mortgage bonds were also sold, aggregating an amount of about 25x dollars. After about two years the company found that it could not keep up the interest on its first-mortgage bonds and foreclosure was begun in the spring of 1915. In order to protect the bondholders, an agreement was entered into in ——, 1915, providing for the appointment of three persons as a committee. The agreement was signed by holders of 24x dollars of the mortgage bonds, the committee owning in the aggregate x dollars of bonds.

The committee having acquired the bonds under the agreement referred to, bid in at the foreclosure sale and acquired the property for a bid of 8x dollars. In 1919 this property was sold for 16x dollars. Advice is requested as to the tax liability of the committee with reference to the sale of the property in 1919.

The agreement of ——, 1915, provided among other things that the committee constituted a bondholders' protective committee. Bondholders might become parties to the agreement by depositing their bonds with transfer powers duly executed in blank with a named depositary which was to issue the committee's nonnegotiable receipt for the bonds deposited with it. The committee is authorized to take such steps as it may deem expedient in enforcing and prosecuting to final judgment the foreclosure and sale of the property covered by the mortgage securing the bonds. The committee is authorized to bid for the property, or cause a bid to be made therefor, in such sum or sums as it may deem expedient, not exceeding an amount sufficient to

pay the expenses of the foreclosure and the full amount then due for principal and interest upon the outstanding bonds. If the property is bid in by the committee, it may resell the same at a higher or lower price, as it may see fit, accounting to the bondholders for the proceeds proportionately after the payment of the committee's disbursements and liabilities; or it may organize a corporation to take title to said property, distributing stock or other securities of the corporation proportionately.

The committee is further authorized to incur and pay expenses, borrow money, pledge the bonds deposited, and limit the time within which bondholders may become parties to the agreement. The action of the majority of the committee taken at a meeting or evidenced in writing, signed by at least two members of the committee, shall be controlling. Vacancies in the committee by death or resignation shall be filled by written appointment made by the remaining members of the committee. The depositary is to hold the bonds in every way subject to the direction of the committee.

Under the circumstances outlined, the committee of the bondholders is held to be a trust and as such is a taxable entity which realized a gain or sustained a loss from the sale of the property determined in the following manner:

The cost of the property to the committee, which is the basis for determining the gain or loss upon its disposition, was the actual value of the bonds when acquired by it. This value is not the face value of the bonds but the actual market value thereof, determined on the basis of actual sales or bona fide offers, or if there were none, then in the light of all the available evidence as of the date of their acquisition by the committee.

If the amount realized by the committee from the sale of the property was greater than such value of the bonds, then a gain resulted and if such gain equals or exceeds $1,000, a return should be filed by the committee on Form 1040 or 1040A, as the case may be, and any tax shown to be due thereon should be paid by the committee in its official capacity.

ARTICLE 1561: Basis for determining gain or loss from sale. (Also Section 213(a), Article 52.)

II–22–1065
I. T. 1764

REVENUE ACT OF 1921.

There was a short sale in 1921 of $3y$ shares of stock by a broker for the taxpayer, that number of shares having been borrowed for the purpose. In 1922, y shares were repurchased by the taxpayer, the remaining $2y$ shares being "short" at the end of 1922. The broker credited her account in 1922 with $11x$ dollars interest, occasioned by the short sale, and charged her with dividends in the amount of $18x$ dollars, which were due the lender of the stock. The gain or loss on the repurchase of y shares in 1922 is the difference between the proportionate part of the selling price of the $3y$ shares sold in 1921 attributable to such y shares and the cost of the y shares acquired in 1922 plus the proportionate part of the total amount advanced as dividends attributable to such y shares. The interest credited to taxpayer's account may not be taken into consideration

in determining the gain or loss on the purchase and sale of the stock, but must be reported as income when unqualifiedly subject to taxpayer's order.

ARTICLE 1561: Basis for determining gain or loss from sale. II-24-1093 A. R. R. 3515

REVENUE ACT OF 1918.

A taxpayer made no depreciation charges on its books. Nevertheless, accrued depreciation from date of purchase in 1917 to the date of sale should have been added to the profit on the sale of a building by the taxpayer.

The Committee has considered the appeal of the M Company from the action of the Income Tax Unit in proposing to assess additional taxes of $2.25x$ dollars for the year 1919 due to the addition to the profit on the sale of a building the amount computed by the Income Tax Unit as accrued depreciation to the date of sale.

During 1917 the appellant acquired a building in the city of S, at a cost of $175x$ dollars. Its affairs were not financially successful, a net loss being shown on its tax returns of 1917 and 1918. In 1919 it was decided to liquidate and the building was sold for $200x$ dollars, being $25x$ dollars over and above the original cost.

The return filed for the year 1919 shows a net profit of $17.2x$ dollars after including this $25x$ dollars. To this the Unit has added $5.83x$ dollars as depreciation accrued in 1917 and 1918 and assessed thereon the additional taxes noted, quoting as its authority article 545 of Regulations 45.

The appellant protests this action, stating that no depreciation has ever been charged on its books or shown on its tax returns, and accordingly that the only profit realized is the net $25x$ dollars.

It is the opinion of the Committee that the fact that the appellant made no depreciation charge on its books, and claimed no such item on its tax returns, due in all probability to the fact that operations reflected a net loss, did not eliminate the existence of such depreciation or relieve the taxpayer from making the charge. Such a charge should unquestionably have been made in each year in order to properly reflect its financial condition.

The Committee therefore recommends that the action of the Income Tax Unit be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1561: Basis for determining gain or loss from sale.

(See A. R. R. 2954; sec. 233, art. 546.) Deductibility of Federal income taxes by corporation in determining earnings chargeable to good will in accordance with A. R. M. 34 (C. B. 2, p. 31).

ARTICLE 1561: Basis for determining gain or loss from sale.

(See I. T. 1787; sec. 213(a), art. 49.) Determination of gain or loss upon the sale or other disposition of property a portion of which had been condemned for street-widening purposes.

ARTICLE 1561: Basis for determining gain or loss from sale. II-30-1149 I. T. 1807

REVENUE ACT OF 1918.

In I. T. 1188 (C. B. I-1, p. 28) it was ruled that taxes paid in prior years may not be added to the cost of property in determining the gain or loss upon a sale thereof. It has been contended that taxes which could not be deducted in prior years due to the absence of income should be capitalized and a reconsideration of the ruling has been requested.

Section 202 of the Revenue Act of 1918 provides that the basis for ascertaining the gain or loss sustained on the sale or other disposition of property acquired subsequent to March 1, 1913, is the cost thereof. The cost of subsequent capital additions must also be taken into consideration in computing gain or loss. The Revenue Act of 1918 treats taxes as yearly expenses rather than capital expenditures and provides (sections 214(3) and 234(3)) that they shall be allowed as deductions in the taxable year in which paid or accrued. It is therefore held that there is no authority in the Act for permitting taxes which are paid in one year to be carried over and taken as a deduction in a subsequent year, although in such prior year there is no income against which to take the deduction. I. T. 1188 (C. B. I-1, p. 28) affirmed.

ARTICLE 1564: Exchange of property. (Also Section 214(a)4, 5, 6, Article 147.) II-34-1206 Mim. 3156

REVENUE ACT OF 1921.

Gain or loss where bonds are converted into stock.—Application of section 214(a)(5) of the Revenue Act of 1921 to losses in connection with sales of securities purchased on the margin.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., November 17, 1923.

To collectors of internal revenue, internal revenue agents, and others concerned:

Attention is directed to article 1564 of Regulations 62 (this article was numbered 1563 in Regulations 45). The following sentence in Regulations 45 is omitted from Regulations 62:

* * * Where the owner of a bond exercises the right, provided for in the bond, of converting the bond into stock in the obligor corporation, such transaction does not result in a realization of profit or loss, the transaction not being closed for purposes of income taxation until such stock is sold.

In view of the omission of this sentence from Regulations 62, the question has arisen as to whether the ruling expressed therein is incorrect or whether it is still adhered to by the Bureau.

It is held that the ruling contained in the above-quoted sentence of article 1563 of Regulations 45 is correct. The ruling is equally applicable under the Revenue Act of 1921 and is still adhered to by the Bureau.

The question has also been raised as to whether the following provision of section 214(a)(5) of the Revenue Act of 1921, relating to losses, applies to sales of securities which have been purchased on the margin:

* * * No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of this Act where it appears that within 30 days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition.

It is to be noted that the provision of the statute referred to specifically states that under the conditions described no deduction shall be allowed for "any loss" sustained in "any sale" or other disposition of shares of stock or securities. A sale of securities purchased on the margin is recognized by business men, brokers, and others as being as much a sale as any other sale; and it is so recognized in law. It is held, therefore, that the 30-day limitation does apply to the sale of securities which have been purchased on the margin.

D. H. Blair, *Commissioner.*

ARTICLE 1568: Exchanges of property for other property and money. II–33–1191 I. T. 1833

REVENUE ACT OF 1921.

The capital stock of a corporation was reduced from $10x$ dollars to $5x$ dollars. The number of outstanding shares remained the same and the stockholders were paid cash, out of the capital assets of the corporation, the amount of $5x$ dollars, in proportion to their stock holdings.

The transaction constitutes a recapitalization under the provisions of section 202(c)2, and any gain realized by the stockholders should be determined in accordance with the provisions of section 202(e) of the Revenue Act of 1921 as amended by the Act of March 4, 1923.

The stockholders of the M Company adopted a resolution in 1923 reducing the capital stock of the company from $10x$ dollars to $5x$ dollars and reducing the par value of the stock from $2y$ dollars to y dollars, leaving the number of outstanding shares the same. It was further resolved that the reduction of capital stock be effected by paying in cash, out of the captial assets of the corporation, the sum of $5x$ dollars per share at such time and in such manner as the board of directors may determine. In pursuance of this resolution of the stockholders, the board of directors resolved that the proper officers of the corporation pay to the stockholders on each share held

by them $5x$ dollars in cash on presentation of their stock certificates for indorsement thereon as to the reduction of the capital stock.

Held, that the distribution should not be treated as a dividend for income tax purposes but that the transaction constitutes a recapitalization of the M Company under the provisions of section 202(c)2 of the Revenue Act of 1921, and that any gain realized by the stockholders determined in accordance with the provisions of section 202(e) of the Revenue Act of 1921, as amended by the Act of March 4, 1923, constitutes taxable income to them for normal and sur tax purposes.

ARTICLE 1568: Exchanges of property for other property and money. II-36-1231 I. T. 1861

REVENUE ACT OF 1921.

A stockholder of the M Company, organized in 1918, received in 1922, upon a distribution in liquidation, one share of stock of the N Company, having a market value of $5x$ dollars; one share of stock of the O Company, having a market value of $5x$ dollars; and $3x$ dollars in cash. The par value of the stock of the M Company was $5x$ dollars and its cost to the stockholder who purchased it on the market was $8x$ dollars.

The procedure applicable to this situation outlined by article 1545 of Regulations 62 is first to compute the gain realized by the stockholder under section 202, prior to the amendment of March 4, 1923, effective January 1, 1923. Taken together, subdivisions (a), (c), (d), and (e) of that section provide that the stock shall be considered as taking the place of the stock exchanged and the money shall be applied against and reduce the basis for determining the gain or loss from a disposition of the property exchanged. Since the cash received is not in excess of this basis, no taxable gain or loss is realized out of this transaction but the determination of gain or loss is deferred until the subsequent disposition of the stock received in exchange.

The M Company was organized in 1918 with a capital stock of a par value of $5x$ dollars per share, which stock was issued for cash. The company thereafter purchased from the N Company certain properties which were no longer required in the vendor's business. The M Company thereupon salvaged and disposed of the properties which it had purchased at a substantial profit. A portion of the money received through the sale of these properties was invested in stock of the N Company. Such property as remained unsold in 1922 was sold to the O Company at the appraised value of the property, payment therefor being made in stock of the O Company, the par value of which was $2x$ dollars per share. This left the M Company with assets consisting of stock of the N Company, stock of the O Company, and cash. The company proceeded to liquidate and distributed to its stockholders for each share of stock held by them:

1 share of O Company stock,
1 share of N Company stock,
$3x$ dollars in cash.

At the time the liquidating dividend was paid the market value of the O Company stock was $5x$ dollars per share and that of the N Company stock $5x$ dollars per share, on which basis there was

turned over to the shareholders of the M Company for each share held by them cash and securities at a market value of $13x$ dollars.

Advice is requested as to the manner in which a stockholder of the M Company, who purchased his stock on the market at $8x$ dollars per share, should account for the liquidating dividend which he received in 1922 under the plan above outlined.

Since the Revenue Act of 1921 contains no provisions specifically governing distributions in liquidation by a corporation, the general provisions of section 201, which in terms deal with "any distribution" by a corporation, and section 202, which give the basis for determining gain or loss on such a distribution, are applicable. Article 1545 of Regulations 62 interprets these sections, with particular regard to distributions in liquidation, in the following language:

> Where a corporation distributes all of its property in complete liquidation or dissolution, the gain realized by the stockholder from the transaction, computed under section 202, is taxable as a dividend to the extent that it is paid out of earnings or profits of the corporation accumulated since February 28, 1913. If the amount received by the stockholder in liquidation is less than the cost or other basis of the stock, a deductible loss is sustained.

In other words, the procedure outlined by article 1545 is, first, to compute the gain realized by the stockholder under section 202 of the Act. Section 202, prior to the amendment of March 4, 1923 (42 Stat. L., ch. 294), effective January 1, 1923, provided in subdivisions (a), (c), (d), and (e) as follows:

> (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—
>
> * * * * * * *
>
> (c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—
>
> (1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use;
>
> (d) (1) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (c), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor, except as provided in subdivision (e);
>
> * * * * * * *
>
> (e) * * * but when property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and in excess of such basis, shall be taxable to the extent of the excess.

In the instant case, the stockholder received, on the disposition of his stock in the M Company, stock of the O Company and of the N Company, together with $3x$ dollars in cash. This situation is covered directly by section 202 (c), (d), and (e) of the statute, which, taken together, provide that the stock shall be considered as taking the place of the stock exchanged, and the money shall be applied against and reduce the basis for determining gain or loss from a disposition of the property exchanged. Since the cash received is not in excess of this basis, no taxable gain or loss is realized out of this transaction, but the determination of gain or loss is deferred until the sub-

sequent disposition of the stock received in exchange. This would not be true, however, if the transaction had occurred subsequent to the amendment of section 202 (42 Stat. L., ch. 294), which amendment took effect January 1, 1923.

SECTION 203.—INVENTORIES.

ARTICLE 1581: Need of inventories. II–13–957
A. R. R. 2658

REVENUE ACTS OF 1917 AND 1918.

The M Company, manufacturer of bricks, contracted with the N Company and the O Company for the manufacture of a definite number of them in a given time in 1920 at a certain price per M, the only stipulation in the contract being that invoices be furnished each month during the period covering the preceding month's quota set aside for the vendees. The bricks so invoiced in 1920 were held by the M Company and not separated.

In view of the special relationship existing between the parties under the terms of the contract and in the light of all the facts shown it is concluded that there was an appropriation of the bricks so invoiced and title to them passed.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in denying the taxpayer as a deduction in either its 1917 or 1918 tax returns an item of 4.38x dollars additional salaries authorized by corporate resolution taken February —, 1918, as additional compensation for services rendered during the taxable year 1917, and in requiring the taxpayer to set up as sales consummated within the year 1920 and report as gross income for that year said sales under the circumstances hereinafter outlined.

Upon examination of the evidence submitted, it is apparent that at the time of incorporation it was agreed among the several officers and stockholders that only nominal salaries should be paid for services rendered by them until such time as the business would permit compensation payments comparable to the character and amount of services rendered; that this agreement was a verbal one and not evidenced in writing or authorized by any formal corporate action; that in February, 1918, after the close of the taxable year 1917, the corporation, by resolution formally adopted, voted to its officers and stockholders as additional compensation for 1917 an aggregate amount of 4.38x dollars; that the corporation deducted said additional compensation in its 1917 returns; that the examining officer who conducted the field investigation disallowed such additional compensation as not constituting a proper deduction for 1917; that such examining officer did, however, recommend the allowance of this additional compensation for 1917 as a deduction from gross income in the year 1918, and that the Income Tax Unit in passing on this question denied the deduction for either year.

In T. B. M. 86 (C. B. 1, p. 106) it was held that additional compensation voted after the close of a taxable year and after the close of the books for a taxable year does not constitute a liability for such taxable year or any subsequent taxable year. In accordance with this ruling, the Committee recommends that the action of the Income

Tax Unit in its treatment of the additional compensation voted in 1918 for 1917 be sustained and the appeal denied.

The second question, concerning sales consummated in 1920 which the Unit required the appellant to report as income for that year, was submitted to the Solicitor of Internal Revenue for an expression of his opinion, and under date of February —, 1923, his opinion was received by this Committee. The opinion follows:

It appears that in the summer of 1920 the M Company advised the N Company and the O Company, both of which were sales agents for the M Company, that it would be impossible for the latter to finance the manufacture of a sufficient quantity of bricks to meet their requirements for the spring season of 1921. After numerous conferences, it was agreed that the O Company and the N Company should each bear —— of the burden of financing the manufacture of these articles during the fall and winter of 1920. The following operating agreement was adopted:

"The M Company was to continue the production of bricks, and at the close of each month was to advise the N Company and the O Company as to the quantity produced. This quantity was to be divided by —, —— being considered the finance burden of the M Company, —— the finance burden of the N Company, and —— the finance burden of the O Company.

"Each of the agent companies, after first deducting from the —— obtained as above the quantity actually ordered by it and shipped on its orders, was to pay the M Company, on the usual terms, $5y$ dollars per M for the remaining quantity."

The following is an excerpt from the N Company's letter of November —, 1920, confirming this agreement, which was verbal:

"1st. You are to manufacture for our account $50.0z$ articles as a maximum between the 1st of October and the 1st of January, 1921.

"2d. We are to pay you on the usual terms for $33.3z$ of these articles at a price of $5y$ dollars per M, payment to be made upon the basis of invoices furnished us the 1st of each month during this period covering the preceding month's quota set aside for us.

"3d. The $16.6z$ bricks manufactured for our account, and which will not be paid for as per the preceding paragraph, are to be held for our account pending shipping instructions and payment for same will be made upon the basis of prices governing at time of shipment."

The above stipulations are hereinafter referred to as "stipulation 1st," "stipulation 2d," and "stipulation 3d."

On or about the — day of September, October, November, and December, 1920, the accounts of the N Company and the O Company were charged at $5y$ dollars per M as per "Stipulation 2d," with certain quantities of bricks determined as explained above. These bricks totaled for the four months:

The N Company	$31.1z$
The O Company	$34.7z$
Total	$65.8z$

The file shows that these items were excluded from the M Company's inventory as of December 31, 1920, and that the O Company included its quota of the bricks in its inventory as of that date. The N Company's fiscal year ended March 31, 1921; but its letter of January —, 1923, indicates that it treated the $31.1z$ bricks as its own property, though held by the M Company. The following is quoted from this letter:

"The M Company manufactured and delivered to their yard for our account, and so paid for, $31.1z$ bricks. These deliveries were made over the following months: Sept. * * * Dec. Prior to the close of our fiscal year, which ended March 31, 1921, we had sold and shipped out $11.72z$ bricks leaving on hand, as of that date, the sum of $19.29z$ bricks. The latter quantity was credited to our closing inventory the date of which would be March 31, 1921. * * * When our remittance was made to cover the quantity manufactured and delivered during the preceding month, the bricks were charged to a 'Stock on hand' account and any shipments made therefrom were credited to this account. * * * The transaction presented itself to us as at the

time as an ordinary purchase. * * * At the time of making our annual inventory or cut off, the transaction was considered by us as a bona fide purchase and the number of bricks on hand taken up in our inventory."

It is further shown that, in accordance with "Stipulation 2d," providing that payments be made upon the basis of invoices furnished us the 1st of each month during this period, the secretary and manager of the M Company directed its bookkeeper to charge against the N Company and the O Company, on the 1st of each month during the period in question, the quantity of articles manufactured for them at 5*y* dollars per M during the preceding month, and to credit the same to sales account. It also appears that on December 31, 1920, these articles were more than 50 per cent paid for; but according to the vendor's affidavit, they had not been separated or inspected, and some of them were later rejected on account of deterioration and new articles substituted therefor.

The question presented is whether the sales made under "Stipulation 2d" had been completed on December 31, 1920.

The uniform sales act is in force in the State of residence of the M Company. Section 6 of this act provides:

"(1) There may be a contract to sell or a sale of an undivided share of goods. If the parties intend to effect a present sale, the buyer, by force of the agreement, becomes an owner in common with the owner or owners of the remaining shares.

"(2) In the case of fungible goods, there may be a sale of an undivided share of a specific mass, though the seller purports to sell and the buyer to buy a definite number, weight, or measure of the goods in the mass, and though the number, weight, or measure of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such a share of the mass as the number, weight, or measure bought bears to the number, weight, or measure of the mass. If the mass contains less than the number, weight, or measure bought, the buyer becomes the owner of the whole mass and the seller is bound to make good the deficiency from similar goods unless a contrary intent appears."

Section 18 of this act provides in part:

"(2) For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties, usages of trade, and the circumstances of the case."

Section 19 of this act provides in part:

"(Rules for ascertaining intention.) Rule 4. (1) Where there is a contract to sell unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made."

But it is contended by the taxpayer that it was not contemplated by "Stipulation 2d" that the bricks should be actually sold at 5*y* dollars per M, that this was merely an arrangement to provide funds for the M Company in order that it might furnish to the agent companies a sufficient quantity of bricks in the spring of 1921; that title did not pass to the bricks covered by "Stipulation 2d" for the reasons that (1) the articles were not separated, (2) that they had not been inspected by the vendees, (3) that they had not been shipped, (4) that they were later rejected.

It is true that the agreement between the parties was for the purpose of providing funds for the vendor, but the main purpose, from the vendees' point of view, was to secure the bricks and have them in the possession of the vendor ready for immediate shipment to contractors. It was stipulated in the contract that the bricks were to be "*set aside for us*," and that payment was to be made "*upon the basis of invoices furnished us the 1st of each month.*"

It is clear that both the vendees intended to effect a present sale and contemplated an immediate separation of the bricks. And the act of the vendor in excluding the bricks from its inventory as of December 31, 1920, and making corresponding credits to sales account goes to show that it considered the bricks as belonging to the vendees on December 31. The taxpayer's only explanation of these facts is, that after reading the Income Tax Regulations and seek-

ing advice on the matter, it concluded that the Bureau would construe the transaction as a sale, and accordingly directed its bookkeeper to exclude the bricks from inventory and enter corresponding credits to sales account. This explanation is very weak in the face of the fact that both of the vendee companies considered, with apparently good reason, that the sales had been completed in 1920. The only stipulations laid down in the contract were complied with, no delivery of the bricks being contemplated because the vendees intended to have the vendor make shipments for them to third parties. The terms of the contract indicate that the vendees considered that they were getting in exchange for the money advanced something more than a mere right to sue for damages in case of breach. They considered that the bricks would be "*set aside*" for them. They wanted the bricks for a special purpose; and it was disclosed at the hearing before the Committee that the bricks were of special quality which the vendees could not procure elsewhere.

Where goods are manufactured on order it appears that the courts have been influenced by the unusual nature of the contract, which approaches a contract for work and labor, and have uniformly been less exacting as to proof of the passing of title. In *Williams* v. *Chapman* (24 S. R., 810), where the whole product of a plant was sold in exchange for funds advanced for the operation of the plant, it was held that the property in the product passed to the buyer as soon as manufacture was completed, and without any act of acceptance. And in *Higgins* v. *Murray* (4 Hun., 564) (N. Y.), where an article was manufactured on order and notice of the fact given to the party who had ordered it, it was held that the article became the property of the party ordering it, subject to the lien of the manufacturer for the price. It is true that in this line of cases many are found where the articles ordered were peculiar in design and could not, therefore, be easily disposed of in the regular market, but there are other cases where the articles were not of special design. (*Acme Food Co.* v. *Older* (W. Va.), 807 S. E., 235; *Briggs* v. *U. S.*, 143 U. S., 346.) Such cases have been explained by stating that the appropriation of the article is effected by the terms of the contract itself. The contract may appropriate the subject matter when produced or finished without any act of the parties, as where it is for the sale of all of a certain article manufactured by the seller *in a given time.* (50 L. R. A. (N. S.), 125, Note.) It seems clear, then, that the time of appropriation of the goods to the contract is a fact to be ascertained from the intention of the parties.

In view of the special relationship existing between the parties under the terms of the contract in the instant case and in the light of all the facts shown, it is concluded that there was an appropriation of the bricks to the contract. Therefore, I am of opinion that the sales made by the M Company under "Stipulation 2d" of its agreement with the N Company and the O Company were consummated in the taxable year 1920, and that any gain resulting therefrom should be reported as income for that calendar year.

In view of the above opinion of the Solicitor, in which the Committee concurs, it is recommended that the action of the Income Tax Unit in this connection be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1581: Need of inventories. II–21–1057
(Also Section 214(a)1, Article 111.) I. T. 1759

REVENUE ACT OF 1921.

A corporation selling merchandise C. O. D. by mail intends that payment and delivery be concurrent. Title passes when payment is made. Merchandise so shipped, unpaid for, and excluded from sales for any taxable year, should be included in the closing inventory.

The postage on shipments included in the closing inventory is deductible only in the year it is paid.

A mail order corporation makes parcel post shipments C. O. D., guarantees arrival of goods, and advances postage and collection

charges, subject to repayment by the buyer. For convenience, all shipments are entered as sales when shipped, although about one-third of such shipments are never claimed by the purchaser and the corporation is obliged to pay return postage for the shipments, which are usually in an impaired condition. It appears to be the intention of the corporation that a sale is not to be consummated until the merchandise is paid for and that delivery should be concurrent with the payment for the goods.

Held, that title to the goods does not pass until payment is made and that the amount of the order should not be included in gross sales of a taxable year except as a memorandum, if at the close of a taxable year the purchaser has not paid for a C. O. D. shipment.

Held, further, that the postage on shipments included in closing inventory may not be carried as a deferred charge and written off in the year in which the shipment is paid for, but is deductible only in the year in which the postage is paid for.

Held, also, that loss on account of C. O. D. merchandise carried in closing inventory and returned to the shipper in an impaired condition or after the season therefor is closed, is to be determined by the actual sale of such merchandise or by inventory valuation in accordance with the provisions of article 1582 of Regulations 62.

ARTICLE 1581: Need of inventories. II–22–1067
(Also Section 214(a)1, Article 101.) A. R. R. 3131

REVENUE ACTS OF 1917 AND 1918.

Money, or purchase credits as such, are not the proper subject of inventory for tax purposes.

Amounts expended for Christmas gifts given to buyers of trade customers, under a custom more or less general, are deductible.

The Committee has had under consideration the appeal of the M Company, a partnership, from the action of the Income Tax Unit in disallowing an item claimed as a deduction in 1917 of $6.39x$ dollars; in denying a deduction to the partnership for 1918 of $.369x$ dollars designated as Christmas gifts; and in denying to A, a member of the aforementioned partnership, deductions of x dollars, $1.2x$ dollars, and $1.5x$ dollars claimed in his individual returns for the years 1918, 1919, and 1920, respectively, as entertaining expenses incurred for and in behalf of the partnership.

With respect to the first point involved in the appeal, it is found that the appellant had been purchasing merchandise in a foreign country for a period of over 20 years; that before the war the merchandise was bought on usual credit terms; that at the beginning of the World War merchants and manufacturers of that country insisted upon being paid cash in advance on orders; that this condition continued from 1914 to 1917, when the United States entered the war, at which time all shipments from the foreign country to the appellant ceased; that the moneys to pay merchants and manufacturers in the foreign country, and for advances, were provided by the establishment of a credit through appellant's American banking representative with a bank in the foreign country, who in turn, on

order of the appellant, advanced money to the various manufacturers; that in the establishment of this credit there was necessarily paid a sum in United States coin for an equivalent in money value of currency of the foreign country at the rate of exchange prevailing at that time; that the remainder or balance of such credit remaining unexpended in completed transactions on January 1, 1917, was 6.22x dollars, and that this sum was comprised at that time of a small amount of cash in a bank in the foreign country and numerous and sundry advances to merchants and manufacturers with whom orders had been placed.

The appellant originally contended that, because of conditions arising from the entry of the United States into the World War, the above-mentioned balance should be properly treated as a deductible loss at the end of 1917. It has now, however, receded from its former position and claims the right to deduct over a period of years from 1917 to 1920 a sum representing the actual decline each year in the value of the foreign currency so distributed and so purchased with the coin of the United States at 6.22x dollars as determined by the prevailing rates of exchange at the close of each respective year. In other words, the appellant contends for the right to treat the moneys on deposit in the foreign bank and advanced to merchants on orders for merchandise as though they were merchandise, or stock in trade, and inventory same at their market value at the end of each year as determined by the value of the foreign currency in United States coin according to the rate of exchange prevailing at the close of each year. It is found that without exception all of the foreign merchants to whom advances were made for the purchase of merchandise are and have at all times been willing to settle their account with the appellant upon the basis of the actual number of ——— originally advanced. However, the Committee, after careful consideration of the above, can not concede that the appellant has sustained a deductible loss for any year within the meaning of the language of the taxing statute providing for loss deductions. Nor can it be conceded under the existing conditions that appellant is entitled to any deduction in the nature of bad debts in this connection. The contention of the appellant that it should be permitted the benefit of deductions or reduction in taxable net income through the medium of inventories priced at market at the close of each year in the opinion of the Committee is untenable. Money, or purchase credits as such, are not the proper subject of inventory for tax purposes, and the goods which were to have been acquired upon purchase orders, and for which advances were made, can hardly be said to be properly includable in closing inventory for the obvious reason that such goods, or title to them, was not in possession or vested in appellant.

The foregoing considered, the Committee recommends that the action of the Income Tax Unit in this particular be sustained and the appeal denied.

Concerning the second point, that of a deduction claimed in 1918 of .37x dollars for Christmas gifts, it is found that such expenditures were made for procuring presents in the form of certain articles for male and female buyers of the trade customers with whom the appellant did an extensive business. It is found, too, that this practice is

more or less general throughout the trade, and that because of the keen competition in the line of business in which the appellant engaged it was very necessary that the good will of buyers be maintained by such methods. Consideration of the evidence and arguments submitted in connection with this point leads the Committee to conclude that the amounts so expended in the acquisition of gifts given to buyers of trade customers constituted an ordinary and necessary expense of business, and, therefore, should be allowed as a deduction. Accordingly, it is recommended that the action of the Income Tax Unit in this particular be reversed and the appeal sustained.

With regard to the third point, it is found that the deductions claimed by A in his individual returns for 1918, 1919, and 1920 as entertaining and selling expenses in the respective amounts of x dollars, $1.2x$ dollars, and $1.5x$ dollars are estimates. It appears that A was the moving spirit and active business getter of the firm; that he received a very fair salary as compensation for his services; and that during the years in question he expended certain sums of money for which he was in some measure reimbursed by the partnership in the entertainment of prospective customers and the procurement of business. There is no evidence submitted to indicate the amount expended in each year by A for the aforesaid purposes for which he was not reimbursed. The only single item which A has sought to substantiate as being a proper deduction is reflected as follows:

	Dollars.
Storage, gasoline, and oil according to the average garage bill	$.3x$
Chauffeur	$.48x$
Tires, repairs, and replacements	$.2x$
Total per year	$.98x$

Consideration of the above leads the Committee to conclude that the total of $.98x$ dollars per year is in large measure purely an estimate, and that A's statement to the effect that the automobile in connection with which such estimated annual expense was incurred was used at least 85 per cent of the time in the entertainment of prospective customers and procurement of business is not sufficient proof that such amount was actually expended by him individually for the purpose as stated. The Committee is of the opinion, too, that A, in order to sustain the deductions claimed, should comply with the requirements stated in the latter portion of article 292 of Regulations 45 (1920 edition). It is apparent in the instant case that he is unable to substantiate such claim in accordance with the requirements therein stated.

Accordingly, it is recommended that the appeal in this connection be denied and the action of the Unit sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1582: Valuation of inventories. II-28-1135
A. R. R. 3549

REVENUE ACT OF 1917.

In the case of a taxpayer selling automobiles and receiving cars in part payment, in so far as the inventory of used cars is concerned, it is immaterial whether the basis of valuing the remainder of the inventory is "cost" or "cost or market, whichever is lower." Whichever basis is used, the taxpayer is entitled under the provisions of article 1582 of Regulations 45, as amended by T. D. 3296 (C. B. I-1, p. 40), to inventory its used cars at bona fide selling prices, less selling cost.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in revising the used car inventory as reported on the return for the taxable year 1917.

Appellant company was organized in 1914 for the purpose of conducting an automobile agency business. Like all agencies of this character, it is necessary, in a large percentage of sales of new cars, to receive in trade used cars. To meet competition, however, it is often necessary to allow more for a used car than is expected to be realized on a subsequent sale of that car. The method of handling these used cars on the company's books is set out in an affidavit of A, president of appellant company, as follows:

The new car was entered on the books as sold at the list price—that is, the amount for which it would have been sold for cash; the used car was first charged on the books without regard to its value at the list price of the new car minus the cash received; shortly afterwards, when the old car had been examined and its value ascertained, the selling price was fixed, and if it was found to be worth less than the amount charged on the books it was immediately credited with an amount which, taking the difference between the amount with which it was charged and credited would show the actual amount at which the company was willing to sell the same.

Affiant further states that all used cars taken in exchange were in said years displayed on the floor of the company's salesroom and offered for sale; that the selling price of such cars given to salesmen was the net amount charged after the credit made in the manner above stated plus the cost of repairs, of new tires or parts required, and commission; that the total selling price, including the amount charged for repairs, if any, was in all cases shown as the sales price of such cars.

Affiant further states that the value of such used cars taken into the inventory at the close of the taxable year was the value shown upon the company's books; that is, the difference between the amount so charged and credited to each used car; that such inventory price, plus the items above mentioned in some instances, was the offering price to the public.

Appellant company further states that the inventory for 1917 was taken at cost or market, whichever was lower, book values being used as market values of used cars.

The used car values originally reported by the company were revised by the Income Tax Unit as a result of a revenue agent's investigation, and the trade-in or cost value used for the reason as stated by the Unit that the book values of used cars do not actually reflect market values, and, therefore, the company's inventory was not taken on the basis of cost or market, whichever was lower.

It is immaterial in the instant case, in so far as the inventory of used cars is concerned, whether the basis of valuing the remainder of the inventory is "cost" or "cost or market, whichever is lower." Whichever basis is used, the company is entitled, under the provisions of article 1582 of Regulations 45 as amended by T. D. 3296

(C. B. I-1, p. 40), to inventory its used cars at bona fide selling prices, less selling cost.

In valuing the used car inventory, however, the company has failed to deduct selling costs from the selling prices and to this extent the inventory does not meet the requirements of the regulations. However, it appears that the company has maintained the necessary records from which may be obtained bona fide selling prices and selling costs of used cars included in the inventory. It is therefore recommended that the company be permitted to adjust its inventory by deducting selling costs from the adjusted values as shown by the books (which values should be accepted as bona fide selling prices in the absence of any evidence to controvert the affidavit of A), in order that the inventory may be made to conform with the provisions of article 1582, as amended.

Accordingly, it is recommended that the action of the Income Tax Unit be modified in accordance with the above.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 204.—NET LOSSES.

ARTICLE 1601: Net losses, definition and computation. II–28–1136
I. T. 1803

REVENUE ACTS OF 1918 AND 1921.

Under section 204 only a net loss may be deducted as results from the "operation of any business regularly carried on by the taxpayer." The payment of an estate tax imposed upon the transfer of the estate of a decedent does not give rise to a loss resulting from the operation of the business of an estate of a deceased, since it was in no way connected with the operation of the business.

ARTICLE 1601: Net losses, definition and computation. II–30–1150
I. T. 1808

REVENUE ACT OF 1918.

The words "business operating loss" as used in article 1601 of Regulations 45 must be considered as referring to the annual net loss rather than to any single loss which may go to form a part thereof.

An annual net loss which includes a business fire loss which did not result from the processes or operations used in the business is none the less a net loss "resulting from the operation of any business regularly carried on by the taxpayer" within the meaning of these words in section 204(a) of the Revenue Act of 1918.

In 1919, the factory of the taxpayer, together with machinery, manufactured products, and stock in process, was totally destroyed by fire, resulting in a loss of $6x$ dollars after deducting insurance received.

His return for the taxable year 1919 shows a net loss of $4x$ dollars after deducting all income from other sources as well as profit made up to the time of the fire. The origin of the fire has never been learned and there is nothing to show that the casualty resulted directly from the processes employed in the factory.

Advice is requested as to whether the taxpayer is entitled to have such net loss deducted from his net income for 1918, under the "Net loss" provisions of the Revenue Act of 1918.

The relevant portion of section 204 provides:

(a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or (2) the bona fide sale by the taxpayer of plant, building, machinery, equipment or other facilities, constructed, installed or acquired by the taxpayer on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war; and when so resulting means the excess of the deductions allowed by law (excluding in the case of corporations amounts allowed as a deduction under paragraph (6) of subdivision (a) of section 234) over the sum of the gross income plus any interest received free from taxation both under this title and under Title III.

Article 1601, Regulations 45, interpreting this section, provides in part:

As used in the statute the term "net loss" means * * * a business operating loss or * * *.

Under this article of the regulations, the Bureau has held that certain losses arising from the destruction of business property by fire and flood were not allowable in computing the "net loss" defined in the above section of the 1918 Act. This conclusion was arrived at by taking the words of article 1601, "business operating loss," to mean a single loss, such as may result from a single transaction or casualty, as distinguished from an annual net loss. Accordingly, each single loss has heretofore been examined with a view to determining whether it was a "business operating loss." A loss from fire or flood not caused by or connected with the processes peculiar to the business was not considered such a loss.

However, after a careful reconsideration of the meaning of article 1601, it appears that the view heretofore taken must be modified. The article provides that "The term 'net loss' *means* * * * a business operating loss." [Italics supplied.] Here the word "means" draws an equality between "net loss" and "business operating loss," and it would therefore be unreasonable to suppose that by "business operating loss" is meant a loss from a single transaction whereas by "net loss" is clearly meant a composite annual net loss which is made up of many single losses and gains. Therefore, it is believed that the words "business operating loss," as used in the regulations, must be considered as referring to the annual net loss rather than to any single loss which may go to form a part thereof.

An examination of the language of the section forces the same conclusion. In paragraph (a) it is provided:

That as used in this section the term "net loss" *refers* only *to* net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or * * *; and when so resulting means the excess of the deductions allowed by law * * *.

Here the words "refers to" are clearly used to point out or single out a particular kind of net loss from the general class of net losses. These words can not be taken to have any meaning which would warrant the conclusion that the net losses described in the succeeding clauses are the single losses which go to make up the annual net loss. Such a construction would require that these words be interpreted as meaning the same as "comprises" or "includes"; that is to

say, the words would be given a meaning entirely different from that which they ordinarily import. In the 1921 Act these words have been replaced by the single word "means." As will appear further on, no violence is done to the meaning of the section by interpreting the words "net losses" as if they had been used in the singlar number.

It can not be supposed that by "net losses" is meant losses of an entirely different degree from "net loss." The latter, which is the statutory net loss, is merely a specifically defined kind of ordinary annual net loss. The ordinary meaning of the word "net" as used in the Act is indicative. In other parts of the Act this word means the result of the pluses and minuses taken for the entire taxable year, e. g., "net income." On the other hand, the loss from a single transaction is referred to as a "loss" or a "deduction." It is clear, then, that by "net losses" is meant not deductions but annual net losses.

Now the test as to the right of a taxpayer to take the statutory net loss is whether the ordinary annual net loss is one "resulting from either (1) * * * or (2)." If the taxpayer's annual net loss does arise in either of these two ways, then he has the right to compute and take the statutory net loss. The first part of paragraph (a), down to the semicolon, is devoted to laying down this test; that part after the semicolon is devoted to explaining the manner in which the statutory net loss must be computed. The first part provides that the annual net loss must be a net loss resulting in a certain way. Then the second part, presupposing, by virtue of the words "and *when* so resulting," that the annual net loss has been found to be one of the kinds described in the first part, provides the exact manner in which the statutory net loss is to be computed. The subject of "means" is necessarily "net loss"; and the words "when so resulting," though loosely used, must perforce relate to ordinary annual net losses. It is therefore clear that the test laid down in the first part of the paragraph was never intended to be applied to losses, or "deductions," as distinguished from annual net losses.

Consequently, the Bureau has no authority to examine into the nature of the loss in the instant case, unless it be by virtue of the word "resulting." But it is not believed that Congress intended this word to carry the idea of cause and effect so as to make the test applicable to every element of the annual net loss. Had it so intended, it would have provided that only *losses* resulting in the two ways mentioned could be *included* in computing the statutory net loss. The question therefore comes to this: Whether an annual net loss is a net loss "resulting from the operation of any business regularly carried on by the taxpayer" so long as it includes a business fire loss which did not result from the processes or operations used in the business. To hold that this section does not allow the inclusion of such an item would be to give an unduly refined construction to the language employed. As stated above, the word "resulting" has no narrow meaning. It must be taken to mean simply that the annual net loss must arise from the business rather than from private transactions and that it must arise from "the operation of any business regularly carried on by the taxpayer."

The only doubtful point remaining is whether by "operation" is meant merely the ordinary conduct of the business or the processes

or operations peculiar to the business. It is believed that the latter construction would be so narrow as to be unwarranted. In *McCulloch* v. *State of Maryland* (4 Wheat., 316; 4 L. Ed., 379) Chief Justice Marshall used the following language in regard to the interpretation of a single word:

> Such is the character of human language, that no word conveys to the mind, in all situations, one single definite idea; and nothing is more common than to use words in a figurative sense. Almost all compositions contain words, which taken in their rigorous sense, would convey a meaning different from that which is obviously intended. It is essential to just construction, that many words, which import something excessive, should be understood in a more mitigated sense—in that sense which common usage justifies.

The applicability of these words in the instant case is emphasized when it is considered that the words "operation of *any* business" appear to cover all trades, businesses, and professions. Manifestly, some businesses have no "operating" losses in the technical sense.

In view of the foregoing, it is held that the loss sustained from the destruction of the taxpayer's factory by fire was properly included by him in computing the statutory net loss defined by section 204 of the Revenue Act of 1918.

ARTICLE 1601: Net losses, definition and computation. (Also Section 206, Article 1651.)

II–31–1167
I. T. 1818

REVENUE ACT OF 1921.

> The taxpayer is not a member of a stock exchange, has no place of business, does not make purchases and sales of securities for others, but devotes the greater part of his time in keeping in touch with the stock market and in giving orders to his broker for the purchase and sale of securities. He has no other trade or business.
>
> Held, that he was engaged in the business of buying and selling securities for the purpose of claiming the benefit of a net loss sustained in the operation of a trade or business.
>
> He is not a dealer in securities within the meaning of article 1585, and he is entitled to the benefits of section 206 with respect to gains derived from the sale of stock which was acquired and held for profit or investment for more than two years.

The taxpayer is not a member of any stock exchange, has no place of business, and does not make purchases and sales of securities for customers. Much of his trading is done on margin. He devotes the greater part of the time his broker's office is open to keeping in touch with the market. He has no other trade or business, his income consisting entirely of interest on bonds, dividends on stocks, and profits from the sale or other disposition of securities.

Advice is requested (1) whether this taxpayer is entitled to the benefit of section 204 of the Revenue Act of 1921, with reference to a net loss incurred in 1921 from the sale of stocks; (2) whether he is entitled to the benefit of section 206 of the Revenue Act of 1921, with regard to gains derived in 1922 from the sale of two blocks of stock held more than two years.

1. Section 204(a) provides in part:

> That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer * * *.

The question is, then, whether the taxpayer was regularly engaged in the trade or business of buying and selling securities.

The interpretation placed upon the term "business or trade" by the courts and by the Department may be indicated by a few illustrative decisions. In two early cases (*In re Marston* (1871), Fed. Cas. No. 9142, and *In re Woodward* (1876), Fed. Cas. No. 18001) it was held that a speculator in stocks was not a "merchant or tradesman" within the meaning of the Bankruptcy Act of 1867. It was said in the former case:

> The only business he was engaged in was what is called speculating in stocks, that is, buying and selling them, with a view to his own profit, to be made by the excess of the selling price over the buying price * * *. The fact that the bankrupt was engaged in no other business can not have the effect to make him a merchant or a tradesman, because he carried on the business he did carry on in the way in which he carried it on.

That is, although his business was buying and selling, since this business was simply with a view to his own profit and not for others, he was not a merchant or tradesman. Compare *In re Surety Guarantee & Trust Co.* (1902) (121 Fed., 73) and *In re H. R. Leighton & Co.* (1906) (147 Fed., 311).

With this background, the Department, in Treasury Decisions 1989, 2005, 2090, and 2135 (not published in Bulletin service), held that the provision of paragraph B of the 1913 Act, allowing as a deduction for the purpose of the normal tax "losses actually sustained during the year, incurred in trade * * *," did not include losses from isolated transactions; for instance, in stocks and bonds. In *Mente* v. *Eisner* (1920) (266 Fed., 161) (certiorari denied, 254 U. S., 635), these rulings were upheld in a case in which a manufacturer of bagging was denied deductions for losses in buying and selling cotton on the cotton exchange for his individual account, not connected with his manufacturing business. (Cf. *Black* v. *Bolen* (1920), 268 Fed., 427.) Likewise, in L. O. 601 (not published in Bulletin service), it was held that "losses sustained by a person in buying and selling securities on his own account, he not being a licensed stock and bond broker buying and selling for others as well as for himself, are not deductible as losses in trade within the meaning of paragraph B of the Act of October 3, 1913." The basis of these opinions is thus seen to be (1) that dealing in securities on one's own account is not technically a "trade"; (2) that isolated transactions in securities, not connected with the taxpayer's regular business, do not constitute a "trade."

In the Act of September 8, 1916, the wording of the 1913 Act was slightly changed (sec. 5(a) fourth) to permit a deduction of "losses actually sustained during the year, incurred in his business or trade * * * ." Under this more liberal provision, it has been uniformly held that where a taxpayer devoted all his time, or the major portion of it, to buying and selling securities on his own account, this occupation was his "business"; and therefore he was permitted to deduct losses sustained in such dealings as being "incurred in his business." A. R. R. 404 (C. B. 4, p. 157); *semble* L. O. 601. These rulings are inferentially supported by the definitions of trade or business to comprehend "all his activities for gain, profit, or livelihood, entered into with sufficient frequency, or occupying such portion of his time or attention as to constitute a vocation," contained

in article 8 of Regulations 41, relative to the war excess-profits tax (approved in *Woods* v. *Lewellyn* (1921), 289 Fed., 498).

The wording of section 204(a) of the Revenue Acts of 1918 and 1921, "* * * losses resulting from the operation of any trade or business regularly carried on by the taxpayer" ("trade or" omitted in 1918 Act), is similar to that of section 5(a) fourth of the 1916 Act as construed in these opinions. Accordingly, it has been held that a taxpayer may devote sufficient time and attention to the purchase and sale of securities for his own account only to constitute a business, and so entitle him to the benefits of section 204(a).

It is submitted that these decisions are a sound interpretation of the accepted definition of business: "'Business' is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dictionary, 158, citing *People* v. *Commissioners of Taxes* (23 New York, 242, 244). 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' Bouvier's Law Dictionary, vol. 1, p. 273." *Flint* v. *Stone Tracy Co.* (1910), 220 U. S., 107, at 171, 31 Sup. Ct., 342, 55 L. Ed., 389, Ann. cas. 1912 B, 1312; cited with approval in *Von Baumbach* v. *Sargent Land Company* (1916), 242 U. S., 503, at 515. If they are sound, the facts of the instant case require a ruling that the taxpayer was regularly engaged in the business of buying and selling securities on his own account and was, therefore, entitled to the benefit of the provisions of section 204(a).

2. The second inquiry involves section 206 of the Revenue Act of 1921, which provides an alternative method for taxing capital gains. "Capital gain" is defined as "taxable gain from the sale or exchange of capital assets consummated after December 31, 1921." The term "capital assets" is thus defined:

> * * * property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

For the taxpayer to be entitled to the benefits of these provisions, then, it must appear in the first place that (1) the property was acquired and held by the taxpayer for profit or investment; (2) that it was so held more than two years. There is no definite showing as to (1), although of course it is extremely likely that the provisions of the statute were fulfilled. The question is, of course, essentially one of fact and should ordinarily be susceptible of easy proof. It does appear that the blocks of securities in question were held by the taxpayer more than two years. In the second place, two types of property are excluded from the operation of the paragraph. It is clear that the securities involved here were not held for anyone's personal use or consumption. The remaining question is, then, whether the securities were the stock in trade of the taxpayer or other property of a kind which would properly be inventoried if on hand at the end of the year.

Since the qualifying clause "which would properly be included in the inventory," etc., applies both to "stock in trade" and "other property," it is necessary to determine what taxpayers should take

inventories and what property should be inventoried. Under the authority granted him in section 203 of the 1921 Act, the Commissioner, with the approval of the Secretary, has prescribed, in article 1585 of Regulations 62, regulations for the taking of inventories by dealers in securities. The article permits a "dealer in securities" to make use of inventories; and proceeds:

> * * * a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. * * * Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, * * * are not dealers in securities within the meaning of this rule. A dealer in securities is not entitled to the benefits of section 206 with reference to the gain from the sale of securities.

It is clear that this article distinguishes between a dealer in securities and a speculator. The earmarks of the former are (1) an established place of business; (2) regular employment in purchasing securities and reselling them to customers; the latter lacks these indicia. It will be observed that the distinction is similar to that made in *In re Marston, supra.*

In A. R. R. 755 (C. B. I–1, p. 225), a taxpayer with an established place of business, who purchased securities and resold them to customers, was classed as a dealer therein, and it was similarly held in the case of real estate dealers. A taxpayer who bought and sold foreign money merely on his own account was held not to be a dealer therein for inventory purposes, and a taxpayer who bought and sold tax-sale certificates on his own account alone was likewise held not to be a dealer. Thus, not every individual who buys and sells securities is a dealer therein within the regulations and decisions; if such individual has no established place of business and no customers, but simply buys and sells securities on his own account only, he is not a dealer. Since these are exactly the facts in the case submitted, it follows that the taxpayer is not a dealer in securities within the regulations and decisions; he therefore may not make use of an inventory, under the provisions of article 1585.

Since the securities here in question, then, are neither "property held for the personal use or consumption of the taxpayer or his family," nor "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer," they comply with the definition of "capital assets" in section 206(a)6, provided that they were acquired and held by the taxpayer for profit or investment for more than two years.

ARTICLE 1602: Claim for allowance of net loss. (Also Section 205, Article 1622.) — II–13–958 I. T. 1704

REVENUE ACTS OF 1918 AND 1921.

It is held that article 1623 of Regulations 45 is the correct interpretation of section 204(b) of the Revenue Act of 1918 and that net

losses deductible from net income of the fiscal year ended November 30, 1918, under the provisions of section 204 of the statute shall be deducted in computing the tax attributable to the calendar year 1917 as well as in computing the tax attributable to the calendar year 1918.

In computing the tax under section 205(a) of the Revenue Act of 1921, for a fiscal year ended in 1921, in the case of a corporation sustaining a net loss for the calendar year 1919, which was incorporated in November, 1918, and filed returns (1) for the period November and December, 1918, (2) for the calendar year 1919, (3) for the period January 1, 1920, to August 31, 1920, and (4) for the fiscal year September 1, 1920, to August 31, 1921, the net loss for the calendar year 1919 should be deducted in computing the tax attributable to the calendar year 1921 as well as in computing the tax attributable to the calendar year 1920. (I. T. 1509 (C. B. I–2, p. 39) modified.)

ARTICLE 1602: Claim for allowance of net loss. II–15–980
I. T. 1718

REVENUE ACT OF 1921.

A taxpayer having a net loss for 1921 and 1922 may credit the entire net loss sustained for 1921 against his net income for 1923 but no part of the excess of the net loss for 1921 over the net income for 1923 may be credited against the net income for 1924. If the net income for 1923 is absorbed by the net loss for 1921, the entire net loss sustained for 1922 may be credited against the net income for 1924, but no part of the excess of the net loss for 1922 over the net income for 1924 may be credited against the taxpayer's net income for 1925.

Inquiry is made whether in the event a taxpayer has sustained a net loss during the year 1922 as well as during the year 1921 and the loss for the year 1921 absorbs the total earnings for the year 1923, the entire net loss for the year 1922 may be deducted from the net income for the year 1924, or whether only the excess of the net loss for the year 1922 over the net income for the year 1923 may be claimed as a deduction from the net income for 1924.

Under the provisions of section 204(b) of the Revenue Act of 1921 the rule is that a taxpayer sustaining a net loss for any taxable year ending after December 31, 1920, may deduct the amount of such net loss, computed in accordance with section 204 and articles 1601 to 1605 of Regulations 62, from his net income for the succeeding taxable year, and if such net loss is in excess of the net income for such succeeding taxable year the amount of such excess shall be carried over and credited against the net income for the next succeeding taxable year. See article 1602 of Regulations 62. Under these provisions of the law and regulations the deduction of a net loss is limited to the first two taxable years succeeding the year in which the net loss was sustained.

In the case presented the taxpayer, having no net income for 1922, may credit the entire net loss sustained for 1921 against his net income for 1923, but no part of the excess of the net loss for 1921 over the net income for 1923 may be credited against his net income for 1924. Inasmuch as the net income for 1923 is absorbed by the net loss for 1921, the entire net loss sustained for 1922 may be credited against

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the net income for 1924, but no part of the excess of the net loss for 1922 over the net income for 1924 may be credited against the taxpayer's net income for 1925.

By way of illustration, if, in the case referred to, the net losses for 1921 and 1922 were $10,000 and $5,000, respectively, and the taxpayer's net income was $4,000 for 1923, $3,000 for 1924, and $6,000 for 1925, the net losses should be credited as follows:

Of the $10,000 net loss for 1921, $4,000 should be credited against the net income for 1923, but no part of the remaining $6,000 of such net loss may be credited against the net income for 1924. Of the 1922 net loss, $3,000 should be credited against the 1924 net income, but no part of the remaining $2,000 of the 1922 net loss may be credited against the 1925 net income.

ARTICLE 1603: Net losses of partnerships, trusts, estates, and insurance companies. II–23–1079 I. T. 1771

REVENUE ACT OF 1921.

The decedent was a member of a partnership at the time of his death in 1909. His estate continued the decedent's interest in the partnership, which sustained a net loss for the year 1921.

It is held that, since the estate is still in process of administration, the net loss is not deductible from the income of the beneficiaries but should be charged against the income of the estate for the following year.

SECTION 205.—FISCAL YEARS 1920–21 AND 1921–22.

ARTICLE 1622: Fiscal year ending in 1921.

(See I. T. 1704; sec. 204, art. 1602.) Application of net loss for calendar year 1919 in computing tax for fiscal year ended in 1921 where taxpayer properly filed a short return for a period of less than 12 months ended in 1920.

SECTION 206.—CAPITAL GAIN.

ARTICLE 1651: Definition and illustration of capital net gain. II–17–1018 I. T. 1737

REVENUE ACT OF 1921.

The tax on that part of the total net gain derived from an installment sale of real estate which is applicable to the year for which the return is made may be computed in accordance with the provisions of section 206.

ARTICLE 1651: Definition and illustration of capital net gain. II–22–1068 I. T. 1765

REVENUE ACT OF 1921.

Section 206 provides that the specific property sold or exchanged must have been held for more than two years. In the case of a stock

dividend the prescribed period starts from the date of the acquisition of the stock upon which the stock dividend is declared, and where property is exchanged for other property and no gain or loss is recognized under the provisions of section 202 the prescribed period starts from the date of the acquisition of the original property.

ARTICLE 1651: Definition and illustration of capital net gain. II–25–1107 I. T. 1786

REVENUE ACT OF 1921.

In the case of stock acquired upon the exercise of rights, if the stock with respect to which such rights were issued was acquired and held by the taxpayer for profit or investment for more than two years, he may elect to be taxed upon the gain from the sale of such stock under the provisions of section 206 of the Revenue Act of 1921.

ARTICLE 1651: Definition and illustration of capital net gain.

(See I. T. 1818; sec. 204, art. 1601.) Gains from the sale of stock by one who buys and sells securities on his own account but who is held not to be a dealer in securities.

ARTICLE 1653: Partnerships, estates, and trusts. II–15–981 I. T. 1719

REVENUE ACT OF 1921.

Whether or not the executor or testamentary trustee is the same person, the two-year period provided in section 206(6) during which property must be held for profit or investment begins to run on the date of the decedent's death.

PART II.—INDIVIDUALS.

SECTION 211.—SURTAX.

ARTICLE 11: Surtax.

(See T. D. 3521; sec. 226, art. 431.) Constitutionality of surtax rates.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 22: Computation of net income. II–14–968 I. T. 1710

REVENUE ACT OF 1921.

The provisions of article 155 of Regulations 62 relating to reserves for bad debts are not applicable to reserves for cash discounts. If, in rendering his income tax return for the current tax-

able year, a taxpayer changes from the second method of treating cash discounts outlined in I. T. 1348 to the first method outlined therein, he should report the gross amount of his sales for the current taxable year less the reserve for the amount of cash discounts allowable upon the accounts receivable outstanding at the close of the current taxable year, and from the amount of the sales so returned he may deduct the actual discounts allowed during the taxable year. Any portion of the cash discounts allowable upon the accounts receivable outstanding at the close of the current taxable year which is collected in subsequent years should be returned as income when collected. Under no circumstances will a taxpayer be allowed to throw back into the prior year discounts actually allowed after the close of that year.

A taxpayer may, in rendering his return for the current taxable year, change from either one of the two methods of treating cash discounts outlined in I. T. 1348 (C. B. I–1, p. 51) to the other method outlined therein without obtaining formal permission from this office, provided he attaches to such return, in accordance with article 23 of Regulations 62, a statement showing that the method of treating cash discounts employed in rendering the return represents a change from that previously used, and provided the new method is consistently followed thereafter.

Under the first method of dealing with cash discounts outlined in I. T. 1348 the seller, in setting up accounts receivable, currently sets up a reserve for the amount of cash discounts allowable and in such case he reports each year the amount of his sales less the cash discounts allowable and any portion of such discounts collected in subsequent years is required to be returned as income when collected. Under the second method outlined in the ruling the seller sets up no reserve but reports the gross amount of the sales, taking as a deduction therefrom the actual discounts allowed during the current year and in the following year he takes a deduction in respect of any discounts allowed upon outstanding accounts at the close of the preceding year.

The provisions of article 155 of Regulations 62 relating to reserves for bad debts are not applicable to reserves for cash discounts. If, in rendering his income tax return for the current taxable year, a taxpayer changes from the second method of treating cash discounts outlined in I. T. 1348 to the first method outlined therein, he should report the gross amount of his sales for the current taxable year less the reserve for the amount of cash discounts allowable upon the accounts receivable outstanding at the close of the current taxable year, and from the amount of the sales so returned he may deduct the actual discounts allowed during the taxable year. Any portion of the cash discounts allowable upon the accounts receivable outstanding at the close of the current taxable year which is collected in subsequent years should be returned as income when collected. Under no circumstances will a taxpayer be allowed to throw back into the prior year discounts actually allowed after the close of that year.

A taxpayer may, in rendering his return for the current taxable year, change from either one of the two methods of treating cash discounts outlined in I. T. 1348 (C. B. I–1, p. 51) to the other method outlined therein without obtaining formal permission from this office, provided he attaches to such return, in accordance with article 23 of Regulations 62, a statement showing that the method of treating cash discounts employed in rendering the return represents a change from that previously used, and provided the new method is consistently followed thereafter.

ARTICLE 22: Computation of net income. II–30–1151
I. T. 1809

REVENUE ACT OF 1918.

The current or market rate of exchange on the pound sterling prevailing as of June 30, 1920, is $3.95125.

ARTICLE 22: Computation of net income. II–32–1175
I. T. 1823

REVENUE ACT OF 1921.

The following rates of exchange, in terms of United States money, have been accepted as the current or market rates prevailing for the countries indicated as of August 31, 1923:

Country.	Monetary unit.	Value in terms of United States money.
England	Pound	$4.5458
France	Franc	.0563
Germany	Reichsmark	.00001025

ARTICLE 22: Computation of net income. II–34–1201
I. T. 1841

REVENUE ACT OF 1921.

The following rates of exchange upon the French franc have been accepted as the current or market rates prevailing as at the dates indicated:

Monetary unit.	Value in terms of United States money.		
	Sept. 5, 1923.	Oct. 1, 1923.	Oct. 2, 1923.
Franc	$0.0558	$0.0604	$0.06

ARTICLE 22: Computation of net income. II–34–1202
I. T. 1842

REVENUE ACTS OF 1917, 1918, AND 1921.

The following are the rates of exchange on Holland prevailing as of the dates indicated:

Monetary unit.	Value in terms of United States money.					
	Dec. 31, 1917.	Dec. 31, 1918.	Dec. 31, 1919.	Dec. 31, 1920.	Dec. 31, 1921.	Dec. 31, 1922.
Guilder	$0.44	$0.4275	$0.3750	$0.314	$0.3698	$0.3959

ARTICLE 23: Bases of computation. II–29–1142
A. R. R. 3656

REVENUE ACTS OF 1917 AND 1918.

The income tax imposed by the State of Wisconsin is held to be accruable by a taxpayer only in the year in which it is definitely determined by application of the personal property offset how much income tax, if any, will have to be paid.

I. T. 1272 (C. B. I–1, p. 123) confirmed.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in holding that the income tax imposed by the State of Wisconsin should be accrued by the taxpayer in the year following the year of the earning of the income and deducted in such following year in arriving at the net income subject to Federal income and profits taxes.

The question was referred to the Solicitor of Internal Revenue with a request for an opinion, and under date of June —, 1923, the following was received by the Committee:

Reference is made to the case of the M Company, in which the taxpayer has appealed from the action of the Income Tax Unit in disallowing as deductions from gross income for the company's fiscal year ending April 30 of the years 1917, 1918, 1919, and 1920 estimated accruals on account of the Wisconsin State income tax. The company estimated at the beginning of each year the amount of income tax it would be required to pay to the State of Wisconsin upon the income earned during such year and reported the same as a deduction for the year in which the income was earned. Upon the basis of I. T. 1272 (C. B. I–1, p. 123) the Unit has ruled that the income tax payable to the State should be accrued by the taxpayer in the year following the year of the earning of the income. The taxpayer's returns have been adjusted accordingly.

The inquiry in the present case is whether the rule announced in I. T. 1272 is applicable to the facts involved. In I. T. 1272 it appeared that the taxpayer was assessed an income tax during the calendar year 1919 in the amount of $4x$ dollars upon its income for the calendar year 1918. In 1919 it was also assessed a personal property tax in the amount of $12x$ dollars for the calendar year 1919. The personal property tax was paid December 30, 1919. The income tax assessment was never paid, but upon the presentation by the taxpayer of its personal property tax receipt for 1919 the income tax assessment was marked satisfied. This procedure was based upon section 1087m–28 of the Wisconsin Statutes, 1915, which reads in part as follows:

"Any person who shall have paid a tax assessed upon his personal property during any year shall be permitted to present the receipt therefor to the tax collector, together with similar receipts for personal property taxes paid by members of his family whose incomes have been assessed to him, and have the same accepted by the tax collector to their full amount in the payment of income taxes assessed against such person during said year; * * *."

The agent of the Bureau, upon an examination of the taxpayer's books, set up the income tax assessment as an accrual for 1918, treating $4x$ dollars of the amount paid December 30, 1919, as a satisfaction thereof and set up the balance as personal property taxes paid during the year. In view of section 1087m–26 the taxpayer contended that no liability had been actually incurred for an income tax upon its 1918 income, since the personal property taxes assessed and paid in 1919 completely offset the taxes assessed upon such income. Under the peculiar method provided by the laws of Wisconsin for the discharge in whole or in part of income tax assessments by reason of the so-called offset for personal property taxes assessed and paid during the year of the assessment of income tax, amounting as it does to the granting of an exemption for income tax purposes of an amount which at the end of the income year is indeterminate, it was the opinion of this office that the taxpayer's liability to the Wisconsin income tax was not actually determined and accruable under the practice of the Department until the amount of personal property tax was actually determined as explained in I. T. 1272. Inasmuch as the personal property tax assessed against the taxpayer in that case and paid by it on December 30, 1919, greatly exceeded the income tax assessment, it never as a matter of fact became liable

for the payment of an income tax upon its 1918 income. It was completely exempted from the payment of such tax by reason of the so-called personal property tax offset. This office is of the opinion that the conclusion reached in that case was correct and adheres thereto.

In the instant case the amount of the income tax assessments for the respective fiscal years is not shown, nor is there shown the amount of the personal property taxes assessed against the taxpayer within each succeeding year. The agent's report shows certain amounts accrued by the taxpayer as of the beginning of each fiscal year. Since the accruals are made as of the beginning of the fiscal year, the amount thereof appears to be merely an estimate. The amount of income tax liability actually incurred and paid, if any, is not set forth. It is assumed, however, that the income tax assessment upon the income of each of the years in question exceeded the amount of the personal property taxes assessed and paid within each succeeding year and that the taxpayer has actually paid a certain amount of its income tax assessments.

At the close of the income year, upon the basis of the net income disclosed, the amount of the income tax assessment to be made under the Wisconsin laws may easily be determined. If the taxpayer has no taxable personal property at that time the amount of his income tax liability may tentatively be said to equal the assessment which will be made. Personal property is assessed for taxation as of May 1 of each year. The taxpayer may acquire personal property between the close of the income year and the following May 1. If on such date the taxpayer does not own any taxable personal property, it is then certain that it will be necessary to pay the entire income tax assessment in cash. If the taxpayer is the owner of taxable personal property on such date, then the amount of his income tax liability can not be determined until the rate of personal property tax for State and local purposes combined is determined. Statistics published by the Wisconsin Tax Commission covering the period from 1913 to and including 1922 show that of the total income tax assessments for each of the years within such period there has been offset and marked off the tax rolls without payment in cash an amount thereof varying from 35.39 per cent for 1918 to 58.65 per cent in 1921. The average for all the years within the period is 45.70 per cent. Of the 10 years within the period only 4 years are under the average. It will be seen, therefore, that as a general rule from 45 per cent to 50 per cent of the annual income tax assessments never in fact become actual liabilities to be discharged in cash. While one-half of the total annual income tax assessments is certain to be collected, taking the State as a whole, it can not definitely be said as of the close of a given income year that a particular taxpayer will pay any portion of his assessment, since his liability depends upon the amount of personal property held during the succeeding year and upon the rates fixed for personal property taxation in such succeeding year, which vary according to State and local needs as explained in I. T. 1272. If a taxpayer with little or no personal property at the close of the income year is considered as having actually incurred an income tax liability at the close of the income year the assumption will have to be indulged that the taxpayer will not before May 1 of the succeeding year acquire personal property which will be assessed for taxation in such year.

The accrual system of accounting is used as a general rule only in merchandising and manufacturing businesses. Individuals and corporations engaged in such pursuits must of necessity own varying amounts of personal property as an incident thereof. Accordingly, until the assessment of the personal property taxes, it can not definitely be determined whether any income tax assessment will be paid by such taxpayers to the State of Wisconsin. It is the opinion of this office that the Wisconsin income tax should be held to be accruable only in the year in which it is definitely determined by the application of the personal property offset how much income taxes, if any, will have to be paid.

In this connection, attention is directed to the ruling of the Wisconsin State Tax Commission with respect to such accruals for State income tax purposes. That is to say, in determining net income under the Wisconsin laws, deduction is permitted of all income taxes paid or accrued within the income year. In determining the year in which the accrual should be made, the tax commission has ruled that such taxes are deemed to accrue in the year in which the assessment is made, "for example, State taxes on 1920 income are assessed in 1921 and may be accrued in 1921." See 5th edition, Wisconsin Income Tax Law, pages 49 and 50. The total amount of the deduction allowed is the amount which will have to be paid in cash. It will thus be seen that the result arrived at above has also been reached by the Wisconsin Tax Commission.

Accordingly, it is the opinion of this office that the action of the Income Tax Unit in adjusting the deductions of the taxpayer herein is correct.

In view of the foregoing opinion, in which the Committee concurs, it is recommended that the appeal be denied and the Unit sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 26: Change in accounting period. II-17-1029
T. D. 3500

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. MANDAMUS—AMENDED RETURNS.

Mandamus will not lie to compel the exercise by the Commissioner of Internal Revenue of the power vested in him by section 212 of the Revenue Act of 1918 to approve a change in a taxpayer's accounting period from a fiscal year to a calendar year, or to accept amended returns.

2. ACCOUNTING PERIOD—CHANGE FROM FISCAL TO CALENDAR YEAR.

Where a taxpayer voluntarily changed its accounting period from a calendar to a fiscal year basis and filed returns on this basis, mandamus will not lie to compel the Commissioner to accept amended returns on a calendar-year basis.

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

To collectors of internal revenue and others concerned:

The following decision of the Supreme Court of the District of Columbia in the case of *The Greylock Mills, a corporation*, v. *David H. Blair, Commissioner of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 23, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

IN THE SUPREME COURT OF THE DISTRICT OF COLUMBIA. LAW NO. 67,451.

United States, ex rel. the Greylock Mills, a Corporation, petitioner, v. *David H. Blair, Commissioner of Internal Revenue.*

MEMORANDUM.

This is a petition for mandamus against respondent, filed March 8, 1923.

From the allegations set forth in the petition, it appears that the Greylock Mills, engaged in the manufacture of cotton goods, was incorporated in 1880, under the laws of the State of Massachusetts, and has its principal office in North Adams, in that State; that petitioner, now and for many years past, regularly closed its books on the last day of March, June, September, and December of each year, and computed its income accurately for each said quarter, a physical inventory being taken on the last day of each such quarter; and that neither its charter nor by-laws nor laws of the State of Massachusetts fixed for it any fiscal period.

That petitioner filed on a calendar-year basis all income and excess profits tax returns required under the Acts of 1913, 1916, and 1917, for the years 1913 to 1917, inclusive; and that it did not elect to make any of such returns upon the basis of other than a calendar year, although each of the Acts just mentioned provided that any corporation might designate the last day of any month for the closing of its fiscal year, and thus be entitled to have its tax computed upon the basis of a fiscal instead of a calendar year.

That the Revenue Act of 1918 provided that return shall be made on or before the 15th day of the third month following the close of the fiscal year, or, if the return be made on the basis of the calendar year, the same shall be made on or before the 15th day of March, and that the Commissioner might grant a reasonable extension of time for filing returns, for good cause shown, etc.

That the Commissioner of Internal Revenue did not extend the time for filing the return of petitioner, or of taxpayers generally, and required payment on March 15, 1919, of the first installment of petitioner's taxes for the taxable year 1918, and that petitioner, on or before March 15, 1919, filed its return for the calendar year 1918 on Form 1031–T, whereon it estimated its tax as amounting to $266,000, and transmitted a payment of $100,000 with its return.

The Revenue Act of 1918, *supra*, further provides that the net income shall be computed on the basis of the taxpayer's annual accounting year (fiscal or calendar year, as the case may be), in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income, etc. Also, that the taxable year of the taxpayer means his fiscal year, or the calendar year if he has not established a fiscal year; that the term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December; and that no fiscal year will be recognized unless before its close it was definitely established as an accounting period by the taxpayer, and the books of the taxpayer were kept in accordance therewith; further, that a taxpayer having an existing accounting period, which is a fiscal year within the meaning of the statute, not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns; and a person having no such fiscal year must make return on the basis of the calendar year.

Petitioner further alleges that, in previous years, it had elected to file its return on a calendar-year basis, and that in filing its returns on March 15, 1919, for the taxable year 1918, on a calendar-year basis, it similarly elected the calendar year as its annual accounting period; that petitioner's annual accounting period for the taxable year 1918, and for prior taxable years, was the calendar year, in accordance with the method of accounting regularly employed in keeping petitioner's books; that it clearly reflected the petitioner's income for such period; that petitioner did not, for the taxable year 1918, or for any subsequent taxable years, change its annual accounting period from a calendar to a fiscal year basis; that petitioner never requested nor received permission or approval of the Commissioner of Internal Revenue to a change of its annual accounting period from a calendar to a fiscal year; and that, in 1918, and for many years prior thereto, the books of petitioner, which were closed quarterly, had been ruled down annually on June 30.

Petitioner further alleges that, at the time of preparing its revised and completed return, required to be filed on or before June 15, 1919, it engaged certain auditors and accountants of Boston to prepare the same, and that the latter erroneously interpreted certain provisions of the law of 1918, *supra*, as requiring that petitioner's return should have been filed upon the basis of a fiscal year ending June 30, because its books had been ruled down on that date; and thus it was that the revised and completed return of petitioner for the taxable year 1918, filed June 14, 1919, was on the basis of a fiscal year ending June 30, 1918.

Petitioner further alleges that, thereafter, and on May 25, 1921, there was published a ruling of the Commissioner of Internal Revenue, through his Committee on Appeals and Review [A. R. R. 501; C. B. 4, p. 69], in which it was held that the mere fact that the books of a corporation were not ruled down on December 31 does not preclude the corporation from filing returns on the

basis of a calendar year, provided that the books were closed on that date, and that such closing reflected the correct financial condition and net income.

That, by letter dated February 2, 1922, petitioner sought permission from respondent to file amended returns for the taxable year 1918 and subsequent years on a calendar-year basis; and that was followed by a series of letters, rulings, appeals, etc., all finally terminating adverse to the application of the petitioner; in which connection, it appears that the petitioner, prior to making request for permission to file amended returns on the basis of a calendar year, had successively filed its returns on a fiscal-year basis not only for the year ending June 30, 1918, but for the succeeding years ending June 30, 1919, 1920, and 1921.

The prayer of the petition is for the usual rule to show cause why the writ of mandamus should not issue, and, finally, for a writ of mandamus, commanding respondent to accept petitioner's amended income and profits tax returns for the calendar year 1918, and for each subsequent calendar year.

Upon the filing of the above petition, rule to show cause issued; and, on April 27, 1923, respondent filed answer to the petition and to the rule to show cause; and from which answer the following is summarized:

That, on March 14, 1919, the relator filed "tentative return and estimate of corporation income and excess profits taxes and request for extension of time for filing of returns," on Form 1031–T; that said return was not final and complete for the calendar year 1918, for the fiscal year ended June 30, 1918, or for any other taxable period.

That, on June 14, 1919, relator filed "corporation income and profits tax return," on Form 1120, for the "fiscal period begun July 1, 1917, and ended June 30, 1918," showing amount of corporation income and excess profits tax due for the fiscal period ended June 30, 1918; said return being the regular and final return of corporation income and profits taxes filed on the basis of a fiscal-year accounting period ending June 30, 1918, and being a departure from the relator's practice of filing such returns on the basis of a calendar-year accounting period ending December 31 of each year; and the same was accepted by the respondent as the relator's return for the fiscal year ended June 30, 1918.

That the return filed by relator on March 14, 1919, was a "tentative return and estimate," as above, and the same was not the final and complete return of relator for the year 1918, and was not accepted by respondent as such.

That the annual accounting period of relator for the taxable year 1918 and prior taxable years, in accordance with the method of accounting regularly employed in keeping petitioner's books, was the fiscal year ending June 30, and that it rules down its books on the 30th day of June each year, and makes an annual financial statement to the public as of that date of each year, and its stockholders' meetings are held during the month of July of each year.

That, by filing its return, on June 14, 1919, of "corporation income and profits tax," on Form 1120, for the "fiscal period begun July 1, 1917, and ended June 30, 1918," relator elected to abandon its practice of filing such returns on a calendar-year basis and to adopt as its accounting period fiscal year ending June 30; and that relator, for each taxable year since 1918, namely, on the 30th day of June of the years 1919, 1920, 1921, and 1922, has filed its returns of net income on the basis of such fiscal year accounting period, the dates of filing such returns being September 19, 1919, September 18, 1920, September 15, 1921, and September 14, 1922, respectively, and that the returns so filed have been accepted by respondent without objection.

Respondent denies that he changed the accounting period of relator from a calendar to a fiscal year basis; and states that he merely accepted the change made by the relator itself.

Respondent admits that demand was made upon him for the acceptance of amended returns on a calendar-year basis, and that such demand was refused; but he denies that such action was unwarranted under the Act of 1918, and avers that such refusal was pursuant to the power and authority conferred upon him by law and regulations, and was done in the exercise of his judgment and discretion as a public officer.

For further answer, respondent states that the relator is seeking to review a decision rendered by respondent in the course of administering the internal revenue laws of the United States; that such decision involved the exercise of judgment and discretion; that respondent's jurisdiction is exclusive, and not reviewable by this or any other court; that the action taken by him was as an officer of and in the interests of the United States; that the latter is an indispensable party to the action; that if respondent be compelled, by manda-

mus, to accept amended returns of relator for 1918, and subsequent years, the United States may be liable for the refund of taxes to relator to the extent of many thousands of dollars, and that the United States has not consented to be sued in this form of action; and, finally, that, by not seeking to enforce his alleged right until the filing of this suit (March 8, 1923), or, at least, until the filing of application for permission to amend said returns (February 2, 1922), relator has been guilty of gross laches and is thereby barred of any right to the relief sought, if any such right ever existed.

Thereafter, and on May 9, 1923, petitioner filed plea to the return and answer of the respondent, the details of which, however, do not here require statement, as there seems to be no particular controversy between the parties as to the facts in the case, the real point of controversy being as to the correct legal conclusions to be drawn from such facts.

Following the filing of the above plea, the respondent, May 21, 1923, filed motion to strike out petitioner's said plea, and each and every paragraph thereof, upon divers grounds not necessary here to be specially noted, and, also, demurred to the plea or pleas, as being bad in substance, for the reasons:

1. That the same admit the material averments of the answer and allege no facts in avoidance thereof.

2. That it appears affirmatively therefrom that petitioner elected to file its 1918 return on the basis of its fiscal year ending June 30, 1918, and that under section 212(b) of the Revenue Act of 1918 (40 Stat., 1057), respondent is vested with discretion to withhold or grant his approval of a change in such accounting period.

3. That it affirmatively appears therefrom that petitioner has been guilty of such gross laches in seeking to enforce his alleged right to file amended returns that he is thereby barred of any right to the relief sought by him in this proceeding, if any such right ever existed.

The cause came on for oral argument before the court on June 1, 1923, the same, by agreement of counsel, being limited to the demurrer above mentioned; it being conceded that if said demurrer be well founded, as matter of law, judgment of dismissal of the petition would follow.

The court has carefully considered the questions involved in the case, not only as developed by the oral arguments of counsel, but also, and in addition to those arguments, it has given careful thought and study to said questions, and has reached the conclusion that the demurrer of respondent is well founded, and that the same should be and is *sustained*.

A. A. HOEHLING, *Justice*.

SECTION 213(a).—GROSS INCOME DEFINED: INCLUSIONS.

ARTICLE 31: What included in gross income. II–13–959
I. T. 1705

REVENUE ACT OF 1921.

The annual dues paid by the taxpayer to a purely social club in which he had been a member since prior to March 1, 1913, were paid for the purpose of defraying the running expenses of the club. He made no other payments.

No portion of the dues represents the cost to him of any interest in the assets of the club and the entire amount received by him upon their distribution is taxable income.

The O Club was purely social and A was a member since prior to March 1, 1913. During that time he paid annual dues of x dollars and when the affairs of the club were wound up in 1922 and the assets distributed to the members, he received as his share approximately $40x$ dollars. A had no transferable interest in the club at any time and the only evidence he had of his membership was a record in the back of his copy of the charter and by-laws of the payment of his annual dues. No payments were made by him to the

club other than the annual dues and the dues were not used for any purpose other than to pay the running expenses of the organization.

Held, that inasmuch as all of the annual dues paid by A were paid for the purpose of defraying the running expenses of the club and as the club was a purely social one, no portion of the dues represents the cost to him of any interest in the assets of the club, but the entire amount of such dues constitutes a personal expense. Held, also, that as A's interest in the assets of the club can not be said to have cost him anything and as he had no interest in the club of any value on March 1, 1913, the entire amount received by him upon the distribution of the assets constitutes income subject to both normal tax and surtax in his hands for the year of its receipt.

ARTICLE 31: What included in gross income. II–15–982
(Also Section 219, Article 341.) I. T. 1720

REVENUE ACT OF 1921.

Where the time of payment of specific legacies under a will is deferred by the executors and they have paid interest on the legacies as required under the law of the State, the interest is taxable income to the legatees and deductible by the executors to the extent that the interest is legally required to be paid under the law of the State whether it is paid out of corpus or out of income of the estate.

At the expiration of one year from the date of death of the testator, the executors did not feel that the administration of the estate was sufficiently far advanced for it to be expedient for them to pay the specific legacies. Consequently, under the rule in the State, they have paid interest on the legacies in making payment thereof.

In connection with this payment three questions are submitted:

1. Whether the legatees should report the payment of this interest as income subject to the Federal income tax.

2. Whether the executors in reporting the net income of the estate are entitled to deduct this interest as interest paid.

3. Whether the situation would be affected if the executors actually paid this interest out of principal rather than out of income.

Held, that the legatees should report as income the interest paid to them by the executors. The interest received by the beneficiary is received by the latter not as such beneficiary but as the designated payee of a sum certain, and is for the use of an amount due him from the executors, the payment of which has been deferred.

The executors in reporting the net income of the estate may take as deductions interest paid to the legatees to the extent that the same is legally required to be paid under the law of the State, due to the deferring of payment of the legacies.

The payment of interest out of corpus rather than out of income of the estate would not affect the situation and the interest paid would still be deductible by the executor and taxable income to the beneficiary (i. e., interest received).

ARTICLE 31: What included in gross income. II–16–997
I. T. 1730

REVENUE ACTS OF 1913, 1916, 1917, 1918, AND 1921.

Rents, royalties, or other income of Quapaw Indians derived under lease or otherwise from their allotted lands or inherited lands restricted as to alienation constitute taxable income within the meaning of the several revenue Acts.

ARTICLE 31: What included in gross income. II–17–1019
I. T. 1738

REVENUE ACT OF 1921.

Inasmuch as the Civil Service Retirement Act of May 22, 1920, does not contain a provision by which the civil-service employee can receive any interest prior to separation from the service, interest on retirement deductions should not be reported as income on any employee's return.

Inquiry is made whether under the Civil Service Retirement Act of May 22, 1920, the interest allowed by the Government on the retirement deductions taken from the salaries of employees in the civil service should be reported as income on their returns, in cases where the interest is not actually received but credited; and (2) if so, in the case of a calendar-year return, should the amount of interest be computed on the calendar year or fiscal year, in view of the fact that the interest is compounded (or credited) on the 30th of June of each fiscal year.

Inasmuch as the Civil Service Retirement Act does not contain a provision by which the employee can receive any interest prior to separation from the service, it is held that interest on retirement deductions should not be reported as income on any employee's return.

ARTICLE 31: What included in gross income. II–21–1056
(Ct. D. 32) T. D. 3508

INCOME TAXES—REVENUE ACT OF SEPTEMBER 8, 1916.—DECISION OF SUPREME COURT.

SUPREME COURT OF THE UNITED STATES. No. 301. OCTOBER TERM, 1922.

J. S. Cullinan, plaintiff in error, v. *A. S. Walker, Collector of Internal Revenue.*

1. INCOME—LIQUIDATING DIVIDEND—CORPORATE REORGANIZATION—DISTINGUISHED FROM STOCK DIVIDEND.

A Texas corporation was dissolved and its assets passed into the hands of trustees in liquidation. The trustees organized two Texas corporations and transferred the assets of the old company to the new companies, one-half in value to each. From each they received in return its total issue of both stock and bonds. The trustees then organized a holding corporation under the Delaware laws to which they transferred all of the stocks of the new Texas corporations in exchange for all of the stock of the holding company. They then distributed the bonds of the new Texas companies and the stock of the holding company among the stockholders of the old Texas company by way of final liquidation of the stock and assets of the latter company. The new Texas com-

panies had at the time of the distribution to the stockholders of the old company no assets other than those received from the trustees. Likewise, the holding company at that time had no assets other than the stocks of the new Texas companies. These assets were, at the time of the distribution, of the same value as when held by the trustees. The old Texas company was dissolved solely for the purpose of effecting a reorganization undertaken partly to effect a separation of pipe lines from the producing properties and partly to procure credit required for the developing business. Held, that the excess of the actual value of the new stocks and bonds so received by the stockholders of the old company, at the time of their receipt, over the cost of their original shares in the old company was taxable income to the shareholders of the old company. The transaction is not, in legal effect, a stock dividend. The rule laid down in *United States* v. *Phellis* (257 U. S., 156) and *Rockefeller* v. *United States* (257 U. S., 176) followed; *Eisner* v. *Macomber* (252 U. S., 189) distinguished.

2. INCOME—REALIZATION—LIQUIDATING DIVIDEND.

The gain to the owner of corporate stock, which when segregated becomes legally income subject to the tax, may be segregated by a dividend in liquidation as well as by an ordinary dividend.

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

To collectors of internal revenue and others concerned:

The appended decision of the Supreme Court of the United States, rendered April 30, 1923, in the case of *J. S. Cullinan* v. *A. S. Walker, collector*, is published for your information.[1] The decision affirms the judgment of the United States District Court for the Southern District of Texas in the case of *J. S. Cullinan* v. *Walker, collector.*

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved August 13, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

* * * * * * *

ARTICLE 31: What included in gross income. II-21-1059
I. T. 1761

REVENUE ACT OF 1921.

While the transfer of stock from the name of an individual to the name under which the individual does business is a transfer subject to tax under Schedule A-3, Title XI, of the Revenue Act of 1921, it is not a sale within the meaning of the income tax law and no profit or loss results therefrom.

A transfer of stock was made from A to A & Company, the name under which A does business as a sole proprietor. The question is raised as to whether the transaction constitutes a sale for income tax purposes, in view of the fact that it is taxable as a transfer of property under the stamp tax law.

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[1] The text of the decision is not printed here, having been published as Court Decision 32 in Cumulative Bulletin II-1, ruling 865, page 51.

There is a fundamental difference between the stamp tax law and the income tax law. The stamp tax law (Schedule A–3, Title XI, of the Revenue Act of 1921) imposes a tax—

> On all sales, or agreements to sell, or memoranda of sales or deliveries of or transfers of legal title to shares or certificates of stock * * * whether entitling the holder in any manner to the benefit of such stock, interest or rights, or not.

Under this provision no sale is necessary in order to incur the tax liability.

It has been consistently held for many years that the liability of an instrument to a stamp tax is determined by the form and face of the instrument and can not be affected by proof of facts outside of the instrument itself. (*United States* v. *Isham*, 17 Wall., 496.) The courts have also held that the expression "legal title" as used in stamp tax laws signifies the appearance of title as distinguished from a full and complete title. (*Bonbright* v. *State*, 151 N. Y. S., 35; *Travis* v. *Ann Arbor Co.*, 168 N. Y. S., 53.) In Treasury Decision 21315, dated June 27, 1899, it was held that—

> There is no other feasible rule than to consider the person in whose name the stock stands as the owner of the legal title, and any transfer to another name as a transfer taxable under the law.

This ruling has been consistently followed by the Bureau, and the law has been reenacted, in substantially the same language, in four separate Acts since this ruling was made, which indicates legislative sanction thereof.

The income tax law is very different from the stamp tax law, and requires not only a transfer but also an actual sale resulting in an actual loss to the taxpayer before a deduction can be allowed. In view of the difference in the law with respect to stamp tax and income tax, it is held that, while the transfer of stock is a transfer subject to tax under Schedule A–3, Title XI, of the Revenue Act of 1921, it is not a sale within the meaning of the income tax law, and no profit or loss results therefrom which should be accounted for in income tax returns.

ARTICLE 31: What included in gross income. II–21–1060
I. T. 1762

REVENUE ACT OF 1921.

An individual mortgagor agrees to refund 4 per cent of the normal income tax to the bondholder. A corporate mortgagor agrees to refund 2 per cent of the normal income tax in addition to paying 2 per cent at the source on behalf of the bondholder.

Held, that the 4 per cent tax refunded to the bondholder by individual mortgagor and the additional 2 per cent tax refunded by corporate mortgagor is taxable income to the bondholder and should be reported in his gross income.

ARTICLE 31: What included in gross income.

(See A. R. R. 3513; sec. 213(b), art. 73.) A tract of land conveyed to a company in consideration of the company moving its factory and operating its business thereon.

ARTICLE 31: What included in gross income. II-26-1116
T. D. 3518

INCOME TAX—REVENUE ACTS OF 1913 AND 1916, AS AMENDED—DECISION OF COURT.

1. INCOME, WHAT CONSTITUTES.

Payments by railroad companies, sole stockholders and tenants of a terminal company, as rentals for their proportionate user, held to be income.

A terminal company was organized by three railroad companies to acquire, own, and jointly operate a railroad bridge "for the equal benefit" of the railroad companies and "not for the purpose of making any pecuniary profit from the undertaking." The capital stock was taken by them in equal proportions. The terminal company had a large outstanding mortgage indebtedness, the payment of both principal and interest of which was guaranteed by the railroad companies. The railroad companies agreed, each with the others, and with the terminal company, to contribute as rental to any deficit of the terminal company in proportion to the user by each railroad company of the terminal facilities. It was further agreed that no dividends should be declared by the terminal company, and that "all surplus and net earnings and income shall constitute a reserve fund for additions to and improvements and reconstruction of the property of the terminal company." *Held*, that such contributions by way of rental payments by the railroad companies, to the terminal company, to make up the annual deficit of the latter, were taxable income of the terminal company under section II G(a) of the Revenue Act of 1913; section 10 of the Revenue Act of 1916; and section 4 of the Revenue Act of 1917.

2. The payments so made by the proprietary companies as rentals which were earnings of the latter's operation "proceed from the property" of the terminal company; and constitute a profit therefrom (equally whether or not there was a net gain or net income to it), notwithstanding the agreement that they were not to be transformed into dividends and were ultimately to be a reserve fund for additions, improvements, and reconstruction of the terminal property.

3. Decision of the district court reversed.

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

To collectors of internal revenue and others concerned:

The attached decision of the United States Circuit Court of Appeals for the Sixth Circuit in the case of *Elwood Hamilton, collector*, v. *Kentucky & Indiana Terminal Railroad Company* is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 20, 1923.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT. No. 3821.

Elwood Hamilton, late Collector of Internal Revenue, plaintiff in error, v. *Kentucky & Indiana Terminal Railroad Company, defendant in error.*

Error to the District Court of the United States for the Western District of Kentucky.

[Submitted April 9, 1923. Decided May 8, 1923.]

[289 Fed., 20.]

Before KNAPPEN, DENISON, and DONAHUE, Circuit Judges.

KNAPPEN, Circuit Judge: Defendant in error, which we shall call the Terminal Company, during the years 1915, 1916, and 1917, owned and operated a bridge across the Ohio River for railroad, street car, wagon and foot purposes, between Louisville, Ky., and New Albany, Ind. By section II A(1) [II G(a)] of the Revenue Act of October 3, 1913 (38 Stat., 114, 166), the Terminal Company was liable to a tax of 1 per cent upon its "entire net income arising or accruing from all sources" during the year 1915; by Title I, Part II, section 10, of the Revenue Act of September 8, 1916 (39 Stat., 756, 765), it was liable to a tax of 2 per cent upon such income during the year 1916; and by Title I, section 4, of the Revenue Act of October 3, 1917 (40 Stat., 300, 302), it was liable to a tax of 4 per cent upon such income during the year 1917. Taxes assessed for each of the three years were paid under protest, and suit brought for their recovery. The only question presented is whether in that suit the district court rightly rendered judgment for the Terminal Company, upon the ground that it had not, during any of the years in question, any taxable income whatever.

The Terminal Company was organized with a capital stock of $75,000, held (except as to a few qualifying shares) in equal proportions by three railroad companies (the Southern, the Baltimore & Ohio Southwestern, and the Chicago, Indianapolis & Louisville), which acquired the terminal properties (as stated in the plan of reorganization) "for the equal benefit" of the three companies, and "not for the purpose of making any pecuniary profit from the undertaking," but "with the view to securing to these companies terminal facilities in the city of Louisville, and without any purpose of making the corporate organization a profitable one in the way of dividends upon any corporate stock to be issued by the new corporation." During the years in question the Terminal Company had an outstanding mortgage bond issue of more than $6,000,000, the payment of both principal and interest whereof was guaranteed by the three railroad companies to facilitate the sale. By contract between the Terminal Company and the three proprietary companies each of the latter was to have "full and equal rights with the others" in the terminal property, each agreeing for a period extending beyond the taxing years in question to make use of the Terminal Company's properties for all passenger and freight traffic within its control destined to cross the Ohio River at Louisville. Each proprietary railroad company was to be charged the same amount for switching per car, but any deficit of the Terminal Company was to be "made up" by the three proprietary companies in proportion to each company's use of the terminal,[1] the Terminal Company being required to render monthly bills to the proprietary companies for switching charges, and also monthly bills to each showing amounts due by each company under the clause we have quoted in the margin, each bill to include in its estimates $\frac{1}{12}$ part of the annual taxes and of the annual fixed charges.[2] Provision was also made for excluding any proprietary company which defaulted in payment of such bills from further use of the Terminal Company's property and from enjoyment of the terminal service. It was also provided that until otherwise expressly agreed by the proprietary

[1] The contract provided that the proprietary companies "shall pay for the use of the property and facilities of the said Terminal Company such sums of money as shall from time to time be required, in addition to other revenues of the Terminal Company, to meet all expenses of operation and maintenance of the property of the Terminal Company and all of its obligations for taxes and interest upon its first mortgage bonds as the same may be outstanding from time to time; the respective amounts to be paid by each company being fixed and determined" on a basis of usage of the terminal property.

[2] During the year 1915 the proprietary companies, under the contract provisions referred to, paid $363,445.59; during 1916, the sum of $361,994.47; during 1917, the sum of $534,981.16.

companies no dividend from profits should be declared by the Terminal Company, but that "all surplus and net earnings and income shall constitute a reserve fund for additions to and improvements and reconstruction of the property of the Terminal Company."

If the payments so made by the proprietary companies are excluded from the Terminal Company's returns, that company not only had no income but it suffered a substantial deficit during each of the years in question. If, however, the contributions by the proprietary companies constitute income, the Terminal Company had a substantial net income within the meaning of the statute for each of the three years; due to the fact that while the proprietary companies paid the bond interest in full, the Terminal Company was entitled in computing its net amount to deduct but a trifle more than one-half of the amount of the interest so paid. The Terminal Company raises no question of the validity of the income tax provisions so limiting interest deductions. See *Anderson* v. *42 Broadway Co.* (239 U. S., 69 [T. D. 2261; not published in Bulletin service].) It results that if the payment of the bond interest by the proprietary companies to the Terminal Company was income, the judgment below is concededly wrong and should be reversed. The case thus turns solely upon the definition of income.

In *Stratton's Independence* v. *Howbert* (231 U. S., 399, 415 [T. D. 1913; not published in Bulletin service]) income was defined as "the gain derived from capital, from labor, or from both combined." In *Doyle* v. *Mitchell* (247 U. S., 179 [T. D. 2723; not published in Bulletin service]) this definition was approved when made to include profit gained through a sale or conversion of capital assets. In *Eisner* v. *Macomber* (252 U. S., 189, 207 [T. D. 3010; C. B. 3, p. 25]) and in *United States* v. *Phellis* (257 U. S., 156, 168–9 [T. D. 3270; C. B. 4, p. 25]) (both of which were stock-dividend cases), the definition above quoted was approved, being elaborated in statement (to use the language of the Phellis case) as "a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value, proceeding from the property, severed from capital, however, invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal." The Terminal Company invokes these definitions, and contends that the payments made by the proprietary companies are wholly excluded therefrom. In this connection it contends that its road was not operated for profit, and invokes the broad proposition that the income tax laws do not treat as income that which in the generally accepted sense is not income.

We think these contentions overlook the substantial situation. The payments made by the proprietary companies were part of the rentals to be paid by those companies for their use of the terminal facilities. The Terminal Company had a substantial gross income apart from payments made by the proprietary companies. The latter needed the terminal facilities, and were willing to pay what these facilities were worth. They found it to their interest as stockholders to own equal interests in the stock, but as proprietary companies (as distinguished from their interests as stockholders) they saw fit to contract to pay to the Terminal Company, which owned and operated the physical properties, whatever amount was required above receipts from other sources to meet the expenses of operation, repairs, maintenance, and conservation of property, including interest upon the corporate indebtedness. These contributions were apportioned according to the beneficial use of the terminal facilities which each of the three proprietary companies enjoyed. These payments were nothing more or less than rentals of the terminal facilities. It could not well be doubted that had they been beforehand fixed in amount they would properly be treated as income. That these amounts were uncertain until fixed by experience does not alter their essential nature. Nor is it open to reasonable doubt that had the amount of these so-called deficiency payments been derived from rentals to other than the proprietary companies they would have constituted income. Upon principle, we think these payments were true income, and they did not fail of being such from the fact that as the only (at least the chosen) means of obtaining the Terminal Company's facilities, and the preferred rights thereunder, the proprietary companies were required to pay more for the facilities than perhaps could be obtained for casual or less complete or less important service. Nor, in our opinion, can it properly be said that the corporation was not organized for profit. The contract provision that until otherwise expressly agreed by the proprietary companies no dividend from profits should be declared, etc., does

not preclude a change of policy in that regard. Nor do we think that payments such as are here in question are outside the generally accepted definition of income. We think it clear that the payments so made by the proprietary companies as rentals did "proceed from the property" of the Terminal Company, were earnings of the latter's operation, and did constitute a profit therefrom (and equally whether or not there was a net gain or net income), notwithstanding according to the then existing policy such profits were not to be transformed into dividends but were ultimately to find their way into "additions to and improvements and reconstruction of the property of the Terminal Company."

The contemplated "reserve fund" to result from "surplus and net earnings and income" could be nothing else than profits. The fact that a net income, in a taxable sense, resulted only because the Terminal Company could not deduct from the rentals received all the interest paid is unimportant, as has already appeared. That statutory "net income" was directly and immediately due to the interest payments made by the proprietary companies is not important. We are not impressed with the Terminal Company's contentions that it acted only as distributing agent in the collection of the interest payments from the proprietary companies. The Terminal Company owned the terminal properties subject to the payment of the mortgages thereon. The interest money was thus paid to and used by the Terminal Company for meeting charges against its own property, default in whose payment might well result in the loss of the property. Had the interest payments been made by the proprietary companies directly to the bondholders or the mortgage trustee, the payments would have been none the less income of the Terminal Company. (*Anderson* v. *Morris, Etc., Co.*—C. C. A.—216 Fed., 83, 90.) It has been held that interest on bonds of a lessor company and dividends to stockholders of such company, paid as part of rentals by a lessee company, are "income" of the lessor company (*Rensselaer, Etc., Co.* v. *Irwin*—C. C. A., 2—249 Fed., 726; *Northern Ry. Co.* v. *Lowe*—C. C. A., 2—250 Fed., 856). That dividends on stock paid by a lessee company directly to the lessor's stockholders, as part of an agreed rental, constitute "income" of the lessor corporation is held in *West End Street Railway* v. *Malley* (C. C. A., 1; 246 Fed., 625 [T. D. 2620; not published in Bulletin service]). Our conclusion, so far stated as on principle, that the proprietary companies' payments here involved are income within the taxing acts here in question, is fully supported by reasoned and convincing adjudications, which we are content to follow. (*Boston Terminal Co.* v. *Gill*, C. C. A., 1; 246 Fed., 664 [T. D. 2671; not published in Bulletin service]. *Houston Belt & Terminal Ry. Co.* v. *United States*, C. C. A., 5; 250 Fed., 1 [T. D. 2710; not published in Bulletin service]). The Boston Terminal case was in its facts almost identical with the instant case. The Houston Terminal case directly involved, as did the Boston Terminal case, the question of interest upon a terminal company's bonds. Every vital question here involved was presented and decided in one or both of these cases. The Terminal Company here makes no attempt to distinguish these cases from the instant case.

It results from these views that the judgment of the District Court should be reversed, and the cause remanded with directions to take further proceedings not inconsistent with this opinion.

ARTICLE 31: What included in gross income. II–28–1137
I. T. 1804

REVENUE ACT OF 1921.

Damages received for breach of promise to marry do not constitute taxable income.

Inquiry is made whether damages received for breach of promise to marry constitute taxable income; and if so, whether attorney's fees and other costs of such a suit constitute allowable deductions from gross income.

Held that, in accordance with O. D. 546 (C. B. 2, p. 157), attorney's fees and other costs represent personal expenses and as such are not deductible.

Held further, that, in accordance with Solicitor's Opinion 132 (C. B. I–1, p. 92) and with the definition of income in the United States Supreme Court decision of *Eisner* v. *Macomber*, a promise to marry is a personal right not susceptible of any appraisal in relation to market values and that damages or payment in compromise of the invasion of such right does not constitute taxable income.

ARTICLE 31: What included in gross income. (Also Section 219, Article 345; Section 223, Article 401; Section 225, Article 422.)

II–33–1192
I. T. 1834

REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

All gains, profits, and income accruing to the members of the Osage Tribe, Oklahoma, from their surplus allotments and from their shares as members in the mineral estate reserved to the tribe are subject to the income taxes imposed by the Revenue Acts of 1916, 1917, 1918, and 1921. The income accruing to such Indians from homestead allotments conveyed to them by the Act of 1906 will not be subject to income taxation prior to April 8, 1931, if such homestead is held by the original allottees.

The income accruing to the United States as trustee is distributable regularly within the meaning of section 2(b) of the Revenue Act of 1916 (which is applicable to the taxable years 1916 and 1917) and is distributable periodically within the meaning of sections 219(a)4 of the Revenue Acts of 1918 and 1921. Taxes to be asserted are to be computed upon the individual share of each member of the tribe. Since the shares of the members having certificates of competency are paid to them without restriction, they should include such income in the individual returns filed by them. With respect to those persons who do not have certificates of competency and minors, a return of the entire shares of such persons should be made by the United States as guardian.

The following questions have been presented for consideration:

(1) Is the income accruing to Indians of the Osage Tribe, Oklahoma, derived from "restricted" property subject to the income tax levied by the Internal Revenue Acts of 1916, 1917, 1918, and 1921?

(2) If so, should the Osage Tribe as a unit, rather than individual allottees thereof, file a separate tax return in order to take advantage of authorized allowances or deductions for depletion and depreciation on oil and gas wells?

The various Revenue Acts referred to above impose the income tax levied thereunder upon the entire net income (as defined in such Acts) of every individual a citizen or resident of the United States. See section 1 of the Revenue Act of 1916, sections 1 and 2 of the Revenue Act of 1917, and sections 210 and 211 of the Revenue Acts of 1918 and 1921. The members of the Osage Tribe of Indians of Oklahoma, whether or not owning restricted property, come within the purview of the language used therein. Indians as such are not exempted from liability under the provisions of the general revenue laws. *The Cherokee Tobacco* (11 Wall., 616). The members of the Osage Tribe are, therefore, subject to the taxes mentioned, unless there is some special provision under the terms of which such taxes are not to be asserted against them.

In the Act of June 28, 1906 (34 Stat., 539), which provided for the allotment in severalty of the lands formerly constituting the reservation of the Osage Tribe, now Osage County, Okla., distinct provisions are to be found with respect to the taxation of the lands so allotted. The Act referred to provided for the conveyance to each of the several members of the tribe of three selections of 160 acres each and provided also for an equal division of any lands which might remain after such selections. Each member was permitted to designate which of his three selections should be a homestead. The other selections of the member, together with his share of the remaining lands to be divided, were designated as surplus lands. Pursuant to the provisions of the Act, the homestead allotment was made inalienable and nontaxable until otherwise directed by Congress, unless the Secretary of the Interior should, upon application of a member, issue to him a certificate of competency, as provided for in such Act, in which case the homestead allotment of such member was made inalienable and nontaxable for a period of 25 years or during the life of such person. By section 3 of the Act of March 3, 1921 (41 Stat., 1249), the restriction against the alienation of the homestead allotments of all members of less than one-half Indian blood were removed. It was further provided that the homestead allotments of *all the members* of the Osage Tribe should not be subject to taxation, if held by the original allottee, prior to April 8, 1931. With respect to the surplus lands, the Act of June 28, 1906, provided that all such lands, to the extent of the interest therein conveyed to the Osage allottees, should be taxable at the expiration of three years from the date of the approval of the Act (notwithstanding a restriction against the alienation thereof for a period of 25 years or until the issuance of a certificate of competency) unless prior to the expiration of such three years a member should receive a certificate of competency or a member should die, in either of which cases the surplus lands of such member should become taxable upon the happening of such event.

In accordance with the express provisions of the legislation of Congress, the homestead allotment, to the extent of the interest therein conveyed to each member of the Osage Tribe by the Act of 1906, is nontaxable if held by the original allottee until April 8, 1931. A tax upon the income from such interest in the land would be equivalent to a tax upon the interest itself. See *Pollock* v. *Farmers Loan & Trust Co.* (157 U. S., 429). Accordingly, until April 8, 1931, income accruing to members of the Osage Tribe from the homestead allotments conveyed to them by the Act of 1906 is not taxable, if such homestead is held by the original allottee. The surplus allotment of any such members became taxable upon the expiration of three years from the date of the approval of the Act of 1906 (June 28, 1906), provided a certificate of competency was not issued to such member prior thereto or such member did not die before the expiration of such period. It may be stated, therefore, that the surplus lands of the Osage Indians became taxable not later than June 28, 1909. The income derived from the surplus lands is taxable under the Revenue Acts in question, since Congress has expressly provided that such lands would in any event be taxable at the expiration of three years from June 28, 1906.

The oil, gas, coal, and other minerals underlying the allotted lands of the Osage Tribe were, by sections 3 and 5 of the Act of 1906, reserved to the Osage Tribe for a period of 25 years from April 8, 1906. It was provided that at the expiration of such period of 25 years such minerals or the rights thereto should become the property of the individual owners of the land, unless prior to the expiration of such period Congress should otherwise direct. By the Act of March 3, 1921, such minerals or the rights thereto were further reserved to the tribe for an additional period of 15 years, the reservation being made to end April 7, 1946.

By reason of the reservation described, the minerals contained in the allotments did not pass by the allotment to the individual members of the Osage Tribe. See *Board of Commissioners* v. *United States* (216 Fed., 883). Such interest remained tribal property and the title of the Indians thereto remained in the tribe as is the case where property is held by an Indian tribe for the common use and equal benefit of all the members. See *Cherokee Nation* v. *Hitchcock* (187 U. S., 294, 307). The tax exemptions provided for in the case of homestead and surplus land allotments do not appear to have any application to the oil, gas, coal, and other minerals underlying the allotted lands, and there appears to be no other statutory provision which would exempt such minerals from taxation. The Act of March 3, 1921, permitted the State of Oklahoma to levy its gross production tax upon all oil and gas produced in Osage County. By the same Act Congress made an additional levy of a sum equal to 1 per centum of the amount received by the Osage Tribe as royalties from the production of oil and gas, such levy to be used for the construction and maintenance of roads and bridges in Osage County. These instances are indicative of the power of Congress to subject such tribal property to taxation.

As stated before, Indians as such are not exempt from liability under the provisions of the general revenue laws of the United States. If they are to be exempted from such liability there must be special language in such general revenue laws excepting them. (*The Cherokee Tobacco, supra.*) Since, therefore, Congress, having plenary power over Indian affairs, has made no provisions whereby the reserved mineral estate of the Osage Tribe shall be excepted from taxation by the Federal Government, since Congress has not excepted the members of the Osage Tribe from liability under the income tax provisions of the various revenue Acts in question, and since such persons clearly come within the general classes of persons upon which such taxes are imposed, it accordingly appears that it was the intention of Congress that any income accruing to the members of the Osage Tribe from minerals underlying allotted lands would be subject to the provisions of the various revenue Acts.

It is therefore held that all gains, profits, and income accruing to the members of the Osage Tribe, Oklahoma, from their surplus allotments and from their shares as members in the mineral estate reserved to the tribe are subject to the income taxes imposed by the Revenue Acts of 1916, 1917, 1918, and 1921. The income accruing to such Indians from homestead allotments conveyed to them by the Act of 1906 will not be subject to income taxation prior to April 8, 1931, if such homestead is held by the original allottee.

By reason of section 4 of the Act of 1906, all funds then belonging to the Osage Tribe and all moneys due and to become due to the tribe were directed to be held in trust by the United States for a period of 25 years from and after January 1, 1907. It was directed that such funds should be segregated into individual shares as soon after January 1, 1907, as practicable and placed to the credit of the individual members of the tribe or their heirs at interest and that such interest should be paid quarterly to such members or their heirs. In respect, however, of all moneys received from oil, gas, coal, and other minerals, from the sale of town lots, and from grazing lands, it was directed that the amount placed to the individual credit of the members should be paid to such members quarterly in the same manner as the interest on their moneys held in trust for the tribe, thus treating such receipts as distributable income. It was provided that at the end of 25 years the pro rata share of the members in all the funds of the tribe so placed to the individual credit of such members should be distributed to them. It will thus be noted that a distribution of all the Osage trust funds was directed to be made by the Act of 1906 and that the United States was made the trustee of the pro rata share of such individual member or his heirs. It will thus be seen that all the moneys constituting the corpus of the Osage trust has been distributed to the individual members by the placing of the same to the individual credit of such members. The tribal title remains only as to the reserved mineral interest. As noted above, the income therefrom is distributable quarterly to the individual members. Section 4 of the Act of March 3, 1921, modified slightly the procedure as to the handling of the income from the mineral interest and from the trust funds in that the Secretary of the Interior was directed to retain and invest so much of the income of the members not having certificates of competency as exceeded $1,000 quarterly and so much of the income of minors as exceeded $500 quarterly. The United States is, therefore, made trustee of the mineral interest for the tribe as a body, the income thereof being distributable to the individual members of the tribe quarterly and payable to them at such time with the exceptions indicated. The United States is also trustee for the individual members of the tribe for their pro rata shares of the funds directed to be held in trust for 25 years, the interest upon which is distributable quarterly, and payable at such time, except as otherwise indicated.

The income of such a trust is distributable regularly within the meaning of section 2(b) of the Revenue Act of 1916 (which is applicable to the taxable years 1916 and 1917) and is distributable periodically within the meaning of sections 219(a)4 of the Revenue Acts of 1918 and 1921. Taxes to be asserted are, therefore, to be computed upon the individual share of each member of the tribe. Since the shares of the members having certificates of competency are paid to them without restriction, they should include such income in the individual returns filed by them. With respect to those persons who do not have certificates of competency and minors, a return of the entire shares of such persons should be made by the United States as guardian.

ARTICLE 31: What included in gross income. II–35–1215
I. T. 1852

REVENUE ACT OF 1921.

A brought suit for the annulment of her marriage on the ground that the marriage was procured by fraud and deceit. She also claimed damages. Prior to the trial of the case and the entering of judgment annulling the marriage the claim for damages was compromised by the payment to A of a fixed amount.

Held, that the amount so received does not constitute taxable income.

ARTICLE 31: What included in gross income. II–36–1232
I. T. 1862

REVENUE ACTS OF 1918 AND 1921.

Taxable income is realized when Liberty bonds are accepted in payment of Federal estate taxes at an amount in excess of that at which they were appraised for Federal estate tax purposes.

Of the estate tax upon the estate of A, $100x$ dollars was paid with the second Liberty loan converted $4\frac{1}{4}$ bonds. These bonds had been held by the decedent for more than six months prior to his death. The bonds were appraised for estate tax purposes at 88.46, so that the total difference between the inventory value and the par value at which they were accepted in payment of the tax was $11.54x$ dollars. The question presented is whether there was taxable gain to the estate for income tax purposes to that extent.

The estate tax was first imposed by the Act of September 8, 1916, which was amended by the Acts of March 3, 1917, and October 3, 1917, increasing the rate of tax. The Revenue Act of 1918 (Title IV) and the Revenue Act of 1921 (Title IV) also levied estate taxes, the latter Act supplanting all preceding as to estates of decedents dying after its effective date. (Art. 1, Reg. 63.) The tax levied by these Acts is in each case payable in money, at rates graduated according to the size of the estate (see secs. 401, 406–408, Revenue Acts of 1918 and 1921; secs. 201, 207–208, Revenue Act of 1916, as amended March 3, 1917 (sec. 300), and October 3, 1917 (sec. 900)). No reference is made in the Acts to the use of Liberty bonds in paying the tax.

The provisions permitting the acceptance of Liberty bonds in the payment of estate taxes are contained in section 6 of the Third Liberty bond Act, approved April 4, 1918 (40 Stat., 502, ch. 44), which was amended July 9, 1918 (40 Stat., 844), and March 3, 1919 (40 Stat., 1309), without changing this particular section. This section provides:

That any bonds of the United States bearing interest at a higher rate than 4 per centum * * * which have been owned by any person continuously for at least six months prior to the date of his death, and which upon such date constitute part of his estate, shall, under rules and regulations prescribed by the Secretary of the Treasury, be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law upon such estate or the inheritance thereof.

The purpose of these provisions is clearly stated in *Smietanka* v. *Ullman* (1921) (275 Fed., pp. 814, 815, 816), by Judge Alschuler:

> It goes without saying that unmatured obligations of the Government are not generally receivable in payment of taxes which the Government levies. * * * It is evident that the receivability of such unmatured obligations in payment of any taxes due the Government enhances the desirability of the obligation as an investment, and facilitates their sale.
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> * * * The first and second Liberty loans had been sold, their billions of dollars having presumably greatly strained the Government's borrowing powers. It was found necessary to float a third loan for yet more billions, and was deemed advisable to augment its attractiveness for purposes of investment. The interest rate was increased to 4¼ per cent, and the feature added of receivability in payment of estates taxes which the Federal Government might impose, which the prior issue did not include.

The United States Supreme Court, in *United States* v. *Woodward, et al.* (1921) (256 U. S., 632; 41 Sup. Ct., 615), held that the estate tax might be deducted from the gross income of the estate in computing its income tax under the Revenue Act of 1918. Justice Van Devanter said (p. 635):

> It is made a charge on the estate and is to be paid out of it by the administrator or executor substantially as other taxes and charges are paid. * * * It does not segregate any part of the estate from the rest and keep it from passing to the administrator or executor for purposes of administration, as counsel contend, but is made a general charge on the gross estate and is to be paid in money out of any available funds, or, if there be none, by converting other property into money for the purpose.

In other words, as appears from the estate tax provisions themselves and from *United States* v. *Woodward*, *supra*, the estate tax was, from its origin, a money obligation of the estate to the United States. After the estate tax had been in force for some time, it became necessary to issue bonds for war purposes. To increase the marketability of these bonds, provision was made in the authorizing Act for their acceptance at par by the Government in payment of estate taxes. The bonds are not receivable at all events in payment of the estate tax, but only under definite restrictions (see *Smietanka* v. *Ullman*, cited *supra*). The estate tax, then, has never been an obligation in the alternative to deliver bonds or pay money; it has always been, as stated in *United States* v. *Woodward*, *supra*, "a general charge on the gross estate, and *is to be paid in money* out of any available funds."

The acceptance of Liberty bonds by the United States in payment of an estate tax is a discharge of the estate's money obligation to the United States by virtue of a provision in an Act entirely distinct from the estate tax for what is, in effect, a redemption of the bonds at par in advance of their due date.

If Liberty bonds held by an estate and valued for estate tax purposes at $88.46x$ dollars were later redeemed at par, there could be little doubt that the estate realized taxable gain to the extent of $11.54x$ dollars. (See art. 1563, Reg. 62; L. O. 1012 (C. B. 2, p. 34).) Further, if as a business transaction, in consideration of the transfer of Liberty bonds valued for estate tax purposes at $88.46x$ dollars, A, a creditor of the estate, released a debt of $100x$ dollars owed by the decedent, it is evident that the estate would have realized a taxable gain of $11.54x$ dollars. (See art. 50, Reg. 62.) It follows that, for the same reasons, the transfer here resulted in a gain of $11.54x$ dollars to the estate, which is taxable as income.

ARTICLE 32: Compensation for personal services. II–17–1020
I. T. 1739

REVENUE ACTS OF 1918 AND 1921.

The Board of United States General Appraisers is an inferior court of the United States. The salaries of those members of the board who were appointed prior to the enactment of the Revenue Act of 1918 are exempt from income tax in accordance with the decision in *Evans* v. *Gore* (C. B. 3, p. 93).

The question is presented of the taxability of the salaries of the members of the Board of United States General Appraisers. In O. D. 902 (C. B. 4, p. 83) it was held that the board is not a court nor are its members Federal judges and their salaries are not exempt from tax under the Revenue Act of 1918.

In the case of *Evans* v. *Gore* (253 U. S., 245) (C. B. 3, p. 93), it was held that a tax upon the income of a Federal judge under an Act passed since he took office operated to diminish his compensation, in violation of the Constitution (Art. I, sec. 1, clause 6), and is invalid. The duties of the Board of United States General Appraisers are concerned with the customs laws, and clearly, if it is a court, the members' salaries would be exempted as judges of an inferior court of the United States. Like the Court of Claims, the board certainly did not, in its origin, possess the status of a judicial body. In fact, the Supreme Court in the year 1903 in the case of *Shurtleff* v. *United States* (189 U. S., 311), in deciding that the President had a right to remove a general appraiser without specifying a cause, held in effect that the office of general appraiser was administrative and not judicial. The question then remains whether through subsequent legislation a different status has been given to the board.

Subsequent to the decision of the court in the Shurtleff case, supra, and beginning with the year 1908, a series of Acts were passed pertaining to the general appraisers. It is not practicable to relate all the differences between the old and the new procedures. In the Act of August 5, 1909, and in all subsequent legislation, the general appraisers are given a life tenure, a characteristic, said by the court in the Shurtleff case, to inure only to judicial officers of the United States. Among the numerous other changes might be mentioned the power to "hear and determine" instead of "examine and decide" the power to establish rules of evidence, practice and procedure, not inconsistent with the statutes, to grant rehearings and retrials in a manner similar to that used by courts; and the board, by the later Acts, is given "all the powers of a circuit court * * * in preserving order, compelling attendance of witnesses, and the production of evidence, and in punishing for contempt," where formerly the penalties against recalcitrant witnesses could be enforced only through the ordinary courts of justice. Customs cases previously went through the circuit court, which passed upon the record made by the appraisers and could require the appraisers, as officers of the court, to take and return further testimony, which, together with the evidence already returned by the board, would constitute the record upon which the circuit court should "proceed to hear and determine the questions of law and fact." Numerous other changes might be mentioned, all tending to show an intention on the part of

Congress to raise the quality of the board to that of a court having a jurisdiction limited solely to cases arising under the customs laws, although nowhere in the statutes is the board referred to specifically as a court.

And it would seem from the implications of the case of *Vitelli* v. *United States* (250 U. S., 355) that Congress succeeded in the purpose of changing the board's status. In this case, after a reliquidation by a collector, an importer appealed to the Board of United States General Appraisers. After a judgment by the board, an appeal was prosecuted to the Court of Customs Appeals, where the action of the board was reversed and the case remanded to it. Another appeal was taken from the board's subsequent action and again its judgment was reversed, whereupon the case went to the Supreme Court on a writ of certiorari directed to the Court of Customs Appeals. The Supreme Court reversed the judgment of the Court of Customs Appeals, and the case was "remanded to the Board of General Appraisers for other proceedings not inconsistent with this opinion."

The point as to the jurisdiction of the Board of General Appraisers as a court was not apparently directly raised in this case any more than it is raised in any appeal from an inferior court. However, throughout its opinion, the court uses such expressions as "on the first hearing below" and "in the argument at bar," and, in its final order, above quoted, language identical with that used only when passing on the acts of inferior courts was used. The word "remand" means "to send back * * * a cause from an appellate court to the court of original jurisdiction." (Century Dictionary.)

Inasmuch as it is fundamental that the question of the jurisdiction, both of the appellate court and the court below, must always be answered whether propounded by counsel or not, it would seem likewise to follow that when an appellate court takes cognizance of an appeal that inferentially, at least, it must determine the status of the officers or bodies upon whose acts it is passing. At any rate, considering the opposite tendency of the Shurtleff case, the Supreme Court's method of handling the Vitelli case is highly persuasive of the view that the Supreme Court considered the later legislation to have changed the quality of the board from that of an administrative to that of a judicial body.

It is, therefore, the opinion of this office that the Board of United States General Appraisers is an inferior court of the United States, having a jurisdiction limited to matters arising under the customs laws, and that, under the ruling in the case of *Evans* v. *Gore*, *supra*, the salaries of those members of the board who were appointed prior to the enactment of the income tax laws are exempt from income tax. Under the opinion of the Attorney General published in Cumulative Bulletin 3, page 103, as Treasury Decision 3049, members appointed since the enactment of the income tax laws are not relieved from paying income tax.

O. D. 902, supra, should be reversed so far as it may be construed to apply to judges appointed prior to the enactment of the income tax laws.

ARTICLE 32: Compensation for personal services.

(See T. D. 3535; sec. 213(b), art. 73.) Bequests to persons made in lieu of compensation or commissions to which they would otherwise be entitled as executors or trustees.

ARTICLE 33: Compensation paid other than in cash.

(See A. R. R. 2895; sec. 250, art. 1012.) Stock received for past services.

ARTICLE 33: Compensation paid other than in cash. II–30–1152
I. T. 1810

REVENUE ACT OF 1921.

A pension bond purchased with a single premium by an employer provides for the payment of an annual pension for the life of an employee reaching a certain age with no payment at death. The bond upon delivery becomes the absolute property of the employee but it is not assignable by him.

Held, that no income was realized by the employee upon delivery of the bond to him. The annuities payable thereunder will be income in the year in which received.

Advice is requested whether the amount paid by the M Company to the O Insurance Company for pension bonds constituted income to the employee for whom the bonds were purchased as of the taxable year in which the bonds were delivered to the employee.

The insurance company, for the purpose of affording employers a means of providing pensions for employees retiring by reason of age, issues two forms of pension bonds, (1) which provides for the payment of an annual pension for the life of an employee reaching the age of —, with no payment at death if he should die either before or after attaining such age; and (2) which provides for an annual pension for at least — years if the employee should reach the age of —, and an annual pension thereafter as long as he lives. If he should die before reaching the age of —, the consideration paid for the bond will be paid to the designated beneficiary; and if the employee dies after reaching such age, but before — annual payments have been made, the balance of the — annual payments will be paid to his beneficiary, either as they become due or commuted into one sum. The employee may, from time to time, change the beneficiary, and in case of the death of a designated beneficiary before the death of the employee, the interest of such beneficiary vests in the employee.

Each bond is purchased with a single premium paid by the employer, is delivered to the employee, thereupon becomes his absolute property, and his ownership is not dependent upon his remaining in the employment of his employer. The bonds are not assignable, and those purchased by the M Company appear to have been of the form first herein mentioned.

L. O. 1014 (C. B. 2, p. 88) deals with group life insurance covering the lives of employees, wherein the insurance contracts continued in force only so long as the insured remained in the employment of his employer, "unless continued under the individual conversion option," and the proceeds were payable at the death of insured to the desig-

nated beneficiary. It was there held that the premiums paid by the employer were not additional compensation, and were not income to the employees. While the group insurance considered in the cited law opinion presents features differing from those found to exist in respect to the bonds under consideration, no fundamental distinction is found to justify a holding that the premiums paid for the group insurance were not income to the employees, whereas the premiums paid by the M Company were. Had the employer, in the instant case, instead of purchasing bonds, orally promised his employees to pay to each after attaining the age of — years the same annuity as is stipulated for in the several bonds, the legal effect would be no different from what it is under the facts submitted. In either case no financial benefit is realized, or realizable, by the employees at the time the promise is made or the bonds are delivered. In either case the employees may never receive any such benefit, and, if they do, it will be at some future date and not when the promise was made or the bonds were delivered.

Article 33 of Regulations 62 provides that—

> Where services are paid for with something other than money, the fair market value, if readily realizable, of the thing taken in payment is the amount to be included as income.

Citing the same article in Regulations 45, it is said in L. O. 962 (C. B. 2, p. 74):

> To constitute taxable income, however, the value of the stock received must be so fixed as to be capable of measurement at the time of receipt. If its value can not be measured in terms of cash or money's worth, then it can not be considered income for income tax purposes.

The amount paid by the employer is not the market value of the bonds, for they are not "readily realizable," being neither assignable nor unconditional promises to pay, and it is the opinion of this office that no income was realized by the employees upon delivery to them of the bonds. The annuities payable thereunder will, however, be returnable for income tax purposes in the year in which received.

ARTICLE 38: Gross income of farmers. II–38–1258
I. T. 1878

REVENUE ACT OF 1921.

> An amount expended by a farmer for the purchase of cattle is held to be a capital expenditure and deductible only from the selling price in the year in which the cattle are sold. It may not be deducted in the year in which the cattle are purchased unless they are also sold during that year.

A is engaged in the business of farming and cattle feeding, purchasing a large number of the cattle and raising some. He keeps his books on a cash receipts and disbursements basis, and each year he shows in block A of his return the amount of cattle sales and from this he deducts the cost of the cattle purchased during the year together with other necessary expenses. In 1922 he purchased more cattle than he sold and the cost of the cattle exceeded the income from the sales of other cattle. He requests advice whether he may deduct the cost of cattle as an expense in the year in which the purchase exceeded the sales provided that when the cattle are sold that

the full selling price shall be returned as income in the year in which they are sold.

Article 38, Regulations 62, promulgated under the Revenue Act of 1921, provides in part:

* * * The profit from the sale of live stock or other items which were purchased is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, * * *.

It is held that the amount expended by a taxpayer for the purchase of cattle is a capital expenditure and may only be deducted from the selling price of the cattle in the year in which they are sold and the amount paid for the cattle may not be considered as a business expense and taken as a deduction for the year in which the cattle were purchased unless they are sold during the same year, when the profit will be arrived at by deducting the cost price from the sale price.

ARTICLE 41: Sale of good will.

(See A. R. R. 2954; sec. 233, art. 546.) Deductibility of Federal income taxes by corporation in determining earnings chargeable to good will in accordance with A. R. M. 34 (C. B. 2, p. 31).

ARTICLE 42: Sale of personal property on installment plan. II–29–1144 I. T. 1805

REVENUE ACT OF 1921.

A corporation engaged in selling furniture on the installment plan which for the taxable years prior to 1922 computed income and filed returns on the installment plan will be permitted to adopt the strict accrual basis in computing its taxable net income for 1922 and subsequent years provided it includes in gross income for the taxable year all sales made during such year and sets up in its books of account, as completed transactions, all balances due on installment contracts as of the close of the preceding taxable year, the unrealized profits pertaining to such balances being reflected in the balance sheet taken from its books as at the end of the taxable year as earned income.

ARTICLE 43: Sale of real estate in lots. II–34–1203 I. T. 1843

REVENUE ACTS OF 1918 AND 1921.

The word "equitably" as used in article 43 of Regulations 45, relating to the apportionment of the cost of a tract of land to the parcels sold, does not mean "ratably." When a taxpayer has purchased a tract of land containing acreage so varied in character that he would not pay the same price for the poorer quality of land as he would for that which was more tillable, the taxpayer should be permitted to show by competent evidence the actual proportion of the cost of the entire tract which is properly allocable to the portion sold.

A taxpayer sold x acres of land from a tract of y acres and submitted an affidavit that all of the land involved in the original tract varied greatly in character because some of the land was compara-

tively good and tillable and would command a sale price of $106x$ dollars to $300x$ dollars an acre, while other land sold in later years brought a very low price, in some cases as low as $22x$ dollars and $24x$ dollars an acre. The taxpayer, at the time of the execution of the affidavit, still owned some of the land which was unsalable owing to its poor quality.

Under these circumstances it is manifest that a purchaser of a tract of land containing acreage so varied in character as the tract involved would not pay the same price for the poorer quality of land described in the taxpayer's affidavit as he would for the better land. The regulations are clear in stating that the cost of the land should be *equitably* apportioned. While an equitable apportionment might in some cases represent a ratable apportionment, " equitably " must be held to mean " fairly " rather than " ratably."

It is therefore held that taxpayer should be permitted to show by competent evidence the actual proportion of the cost of the entire tract which is properly allocable to the portion sold. (See O. D. 1072; C. B. 5, p. 89.)

ARTICLE 44: Sale of real estate involving deferred payments. II-31-1168 I. T. 1819

REVENUE ACTS OF 1918 AND 1921.

The agreement submitted is entirely in the form of a lease for 99 years with an option to purchase at the end of 50 years. It is by no means certain that this option will ever be exercised, since it is entirely optional with the lessees and since the lease contains various provisions for its termination by the lessor in the event that the lessees fail to comply with certain specified conditions. Further, the lease provides for a term extending 49 years beyond the time set for exercising the option, with elaborate provisions for an accounting at its termination. For these reasons, this office holds that the annual payments received under the terms of the lease should be considered as rent, and not as installments on the purchase price of the property.

Advice is requested relative to the tax liability of A, arising from his execution of a certain 99-year lease.

The evidence submitted shows that A executed in 19— an instrument in the form of a lease with an option to purchase to B. The lease provides for a term of 99 years at an annual rental of $8x$ dollars per annum in advance. It is further provided that the lessees shall pay all taxes, assessments, water rights, and other charges levied as a lien upon the premises, including charges for sidewalks, sewers, and pavements; the lessees also agree to keep the buildings on the premises repaired and insured and to erect a new brick building to cost at least $20x$ dollars. It is provided that if the rent is not paid by March 1 each year, or if the taxes and assessments are not paid as they fall due, the lessor may terminate the lease at his option with certain conditions as to notice. If the lessees shall have complied with the conditions of the lease for 50 years, they may purchase the property at their option by paying an additional $2x$ dollars. If, however, the lessees do not choose to exercise their

option in this respect, the lease continues for the remaining 49 years of the term. At the end of the term, if the parties can agree upon the value of the improvements on the property at that time, the lessor may pay to the lessees the value of the improvements as agreed upon, whereupon title to the premises shall vest in the lessor absolutely. If the parties can not so agree, provisions are made for the appointment of appraisers, who shall determine separately the value of the land and of the improvements upon it, whereupon the lessor may, by paying the value of the improvements within 60 days, vest the title to the premises in himself absolutely. If he fails to do so, the lessees may, within 60 days, pay the value of the land and thereupon obtain the title to the premises. If neither option is exercised, the property is to be sold and each party is to receive the proportion of the sale price determined by the appraisers.

It is contended that the arrangement was intended at the time of making as a contract for purchase and sale of the land. It appears, however, that A, since the enactment of the Federal income tax statutes, has reported the $8x$ dollars payments as rent for the property.

It remains, however, to determine the legal effect of the agreement which the parties actually made, aside from the question of their intentions at the time they drew it up. The general form of the contract is that of a lease with an option to purchase the leased property. What are the incidents of such a lease prior to the time the option is exercised?

The relationship between the parties in general is set forth in 16 R. C. L., 804–805:

> While a contract of sale contained in a lease remains dormant or unexerted, necessarily the lease is in full operation and effect, with all the incidents and implied obligations which result from the relation of landlord and tenant. The intent is that the lease shall remain intact while the contract of sale remains unexecuted. The exercise of the right to purchase during the term extinguishes the lease, and thus terminates the relation of landlord and tenant, and creates at once the relation of vendor and vendee * * *. The two contracts can not be operative and coexist, and hence the contract of sale can not have the effect to modify or otherwise affect any provision of the lease, express or implied, while it is in force. And the lessee has no estate in the land beyond the leasehold subject to judgment against him, until he has elected to purchase, and paid or tendered the purchase price in accordance with the terms of the option. (*Bras.* v. *Sheffield*, 49 Kan., 702, 31 Pac., 306, 33 A. S. R., 386; and see *Sweezy* v. *Jones*, 65 Iowa, 272, 21 N. W., 603.) It has been held, however, that while a tenant having the privilege of purchasing the premises remains until such privilege has been availed of, a mere tenant, subject to the same obligations as other tenants, and answerable for any waste committed by him, still his liability to suit for waste is suspended until it is known whether or not he will avail himself of his privilege, and that therefore the statute of limitations will not commence to run in his favor against an action for waste until the termination of his tenancy, or until it is otherwise known that he will not become a purchaser under the privilege given him in such lease. (*Powell* v. *Dayton, etc., R. Co.*, 16 Ore., 33, 16 Pac., 863, 8 A. S. R., 251.)

Likewise, the lessor is given a landlord's lien, prior to the exercise of the option, even in cases where, upon the completion of specified annual rental payments, the lessor is to give the lessee a deed without further payments. (*Solomon* v. *Keesee* (Ark., 1923), 246 S. W., 469; *Thomas* v. *Johnson*, 78 Ark., 574, 95 S. W., 468; *Burwell* v. *Warehouse Co.*, 172 N. C., 79, 89 S. E., 1064.) In the event of the nonpayment of the rent, the landlord may eject the tenant and recover possession of his land, the option agreement constituting no defense

even though the amounts paid are in excess of a fair rent. (*Doullut* v. *Rush*, 142 La., 110, 77 So., 110; *Spooner* v. *Shelfer*, 152 Ga., 190, 108 S. E., 773; *Twitchell* v. *Cummings*, 123 Minn., 270, 143 N. W., 785.) Further, under statutes taxing vendors on amounts due on contracts of sale, it is held that a lease with an option to purchase is not taxable, even though, by virtue of a down payment, it is practically certain that the option will be exercised. (*Bissell* v. *Bd. of Review*, 158 Iowa, 38, 138 N. W., 830; *Schoonover* v. *Petcina*, 126 Iowa, 261, 100 N. W., 490.) The result is otherwise when the so-called lessee is obligated to pay the full amount of the purchase price. (*Stillman* v. *Lynch*, 56 Utah, 540, 192 Pac., 272; *In re Spurgeon*, 72 Ind. App., 580, 126 N. E., 238.) Finally, if the lessor dies prior to the exercise of the option, the land descends to his heir, and if the option is exercised, the heir is entitled to the purchase money, no equitable conversion of the land into personalty being effected merely by the existence of the option to purchase. (*Rockland-Rockport Lime Co.* v. *Leary*, 203 N. Y., 469, 97 N. E., 43, L. R. A., 1916, F., 352.)

If the doctrine of these decisions is applied to the present case, it would follow that the relation between A and B in the present case is that of landlord and tenant until and unless the option is exercised. Hence, the rent received by A should be returned as income each year.

It may be urged, however, that because of the relatively small amount to be paid upon exercising the option ($2x$ dollars) with reference to the total rentals paid during the 50 years previous ($400x$ dollars) the contract is not a lease with option to purchase at all, but is really a contract of purchase and sale of the premises. Reference may be made to the large number of cases of conditional sales of personal property, where courts have repeatedly held that the fact the contract is designated as a "lease" and the installments as "rent" will not prevent its being treated as a contract of conditional sale, if such it is. (See *Hervey* v. *Locomotive Works*, 93 U. S., 664: Williston Sales, sec. 336.) Where the contract provides for the payment of a total sum by installments, upon the completion of which payments a deed to the premises shall be given, a few courts have taken the view that the agreement is a contract of sale. (*Prather* v. *Brandon*, 44 Ind. App., 45, 88 N. E., 700: *Alston* v. *Alston*, 106 Neb., 623, 184 N. W., 82.)

But it should be noted that in these cases the conditional vendee or lessee so called is obligated to pay the entire value of the property so sold. In some of the cases of conditional sales of goods, however, the instrument is drawn in the form of a lease with an option to purchase upon the payment of some additional sum, but the courts will not construe these agreements as conditional sales unless the final amount to be paid is merely nominal. Such is also the provision in the Uniform Conditional Sales Act, section 1. Further, agreements for the conditional sale of personal property are usually drawn as leases to avoid the severity of local rules with reference to conditional sales or requirements of record, etc. These rules and the recording acts are based upon the theory that a conditional sale contract (whereby possession of the goods is given to the vendee and title retained in the vendor as security, with provisions for transfer of title on payment of the price), gives a false credit to

the vendee, and in this way works an injury to third persons, such as purchasers from the vendee, or his creditors. (*Hervey* v. *Locomotive Works*, *supra*.) Therefore, courts will treat attempts to change the form and language, without changing the substance, as mere subterfuges or attempted evasions of the local law. These arguments hardly apply here. The possession of land gives no false credit to the lessee, for the title is on record; and the fact that the lessee may become owner at his option does not affect the question. Hence, even though only a small sum is to be paid in addition to the rents to complete the purchase, or even because of an initial deposit, it is practically certain that the lessee will buy the property, courts have usually treated the agreement as a lease until the option to buy is exercised. (*Heard* v. *Heard & Lee* (Ala., 1906), 41 So., 827; *Davis* v. *Robert*, 89 Ala., 402, 8 So., 114; *Bissell* v. *Bd. of Review*, 158 Iowa, 38, 138 N. W., 830; contra, on its special facts, *McCullough* v. *Ins. Co.*, 155 Cal., 659, 102 Pac., 814.)

The document is completely in the form of a lease with option to purchase. No purchase price is set forth in the instrument as such, the annual payments being designated simply as rent. The term of the lease extends 49 years beyond the time for the exercise of the option, and provisions for the disposition of the property at the end of the whole 99-year period are carefully worked out in detail. Further, there are a variety of provisions for termination of the lease by the lessor in case of nonpayment of rent, taxes, etc. It is quite possible that circumstances will arise which will make it undesirable for the lessees to go on with this lease, and it may well be that the lease will be terminated by the lessor long before the completion of the 50-year period. To be sure, the amount to be paid upon the exercise of the option to purchase is small with reference to the total amount of rent theretofore paid. But the purchase of the premises is purely optional with the lessee, so that the lessor could not obtain specific performance of any contract to purchase. Although no one of these provisions perhaps conclusively determines that this agreement is a lease rather than a contract to purchase, the sum total of them, and the absence of provisions indicating that the agreement was purely a contract of purchase and sale, is very persuasive that the agreement should be treated as a lease until and unless the option to buy is exercised by the lessee.

For these reasons, this office holds that the annual payments received under the terms of the lease should be considered as rent, and not as installments on the purchase price of the property.

ARTICLE 45: Sale of real estate on installment plan.

II–15–983
A. R. R. 2698

REVENUE ACT OF 1917.

A sale of real estate involved a substantial initial payment in cash in 1917. The deferred payments, represented by mortgage notes, were numerous and extended over a period of 24 years. The vendor submits sufficient evidence that the notes must necessarily be sold at a heavy and unreasonable discount. The transaction should be treated as an installment sale and the profit may be returned in accordance with the method outlined in article 45 of Regulations 45.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in treating as a taxable profit for the year 1917 the difference between the selling price and the March 1, 1913, market value of certain improved real estate sold in 1917, allowance for reasonable depreciation being taken into consideration when computing the profit.

Upon examination of the evidence of record the Committee finds that on March 1, 1913, the appellant was possessed of certain improved real estate having a market value on that date of $34x$ dollars (market value in excess of cost and is not in dispute); that in 1917 the said property was sold for a consideration of $50x$ dollars; that under the contract of sale $12.5x$ dollars cash was paid in 1917 and a series of notes, including in their face value interest at the rate of 6 per cent, were given; that these notes were secured by first mortgage on the property sold and were to be paid $3x$ dollars each year for a period of 24 years; that the Unit has treated the excess of the stipulated selling price, $50x$ dollars, over the March 1, 1913, market value of the property ($34x$ dollars), with reasonable allowance for depreciation, as a taxable profit ($17.46x$ dollars) to be reported in full in the return for 1917; and that the appellant contends, because of conditions hereinafter outlined, that the transaction should be treated for tax purposes as an installment sale.

In the determination of the question involved, conceding that a substantial initial payment in cash was made at the date of sale, there must be taken into consideration the question as to whether the notes given in 1917 had a readily realizable market value, and if so, whether they could have been sold at a reasonable discount. Article 44 of Regulations 45 (1920 edition) relates to two classes into which deferred payment sales of real estate ordinarily fall. It would appear that subdivision (2) of that article possibly covers the instant case by the following language:

> Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

Article 46 of Regulations 45 (1920 edition) provides in part:

> In class (2) in article 44 the obligations assumed by the buyer are much better secured because of the margin afforded by the substantial first payment, and experience shows that the greater number of such sales are eventually carried out according to their terms. These obligations for deferred payments are therefore to be regarded as equivalent to cash, and the profit indicated by the entire consideration is taxable income for the year in which the initial payment was made and the obligations assumed. * * *

In the instant case, however, it is shown that the deferred payments are numerous (72 notes) and extend over a period of 24 years from 1917, and in this respect the case evidently differs from those contemplated by article 44(2) of Regulations 45 (1920 edition) in that portion which states:

> Usually by a relatively small number of deferred payments.

Concerning the readily realizable market value of the notes and their discount value, if any, in 1917 and at the present time, the appellant submits in evidence two affidavits by officials of banks in the city of S, where appellant is located, wherein it is averred in the

opinion and judgment of affiants that the notes because of their long maturities and the fact that they bear no interest could not have been sold when received by the appellant nor at any time since except at a heavy and unreasonable discount varying from 10 per cent to 25 per cent of the face of the said notes. It is shown in this connection that a sale, if possible, of the notes at a discount as low as 10 per cent in 1917 would have resulted in a loss upon the transaction.

In O. D. 842 (C. B. 4, p. 89) it is stated in part as follows:

* * * However, if the taxpayer can show that the notes can not be sold at a reasonable discount, the sale will be held to be an installment sale, and he may report as income each year from the transaction that proportion of each payment actually received in that year which the entire gross profit to be realized bears to the gross contract price.

See also O. D. 181 (C. B. 1, p. 76).

The foregoing considered, the Committee concludes that the transaction in question should be treated as an installment sale and the profits returned for tax purposes in accordance with the method outlined in article 45 of Regulations 45 (1920 edition). It may be here remarked that while the articles of Regulations 45 (1920 edition) herein cited were promulgated under the Revenue Act of 1918, the principles and methods therein outlined are applicable to the instant case under the Revenue Act of 1917.

Recommended, therefore, that the action of the Income Tax Unit be reversed and that the appeal be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 49: Compensation for loss. II-25-1108
(Also Section 202, Article 1561.) I. T. 1787

REVENUE ACT OF 1921.

Property was condemned for street-widening purposes, and the compensation paid included a sum which represented the fair market value of the portion condemned and an amount equal to the difference in value of the remaining portion before and after the completion of the improvements. The amount received by the taxpayer should be deducted from the basis, to be used for determining gain or loss upon subsequent disposal of such property.

Advice is requested relative to the determination of gain or loss resulting from the condemnation of a portion of the taxpayer's property by a city in Illinois for street-widening purposes.

The following extract from a decision of the Supreme Court of Illinois clearly sets forth the method for determining the damages sustained by a taxpayer a portion of whose property is condemned for street-widening purposes. The case was that of the *City of Chicago* v. *Lord*, reported in 115 N. E., 8:

The first question to be determined in this case is, What is the proper compensation to be paid to appellants by reason of the taking of their property?—and this involves the proper method of ascertaining such compensation. In cases of condemnation of private property for public use a wide variety of circumstances must be taken into consideration, which would be different in every individual case. The owner of property is entitled to compensation for

the property actually taken and of which such owner is deprived, and is also entitled to damages, if any, to property not taken. The measure of damages in condemnation is the fair cash market value of the property taken for its highest and best use, and the difference between the value of the remainder immediately before the filing of the petition and immediately after the completion of the improvements. In some cases but a small portion of the property will be taken, and that in such a way that the remainder of the property will be fully as valuable as it was before the taking. In other cases, a portion of the property may be taken in such a way as to leave the portion not taken of no value, or of such little value that the condemnation will, in effect, amount to taking the whole. Between these extremes there might be an infinite variety of cases, each of which would depend upon the facts and circumstances of the particular case, and precedents, except those announcing general rules to be followed, would be of little value in arriving at what would be just compensation to be paid in such a case * * *. The amount of compensation to be awarded, both for land taken and damages to the remainder, depending, as it does, upon values, is nearly always a question of fact.

Under the Illinois statutes relating to condemnation of private property for public use, a jury is impaneled to view the property and to make its report as to the compensation to which the property owner is entitled. Section 5259 provides in part:

Provided, That no benefits or advantages which may accrue to lands or property affected shall be set off against or deducted from such compensation, in any case.

Apparently, in the instant case, the compensation paid to the taxpayer by the Illinois city included a sum which represented the fair market value of the portion condemned, and an amount equal to the difference in value of the remaining portion, before and after the completion of the improvements. The cost of the property which was acquired by the taxpayer subsequent to March 1, 1913, was $10x$ dollars. He was awarded $7x$ dollars, which represented the value of the portion condemned and damages to the remaining portion of the property. It is believed that in such cases the estimate of the damages resulting to the remaining property must be, to a great extent, conjectural and speculative, the actual damages thereto not being ascertainable until such time as the property is disposed of.

It is held, therefore, that the amount received by the taxpayer should be deducted from the basis, which in this case is the cost of the entire property, to be used for determining the gain or loss upon subsequent disposal of such property.

ARTICLE 51: When included in gross income. II–32–1176
I. T. 1824

ACT OF OCTOBER 3, 1913, AND REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

The taxpayer purchases land, divides it into lots, leases each lot to a third party subject to a ground rental, and later sells the fee-simple title, carrying with it the right to receive the ground rentals. Subsequently, the taxpayer buys the leasehold, erects a house, and sells it subject to the ground rental.

Held, that there is a closed and completed transaction when the taxpayer sells its fee-simple title, and it is immaterial whether the taxpayer agreed that it would build a house on the lot or that it would purchase the rights of the original lessee.

The business operations of the M Company are essentially as follows:

It purchases land and divides it into building lots. A ground rental is created upon each lot by the process of leasing the ground to a third person, the M Company retaining the fee-simple or reversion interest, which carries with it the right to receive the yearly ground rental from the lessee. The fee-simple or reversion interest is then sold, the company conveying the fee to the purchaser, such fee so conveyed carrying with it the right to receive the yearly ground rental. At this stage of the business operation, the M Company has parted with its freehold and leasehold interest, together with its right to receive the yearly ground rental. Subsequent to selling its fee-simple or reversion interest in the lots, the M Company buys back from the original lessee the right to the lease, and the M Company now becomes the lessee of the property, has parted with its fee-simple or reversion interest, and must pay the yearly ground rental to the owner of the fee or reversion. After purchasing the rights of the lessee, the M Company erects houses on the leased property and sells them subject to the ground rental or lease.

It is contended that no profit should be reported by the M Company on the sale of the reversion of the ground until the house erected on the land has been sold, for the reason that when these ground rentals are created it is necessary that the house be completed or a guarantee given that the house will be completed.

Held, that there is a closed and completed transaction for income tax purposes when the M Company sells its fee-simple or reversion interest, together with the right to receive the yearly ground rental. After this transaction, it has no right, title, or interest in the lots—it has sold its fee-simple or reversion interest in the lots, its right to receive yearly ground rentals therefrom, and divested itself of its rights as a lessor.

It is immaterial whether the M Company might have agreed by written stipulation or otherwise that it would subsequently build houses on the lots in question, or that it would subsequently purchase the rights of the original lessee. If both be done, this would constitute contract rights as between the parties, separate and apart, not detracting from the closed and separate transaction above ruled upon.

If the M Company, upon the sale of the house or houses placed upon the lot, realized a profit by reason of such sale over and above the cost of the house and the lease, the taxpayer should report this taxable gain for the year in which the profit occurs.

ARTICLE 51: When included in gross income. II–37–1250
I. T. 1872

REVENUE ACTS OF 1917 AND 1918.

A corporation treated withdrawals by stockholders in the years 1917 to 1920, inclusive, as dividends in the year of withdrawal and invested capital was reduced accordingly. The stockholders should, likewise, treat the amounts as dividends in the years received, even though surplus was not charged and the stockholders were not credited with these amounts till 1920.

For many years it was the practice of the stockholders of a corporation to withdraw amounts from its funds whenever they saw fit, and these amounts were entered on the books of the corporation to the personal accounts of the stockholders. There were no formal declarations of dividends, but in 1920 an entry was made on the books of the corporation charging surplus with the amount of the withdrawals and crediting the stockholders' personal accounts. The question is raised as to whether this constituted a dividend to the stockholders in 1920.

It is held that the adjustment to be made in the personal returns of the stockholders should be consistent with the adjustment made in the returns of the corporation. As an examination of the returns of the corporation for prior years discloses that the withdrawals had been treated as dividends for the years in which they were made, and that the invested capital of the corporation had been reduced accordingly, the amounts received by the stockholders should be treated as dividends received in the years in which the withdrawals were made.

ARTICLE 52: Income not reduced to possession.

(See I. T. 1764; sec. 202, art. 1561.) Interest credited to taxpayer's account upon a "short" sale of corporate stock.

ARTICLE 52: Income not reduced to possession. II–34–1204
A. R. R. 4385

REVENUE ACT OF 1916.

The taxpayer kept his books on the cash receipts and disbursements basis.

The amount of $22x$ dollars undrawn salary for the year 1916 but not credited to the taxpayer's account on the books of the M Company until January 31, 1917, the end of its fiscal year, constitutes taxable income to him for the year 1916 rather than 1917.

Under the corporate resolution of ——, 1911, the taxpayer's salary accrued to him monthly. The books of the corporation were personally kept by him; he was in actual control of the corporation by virtue of his own holdings and as trustee; he was the active manager; the financial conditions of the corporation were such as to indicate the salary could have been paid or credited to his account monthly without financial embarrassment to the corporation; and it required but an act of his own volition to make the necessary book entries reflecting his undrawn salary, or to actually pay the same.

Furthermore, the taxpayer keeps personal records in which he treated the undrawn salary for 1916 as having been received by him during the year 1916, and upon such personal record the return for that year was rendered.

The Committee has carefully considered the appeal of A from the action of the Income Tax Unit in allocating to the year 1917 salary of $22x$ dollars for 11 months of the year 1916 credited to the account of the appellant on the books of the M Company January 31, 1917.

From the evidence of record and the facts developed at the hearing, it appears that the appellant has been the president of the M Company, a corporation, for many years; that he originally owned all of the capital stock of the corporation but now actually owns but $33\frac{1}{3}$ per cent thereof, the remainder having been set aside to trustees

by two irrevocable trusts for the benefit of his wife and children; that on ——, 1911, the corporation, by vote of its directors, fixed the appellant's salary at $2x$ dollars per month; that the corporation had an established fiscal year ending January 31, as a result of which the undrawn salaries of the appellant were not credited to his account until that date; that appellant's salary for the year 1914 was reported on his individual return for 1915, while the salary for 1915, 1916, and the month of January, 1917, amounting to $50x$ dollars, was reported on his individual return for 1916; that during all of these years the books of the corporation were kept by the appellant in his own handwriting; that in accordance with the practice established in prior years appellant, at the close of the fiscal year January 31, 1917, credited his account with the amount of $22x$ dollars undrawn salary for the calendar year 1916 and $2x$ dollars salary for the month of January, 1917; that thereafter salary has been credited to the appellant's account on the books of the corporation monthly; and that the Income Tax Unit has held that the $22x$ dollars undrawn salary for 1916 credited to appellant's account on the books of the corporation on January 31, 1917, constitutes taxable income for the year 1917, on the ground that appellant's individual returns have been rendered on the basis of cash receipts and disbursements, and since the amount in question was not credited to his account until 1917, there could have been no constructive receipt thereof during 1916.

Upon thorough consideration of all the facts and evidence presented, both written and oral, the Committee has reached the conclusion that the amount of $22x$ dollars undrawn salary for the year 1916, but not credited to appellant's account on the books of the M Company until January 31, 1917, constitutes taxable income to him for 1916 rather than 1917, as held by the Income Tax Unit. Under the corporate resolution of ——, 1911, appellant's salary accrued to him monthly. The books of the corporation were personally kept by the appellant; he was in actual control of the corporation by virtue of his own holdings and as trustee; he was the active manager; the financial conditions of the corporation were such as to indicate the salary could have been paid or credited to his account monthly without financial embarrassment to the corporation; and it required but an act of the appellant's own volition to make the necessary book entries reflecting his undrawn salary, or to actually pay the same.

Furthermore, appellant keeps personal records in which he treated the undrawn salary for 1916 as having been received by him during the year 1916, and upon such personal record the return for that year was rendered.

Accordingly, it is recommended that the action of the Income Tax Unit be reversed and the appeal be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 53: Examples of constructive receipt. (Also Section 201, Article 1541.) II–17–1021 I. T. 1740

REVENUE ACT OF 1921.

There was an increase in the capital stock of a corporation and the stockholders gave, for the shares issued to them, their notes and

cash. Later a dividend was declared out of surplus, which was applied against the notes.

Held, that the stockholders constructively received a cash dividend and not a stock dividend.

ARTICLE 53: Examples of constructive receipt. II-25-1109
I. T. 1788

REVENUE ACT OF 1921.

Where a taxpayer sold municipal bonds received by it in payment for work done and placed in escrow a certain part of the selling price as a guarantee that the annual interest on the bonds would be paid (any withdrawals so made to be redeposited upon collection), it is held that the amount so placed in escrow was constructively received by the seller for the year in which the sale was consummated.

A taxpayer took special assessment bonds from a municipality in payment for work. The bonds ran for 10 years and were entered on the books of the company at par. The company sold to brokers a large block of the bonds at 90 cents on the dollar, 85 cents of which was paid to the vendor. As the vendor guaranteed collection of the bond interest, the balance of the purchase price was held in escrow in the city of Y subject to check to the extent of any deficiency that might occur in any year in the collection of interest on the bonds. Any withdrawals from this fund were redeposited upon collection being made, the fund to remain in escrow for the 10-year period. The vendor makes its returns on a cash receipts and disbursements basis and included the amount of the fund in its receipts for 1921.

It is held, that the vendor constructively received the amount placed in escrow and therefore properly included such amount as part of its gross income in its return for the year in which the sale was consummated.

SECTION 213(b).—GROSS INCOME DEFINED: EXCLUSIONS.

ARTICLE 73: Gifts and bequests.

(See A. R. R. 2895; sec. 250, art. 1012.) Stock received for past services.

ARTICLE 73: Gifts and bequests. II-25-1110
(Also Section 213(a), Article 31.) A. R. R. 3513

REVENUE ACT OF 1918.

A group of business men procured the conveyance of a tract of land to a manufacturing company, in consideration of the company's moving its factory and operating its business thereon. It is held that the fair market value of the land at the time of acquisition is not a gift but taxable income to the company.

The M Company has appealed from the action of the Income Tax Unit in holding that its reported net income for the year 1919 should

be increased by the value of a tract of land received during that year in consideration of the said company locating its plant in the city of S.

It appears from the records in the case that prior to 1919 the appellant company owned and operated a certain factory in the city of T, and because of the fact that the city of T could not supply the amount of labor required, it was found necessary to remove the plant to a larger city if the company's business was to expand. Suitable sites for the said plant located in various cities were examined, among which was one in the city of S, which was offered to the appellant company by a group of business men in the city of S free of cost on condition that the said company locate and operate its plant on the tract of land so offered. The agreement entered into between the appellant company and the representative of the business men's committee reads as follows:

> A, et al., hereinafter known as the parties of the first part, agree to furnish the M Company, hereinafter known as the party of the second part, a deed, free of encumbrance, of the following property:
>
> Westerly — feet of the south one-half of block —, B's addition to the city of S, known as lot —, and the west one-half of lot — of B's addition to the city of S, on which the M Company agrees to build a suitable building for the manufacture and sale of its products, now located at the city of T.
>
> The parties of the first part further agree to deliver to the party of the second part a deed to the above-described property on or before May —, 1919.

The deed to the said property was issued to the appellant company April —, 1919. The field officer who examined the appellant company's returns said in his report of July —, 1922, that—

> With reference to receipt of above-mentioned site, it was ascertained on further investigation that same was purchased by business firms of the city of S through the city of S ——, said site being deeded direct to this taxpayer. The consideration was 1.17x dollars, the site being entered on taxpayer's books at 1.67x dollars for the reason that its fair market value at date of transfer was considered 1.67x dollars, the .5x dollars reduction being made as vendor's contribution to the purchase fund.

The appellant company now contends that " the value of this property is not taxable income because, first, it is a gift; second, it is not consideration moving to the company and supporting any contract; third, it is entirely a capital transaction and not one of income."

The company also contends that—

> Even if it were income, it would not be income to the extent of 1.67x dollars, for the reason that the persons who furnished the site paid only about 1.17x dollars for it and there could not be an appreciation in value of .5x dollars in the very short period which elapsed between the time the site was purchased and the time it was turned over to the company.

It is the opinion of the Committee that the said transfer of land did not represent a free and voluntary gift or donation to the appellant company given without consideration moving from the company. A formal contract was entered into wherein the representative of the donors agreed to furnish to the appellant company a deed to a certain tract of land, and the said company agreed to " build a suitable plant for the manufacture and sale of its products, now located at the city of T." The agreement on the part of the appellant company to transfer its manufacturing operations to, and erect a new plant in, the city of S, constituted a valuable consideration sufficient to support the contract, under the terms of which it received the said tract of land. As the land was not secured by the appellant company

through an outlay of capital, it does not represent an investment of capital. It was acquired as a consideration for the performance of a certain act—that is, the transfer to and the location and operation of its plant in the city of S—and as such the Committee holds that the said land, to the extent of its fair market value at time of receipt, represents taxable income for the year in which received.

The field officer apparently based his conclusions, that the said tract of land was worth $1.67x$ dollars at the time of acquisition by the appellant company, on the fact that such land was set up on said company's books at that value, and he assumed and held that the difference between the amount actually paid for the land by the business interests which turned it over to the appellant company, or $1.17x$ dollars, and $1.67x$ dollars represented the vendor's contribution. The appellant company's representative, during an oral hearing, contended that such was not the case; that $1.17x$ dollars was the full price asked for the land and that the vendor made no concession in order to secure the location of the plant on said tract.

It appears that the said tract of land was owned and deeded over to the appellant company by the N Company, which company, it is understood, was a subsidiary of the O Company, operating as the latter company's land department, subject to certain conditions which permitted the P Company to elevate or depress the grade of certain streets adjacent to the said tract in the event that it became necessary or was deemed advisable so to do without becoming liable for the payment of any damages which might result to the said tract of land by reason of change of street grades. From such evidence as has been submitted it does not appear that the direct gain, if any, which might accrue to the O Company through the location of the appellant company's plant on the said tract was sufficient to warrant a contribution of $.5x$ dollars, inasmuch as the said tract was located on joint railroad switching tracks, over which five or six different railroad companies operated. All switching over these joint tracks is charged for at the same rate regardless of the railroad which delivers or receives the freight, and the O Company was, and is, in no better position to secure the handling of such freight than any of the other companies which make use of the joint trackage.

After giving careful consideration to all the facts presented, the Committee concludes that the price actually paid for the said tract of land, namely, $1.17x$ dollars, should be accepted as establishing the said tract's fair market value as of date of acquisition by the appellant company for gross income and invested capital purposes.

In view of the foregoing, the Committee recommends that the action of the Income Tax Unit in holding that the appellant company's reported net income for the year 1919 should be increased by an amount equivalent to the fair market value of the said tract of land at time of acquisition be sustained, but that a value of $1.17x$ dollars be placed upon the said land for tax purposes instead of $1.67x$ dollars, the value reported by the field officer and accepted by the Income Tax Unit.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 73: Gifts and bequests.

(See I. T. 1793; sec. 214(a)2, art. 121.) Interest paid on notes given by taxpayer to his wife in lieu of his securities used in his business.

ARTICLE 73: Gifts and bequests.

(See I. T. 1811; sec. 214(a)4, 5, 6, art. 141.) Payment by a trustee to cover defalcation of a cotrustee.

ARTICLE 73: Gifts and bequests. II–36–1233
(Also Section 214(a)4, 5, 6, Article 141.) I. T. 1863

REVENUE ACTS OF 1918 AND 1921.

The taxpayer created a valid trust in 1918, naming his son and son's wife beneficiaries. In 1920, the trustor paid a certain sum of money to the trust and on the same day the trust purchased from the trustor, through a brokerage house, certain securities for an amount equal to the cash contributed by the trustor to the trust.

The purported sale of the securities by the trustor at a loss was not a bona fide sale, but a gift of the securities, and accordingly the trustor sustained no deductible loss from the transaction.

In 1918 A created a trust, naming his son, B, and the M Trust Company as trustees and his son, B, his son's wife, C, and their lawful issue, as beneficiaries.

Certain designated property was conveyed to the trustees, who are given complete power of control, management, and disposal of this property, and of any other property which should later be given them by the grantor or which they might acquire. The trust agreement also provided that the trustees had the right to acquire, hold, manage, improve, control, invest, convert, reinvest, lease, sell, pledge, mortgage, transfer, assign, convey, exchange, or in any other additional manner to incumber or dispose of any or all of the trust estate for such consideration or considerations upon such terms and conditions and in such manner as the trustees should approve.

Article — of the instrument creating the trust provides that—

This trust agreement and settlement is absolute, and is irrevocable by the trustor, and the trustor shall hereafter possess no beneficial right or title in the trust hereby conveyed.

Certain securities owned by A were sold on December —, 1920, to the trust through brokers. This sale resulted in a loss, which is claimed as a deduction in the return of A. The facts further show that on the same date, December —, 1920, a donation or gift of $5x$ dollars was made by A to the trust estate, which amount was immediately disbursed in payment for the above-mentioned securities.

The questions presented are (1) whether A created a valid trust, (2) whether the sale of the securities to the trust estate was a bona fide sale or merely a colorable transaction to establish a loss.

It is held that a valid trust was created by the indenture of trust made and entered into in 1918 by A, B, and the M Trust Company.

Article — of the agreement provides that the income from this trust, after the carrying charges and expenses of the trust are paid, is to be used to pay all debts, obligations, and burdens assumed by the trustor, the trustees, the N corporation, and the O building enterprise, in connection with the completion of the O building; and "after (but as soon as) all of the debts, obligations and burdens * * * shall have been fully paid and satisfied, the trustees are authorized and directed to pay to C * * * the sum of * * * $2x$ dollars per annum * * * and to pay the rest of the net income * * * to B * * *."

In accordance with the provisions of these articles, the income of the trust was taxable to the trust until such time as the debts, obligations, and burdens were paid as directed. Subsequent to the payment of the debts, obligations, and burdens, the income is distributable to the named beneficiaries, as directed in the agreement, and is, therefore, taxable to them, whether or not it was paid to them.

It is further held that the sale of the securities on December —, 1920, by A through brokers to the trust did not constitute a bona fide sale. The alleged sale resolves itself into a gift of the securities to the trust by A. It is shown from the record that on December —, 1920, A gave to the trust $5x$ dollars and on the same day the trust paid $5x$ dollars to the brokers for the securities of A. The trust, therefore, received to the very last penny a gift from the trustor with which the trust bought securities from the trustor.

The payment of the trust of $5x$ dollars for the securities resulted in no diminution of the cash funds of the trust, for it merely expended for the securities what the trustor had given it on the very day of the purchase of the securities. A received in return from the trust, via the brokers, the exact amount of cash which he had given the trust, which resulted in no gift from dollars and cents viewpoint having been made to the trust, and resolved itself into A giving to the trust the securities alleged to have been sold to it on December —, 1920.

ARTICLE 73: Gifts and bequests. II–37–1251
(Also Section 213(a), Article 32.) (Ct. D. 34) T. D. 3535

INCOME TAXES—ACT OF 1913—DECISION OF SUPREME COURT.

INCOME TAX—BEQUESTS—EXECUTORS' COMMISSIONS.

Where a testator bequeaths specific sums to certain persons and in a subsequent paragraph of the will names such persons as executors and trustees, and provides that the bequests made are in lieu of all compensation or commissions to which they would otherwise be entitled as executors or trustees, the bequests are not compensation and taxable as income under Section II, A, subdivision 1, and B, Act of October 3, 1913 (38 Stat. L., 114, 166).

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

To collectors of internal revenue and others concerned:

The appended decision of the Supreme Court of the United States in the cases of *United States* v. *Frederick L. Merriam* and *United*

States v. *Henry B. Anderson* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved December 3, 1923.
A. W. MELLON,
Secretary of the Treasury.

—

United States, petitioner, v. *Frederick L. Merriam* and *United States, petitioner*, v. *Henry B. Anderson.*

Writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 12, 1923.]

Mr. Justice SUTHERLAND delivered the opinion of the court.

These are actions brought by the United States against the respective defendants, to recover the amount of additional income taxes assessed against them under the Act of October 3, 1913 (ch. 16, 38 Stat., 114, 166). The pertinent provisions of the statute are:

"A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum upon such income * * *.

"B. That subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent; * * *."

The taxes were assessed upon certain legacies bequeathed to the defendants by the will of the late Alfred G. Vanderbilt. The provisions of the will which give rise to the controversy are as follows:

"Eleventh. I give and bequeath to my brother, Reginald C. Vanderbilt, five hundred thousand dollars ($500,000); to my uncle, Frederick W. Vanderbilt, two hundred thousand dollars ($200,000); to Frederick M. Davies, five hundred thousand dollars ($500,000); to Henry B. Anderson, two hundred thousand dollars ($200,000); to Frederick L. Merriam, two hundred and fifty thousand dollars ($250,000); to Charles E. Crocker, ten thousand dollars ($10,000), and to Howard Lockwood, one thousand dollars ($1,000)."

* * * * * * *

"Sixteenth. I nominate and appoint my brother, Reginald C. Vanderbilt, my uncle, Frederick W. Vanderbilt, Henry B. Anderson, Frederick M. Davies, and Frederick L. Merriam executors of this my will and trustees of the several trusts created by this my will. * * * The bequests herein made to my said executors are in lieu of all compensation or commissions to which they would otherwise be entitled as executors or trustees."

The defendants qualified as executors and letters testamentary were duly issued to them prior to the commencement of these actions. The legacies were received by the respective defendants during the year 1915—$250,000 by Merriam and $200,000 by Anderson.

Demurrers to the complaints were overruled by the District Court and judgments rendered against defendants. Upon writs of error from the Court of Appeals these judgments were reversed. (282 Fed., 851.) The Government contends that these legacies are compensation for personal service within the meaning of paragraph B, quoted above.

The cases turn upon the meaning of the phrase which describes net income as "including the income from but not the value of property acquired by * * * bequest. * * *." The word "bequest" is commonly defined as a gift of personal property by will; but it is not necessarily confined to a gratuity. Thus, it was held in *Orton* v. *Orton* (3 Keyes (N. Y.), 486) that a bequest of personal property, though made in lieu of dower, was, nevertheless, a legacy, the court saying: "Every bequest of personal property is a legacy, including as well those made in lieu of dower and in satisfaction of an indebtedness as those which are wholly gratuities. The circumstance whether gratuitous or not does not enter into consideration in the definition. * * * And when it is said that a legacy is a gift of chattels, the word is not limited in its meaning to a gratuity, but has the more extended signification, the primary one given by Worcester in his dictionary, 'a thing given, either as a gratuity or as a recompense.'"

Without now attempting to formulate a precise definition of the meaning of the word as used in this statute, or deciding whether it includes an amount expressly left as compensation for service actually performed, it is enough for present purposes to say that it does include the bequest here under consideration, since, as we shall presently show, actual service as a condition of payment is not required. A bequest to a person as executor is considered as given upon the implied condition that the person named shall, in good faith, clothe himself with the character. (2 Williams on Executors (6 Am. Ed.), 1391; *Morris* v. *Kent*, 2 Edwards Chancery, 175, 179.) And this is so whether given to him simply in this capacity or for care and trouble in executing the office. (*Idem.*) And it is a sufficient performance of the condition if the executor proves the will or unequivocally manifests an intention to act. (*Lewis* v. *Mathews*, L. R., 8 Eq. Cas., 277, 281; *Kirkland* v. *Narramore*, 105 Mass., 31, 32; *Scofield* v. *St. John*, 65 How. Pr. (N. Y.), 292, 294–296; *Morris* v. *Kent*, *supra*; *Harrison* v. *Rowley*, 4 Vesey, 212, 215.)

In *Morris* v. *Kent*, *supra* (p. 179), it is said:

"A legacy to an executor even expressed to be for care and pains, is not to be regarded in the light of a debt or as founded in contract, or to be governed by the principles applicable to contracts. * * * When a legacy is given to a person in the character of executor, so as to attach this implied condition to it, the question generally has been upon the sufficient assumption of the character to entitle the party to the same. The cases establish the general rule that it will be a sufficient performance of the condition if the legatee prove the will with a bona fide intention to act under it or unequivocally manifest an intention to act in the executorship, as, for instance, by giving directions about the funeral of the testator, but is prevented by death from further performing the duties of his office."

Decisions are cited in the Government's brief which, it is said, establish a contrary rule. These decisions, however, we are of opinion, are clearly differentiated from the case under consideration. Some of them are with reference to testamentary provisions specifically fixing the amount of compensation for services to be rendered while others deal with the question whether the executor is entitled to receive statutory compensation in addition to the amount named in the will. In *Matter of Tilden* (44 Hun., 441), for example, the will directed that: "In lieu of all other commissions and compensation to my executors for performing their duties under this will * * * I authorize them to receive from my estate the following commissions, namely:" The court, construing this provision, said: "The provisions in the will were intended to be as compensation for services rendered, to be in no respect a gift, but an authority to charge for their services a certain sum."

Again, in *Richardson* v. *Richardson* (129 N. Y. Supp., 941), the will was interpreted as directing the payment of compensation. Especial stress was laid upon the fact that the will did not purport to "give" or "bequeath" to the executors the amounts fixed, and, adopting the language of the court in the *Tilden* case, it was said that the provisions of the will were intended as an "authority to 'charge for their services a certain sum.' The compensation provided by the will is not a legacy and does not abate with the legacies, but is compensation, carefully determined by the testator and directed to be paid for the services to be rendered, and is therefore to be paid in full."

It is obvious that in this class of cases the right depends upon the actual performance of the service and the amount fixed is in no sense a legacy but is purely compensative.

In *Renshaw* v. *Williams* (75 Md., 498) the court held that where a bequest had been made in lieu of commissions in a sum larger than the commissions would amount to, it must be treated as full compensation for the entire administration of the estate by the same person, though part of it passed through his hands as administrator *pendente lite* and part as executor.

In *Connolly* v. *Leonard* (114 Me., 29), a devise was made "in lieu of any payment for services as executor or trustee," with the provision that it was so to be accepted and understood. The court held that, in view of this language, the executor was not entitled to commissions in addition to the property devised.

The foregoing are illustrative of the cases relied upon, and, apart from some general language, which we are unable to accept as applicable to the present case, none of them, in principle, are in conflict with the conclusion we have reached. The distinction to be drawn is between compensation fixed by will for services to be rendered by the executor and a legacy to one upon the implied condition that he shall clothe himself with the character of executor. In the former case he must perform the service to earn the compensation. In the latter case he need do no more than in good faith comply with the condition in order to receive the bequest; and in that view the further provision that the bequest shall be in lieu of commissions is, in effect, nothing more than an expression of the testator's will that the executor shall not receive statutory allowances for the services he may render.

The word "bequest" having the judicially settled meaning which we have stated, we must presume it was used in that sense by Congress. (*Kepner* v. *United States*, 195 U. S., 100, 124; *The Abbotsford*, 98 U. S., 440, 444.)

On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. (*Gould* v. *Gould*, 245 U. S., 151, 153.) The rule is stated by Lord Cairns in *Partington* v. *Attorney General* (L. R. 4, H. L. 100, 122):

"I am not at all sure that in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, can not bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute." And see *Eidman* v. *Martinez* (184 U. S., 578, 583).

We are of opinion that these bequests are not taxable as income under the statute, and the judgment below is affirmed.

ARTICLE 74: Interest upon State obligations. II–36–1234
I. T. 1864

REVENUE ACT OF 1921.

Bonds issued under act No. 13 of the Public Acts of 1921 of the State of Michigan, as amended by act No. 34 of the Public Acts of 1923, are held to be bonds of the State of Michigan, or its duly constituted instrumentalities, and the interest on such bonds is, therefore, exempt from the income tax. (O. D. 983 (C. B. 5, p. 103) distinguished.)

The question is raised as to whether certain bonds issued under act No. 13 of the Public Acts of 1921 of the State of Michigan, as amended by act No. 34 of the Public Acts of 1923, are the bonds of the State of Michigan or one of its instrumentalities and the interest thereon exempt from the Federal income tax.

It is understood that it has been decided to execute and sell bonds and that a contract for their sale has been entered into; that the bonds will be secured by a bond mortgage upon certain land upon which the Michigan State fair is now and has been for some years past conducted; that the proceeds of the sale of the bonds are to be used for the construction of improvements upon the lands mortgaged; and that the State of Michigan holds title to the land in fee simple.

It is held that the bonds in question are the obligations of the State of Michigan or its duly constituted instrumentalities, namely, the State department of agriculture and the board of managers of State fairs. That the State department of agriculture is an instrumentality, if not an integral part, of the State government can not be questioned. Its functions are of a recognized public nature; it is supported by appropriations from the public treasury; and its head, the commissioner, is appointed by the governor with the advice and consent of the State senate. That the board of managers of State fairs is also such an instrumentality is equally clear. Its functions are of a public nature, and its members are appointed by the governor. It is apparently self-supporting, but its funds are the property of the State, as is evidenced by the provision in section 4 of the amended act, that any surplus of its funds shall be transferred to the general fund of the State. The obligor in the bonds, if not the State of Michigan itself, is either the State department of agriculture or the board of managers of State fairs or both. The bonds, by their terms, are "payable out of the funds and property in the possession and control of the State department of agriculture and of the board of managers of State fairs for the purpose of conducting the Michigan State Fair," and these funds are the State's property. They are secured by mortgage upon State property, and their proceeds are to be used for a public purpose, namely, the improvement of State property.

The interest upon the above-mentioned bonds is, therefore, not subject to Federal taxes.

This ruling does not conflict with Office Decision 983, published in Cumulative Bulletin 5, page 102. The latter ruling applies to bonds issued under a different act of the Michigan Legislature.

ARTICLE 75: Dividends and interest from Federal land banks, Federal intermediate credit banks, and national farm loan associations. II–24–1094 T. D. 3515

INCOME TAX.

Gross income defined: Exclusions—Article 75, Regulations 62, amended.

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

To collectors of internal revenue and others concerned:

The Federal Farm Loan Act was amended by an Act (ch. 252, 42 Stat., 1454) approved March 4, 1923, authorizing the creation of Federal intermediate credit banks, and prescribing the manner in

which such banks should be conducted. Section 210, Title II, of the Act, as amended, makes applicable to intermediate credit banks the privilege of tax exemption accorded under section 26 of the Act to Federal land banks and national farm loan associations.

Accordingly, article 75 of Regulations 62 is amended to read as follows:

ART. 75. *Dividends and interest from Federal land banks, Federal intermediate credit banks, and national farm loan associations.*—As section 26 of the Federal Farm Loan Act of July 17, 1916 (ch. 245, 39 Stat., 360), as amended by an Act approved March 4, 1923 (ch. 252, 42 Stat., 1454), provides that Federal land banks, Federal intermediate credit 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, and that first mortgages executed to Federal land banks, Federal intermediate credit banks, or to joint-stock land banks, and farm loan bonds, and debentures issued by intermediate credit banks, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of Federal land banks, Federal intermediate credit banks, and national farm loan associations and from interest on promissory notes secured by such first mortgages, or from such farm loan bonds or debentures, is not subject to the income tax. See also section 231(13) of the statute.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved September 11, 1923.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 75: Dividends and interest from Federal land bank and national farm loan association. II–29–1145 I. T. 1806

REVENUE ACT OF 1921.

The interest paid by a joint-stock land bank on its promissory notes is subject to income tax.

The net income of joint-stock land banks is subject to Federal income tax. If such a bank borrows money from other banks and gives its interest-bearing notes for the same, the interest paid by the joint-stock land bank to the holders of the notes is subject to Federal income tax to the same extent as interest derived from other promissory notes, as promissory notes of joint-stock land banks do not enjoy a tax-exempt status with reference to interest paid upon the loans they cover.

ARTICLE 77: Interest upon United States obligations. II–19–1040 I. T. 1748

REVENUE ACT OF 1921.

Interest received from the United States on a refund of Federal estate taxes is not interest upon an obligation of the United States, within the meaning of section 213(b)4.

Advice is requested whether the interest received by the estate of A, deceased, during the year 1923, on a refund of Federal estate taxes, may be excluded from gross income in the return to be ren-

dered for the estate for 1923 on the ground that it is received as interest upon obligations of the United States.

Section 213(b)4 provides that gross income as contemplated in the Revenue Act of 1921 shall not include:

> Interest upon (*a*) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (*b*) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (*c*) the obligations of the United States or its possessions; or (*d*) bonds issued by the War Finance Corporation.

And further provides:

> In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war-profits, and excess-profits taxes.

Section 1324 of the Revenue Act of 1921 provides:

> That upon the allowance of a claim for the refund of or credit for internal revenue taxes paid, interest shall be allowed and paid upon the total amount of such refund or credit at the rate of one-half of 1 per centum per month to the date of such allowance * * *.

Particular attention is directed to that portion of the law quoted above which provides that the interest (that is, interest on United States obligations) shall be exempt only if so provided in the Act authorizing their issue. Aside from the fact that the law, in authorizing the payment of interest on refunds and judgments, does not exempt such interest from taxation, and aside from it being the apparent purpose of the law to exempt only such obligations in which it was desirable to have the public invest, the exemption from tax being an inducement thereto, it would appear from the description, which appears in section 213 of the Act, of the class of United States obligations on which interest is exempt from taxation, that interest on a refund of taxes is not contemplated as falling within such exemption.

It is held, therefore, that the interest received by the estate of A, deceased, during the year 1923, on a refund of Federal estate taxes, is not exempt from taxation, and must be included by the executor in the gross income of the estate.

ARTICLE 88: Compensation of State officers and employees. II–35–1217 Sol. Op. 152

INCOME TAX: SECTION 213, REVENUE ACT OF 1921.

> The compensation of officers and employees of a street railway owned and operated by a municipality is taxable income under the Revenue Act of 1921.

The attached file relative to the income tax liability of salaries and wages paid officers and employees of the M Street Railways, which have been acquired and are now operated by the board of street railway commissioners of the city of S, has been submitted to this office for an opinion on the law involved. The specific question presented

is whether such compensation is taxable income under the Revenue Act of 1921.

Pursuant to authority granted by section — of article — of the constitution of the State of T, and particularly by section — of the State statutes (as amended by Pub. Acts 19—, No. —; Pub. Acts 191—, No. —), a city charter was adopted by the people of the city of S in 19—. This charter provided in chapter — of title — that the city should proceed to acquire or construct a street railway system as soon as practicable, to be operated by a board of street railway commissioners. Under this authority, the city of S now owns and operates a system of street railways in the city.

In the briefs filed by the corporation counsel of the city of S, it is argued that the operation of the street railway system is a governmental function, and is so regarded by the State and city; that, in any case, even regarded as a purely proprietary function, it is a necessary element in the city's existence. In either event, it is urged that the compensation of the street railway officers and employees is exempt, evidently upon the theory that the Federal Government has not the power to lay an income tax upon it.

The sixteenth amendment to the Constitution of the United States provides:

> The Congress shall have power to lay and collect taxes on incomes, *from whatever source derived*, without apportionment among the several States, and without regard to any census or enumeration. [Italics ours.]

During the period in which the proposed amendment was being ratified by the legislatures of the various States it was urged by various writers that the amendment gave Congress the power to tax salaries of officers and employees of the States. (See Foster, *Income Tax*, p. 78 *et seq.;* Minor—The Proposed Income Tax Amendment, 15 Va. L. Reg., 737, 753; Hubbard, The Sixteenth Amendment, 33 Harvard L. R., 794; *contra*, Ritchie—Power of Congress to Tax State Securities, 5 A. B. A. Journal, 602.) The basic argument in support of this conclusion is that the amendment in terms gives Congress the power to tax incomes, irrespective of their source (see opinion of Justice Holmes in *Evans* v. *Gore* (1920), 253 U. S., 245, 267 [C. B. 3, p. 93]); and, therefore, that salaries of State officials need be given no different treatment than any other salaries. Whatever may be the theoretical merit of this construction, the Attorney General has ruled, in 31 Op. Atty. Gen., 441, that such salaries are not subject to the Federal income tax, even in the absence of a specific exemption in the revenue Acts. This opinion has been followed in article 88 of Regulations 62:

> Compensation paid its officers and employees by a State or political subdivision thereof * * * is not taxable.

This exemption is, however, based upon constitutional reasons, irrespective of the statute; that is, it is based upon the necessary implication from judicial decisions construing the Constitution prior to the sixteenth amendment rather than upon any express exemption provisions. Accordingly, it is necessary to examine these decisions, to determine the scope of the exemption directed by the decisions and followed by the regulations.

In *Collector* v. *Day* (1870) (11 Wall., 113), the leading case upon the question, relied upon by the Attorney General, the question was

whether, under the Civil War income tax statutes, the salary of a State judge was taxable under the general provisions of the Acts. In holding that the salary was not taxable, the court said (pp. 125, 127):

> It is admitted that there is no express provision in the Constitution that prohibits the General Government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that Government. In both cases the exemption rests upon necessary implication and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government.
> * * * the means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired, should not be liable to be crippled, much less defeated by the taxing power of another government. * * *

It will be observed that the court grants this exemption by implication to the "means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution." Granted, then, that the sixteenth amendment did not remove this exemption, what are these "means and instrumentalities"? Are *all* enterprises in which a State or municipality may choose to engage *ipso facto* removed from the sphere of Federal taxation? The corporation counsel of the city of S so argues.

The Supreme Court has followed a consistent policy in the series of cases involving this question, which will be indicated by extracts from some of the decisions. In *Bank of U. S.* v. *Planters' Bank of Georgia* (1324) (9 Wheat., 904) Chief Justice Marshall said (p. 907):

> It is, we think, a sound principle, that when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted.

This distinction between the so-called proprietary functions of a municipality or State and its governmental functions has been further brought out in a series of cases involving Federal taxation. In *Salt Lake City* v. *Hollister* (1885) (118 U. S., 256) action was brought by the city to recover taxes paid the Federal collector of internal revenue on spirits distilled by the city. It was *held* that a municipal corporation engaged in the business of distilling spirits was subject to internal revenue taxation under the laws of the United States. In the leading case upon the subject, *South Carolina* v. *U. S.* (1905) (199 U. S., 437), Justice Brewer brings out clearly the distinction noted in the earlier cases, between proprietary and governmental functions of a State. The facts were these: The State of South Carolina established dispensaries for the wholesale and retail sale of liquor, and prohibited sales by others. The United States demanded license taxes from the dealers, which the State paid. The dispensers had no interest in the sales and received no profits thereon. Later the State protested against the payment of the Federal license taxes, and sued to recover amounts already paid. In upholding the power of the United States to levy the license tax, Justice Brewer,

after citing *Collector* v. *Day*, *supra*, and *McCulloch* v. *Maryland* (1819) (4 Wheaton, 316), said (pp. 456, 457, 459):

There is something of a conflict between the full power of the Nation with respect to taxation and the exemption of the State from Federal taxation in respect to its property and a discharge of all its functions. * * * The exemption of the State's property and its functions from Federal taxation is implied from the dual character of our Federal system and the necessity of preserving the State in all its efficiency. In order to determine to what extent that implication will go, we must turn to the condition of things at the time the Constitution was framed. * * * Looking, therefore, at the Constitution in the light of the conditions surrounding at the time of its adoption it is obvious that the framers in granting full power over license taxes to the National Government meant that that power should be complete, and never thought that the States by extending their functions could practically destroy it.

* * * * * * *

It is also worthy of remark that the cases in which the invalidity of a Federal tax has been affirmed were those in which the tax was attempted to be levied upon property belonging to the State, or one of its municipalities, or was a charge upon the means and instrumentalities employed by the State, in the discharge of its ordinary functions as a government.

The court then cites *Veazie Bank* v. *Penno.* (8 Wall., 533), *Collector* v. *Day* (11 Wall., 113), *U. S.* v. *R. R. Co.* (17 Wall., 322), to the same effect, and continues (p. 461):

In *Ambrosini* v. *United States* (187 U. S., 1), in which the Federal war revenue tax act, providing for stamp taxes on bonds, was held inapplicable to bonds required from licenses under the dram shop act of Illinois, the court declared:

"The question is whether the bonds were taken in the exercise of a function strictly belonging to the State and city in their ordinary governmental capacity, and we are of the opinion that they were, and that they were exempted as no more taxable than the licenses."

These decisions, while not controlling the question before us, indicate that the thought has been that the exemption of State agencies and instrumentalities from national taxation is limited to those which are of a strictly governmental character, and does not extend to those which are used by the State in the carrying on of *an ordinary private business.* [Italics ours.]

The court then refers to the distinction in the law of torts between suits against a city for acts done in its public capacity and for acts in its private character and goes on (p. 463):

* * * It is reasonable to hold that while the former may do nothing by taxation in any form to prevent the full discharge by the latter of its governmental functions, yet whenever a State engages in a business which is of a private nature that business is not withdrawn from the taxing power of the Nation.

The application of this decision to the present case is obvious. The city of S is here engaged in an enterprise which is not essentially governmental in its nature, but which is normally an ordinary private business. The operation of this ordinarily private business by the city does not remove the compensation paid its officers or employees from the Federal taxing power, since the implied restriction upon that power relates only to the essential governmental activities of the State or city.

The same distinction has been followed in two recent cases, *Flint* v. *Stone-Tracy Co.* (1911) (220 U. S., 107) and *Vilas* v. *Manila* (220 U. S., 345). In the former the court quoted *South Carolina* v. *United States* with approval, and added (p. 157):

The cases unite in exempting from Federal taxation the means and instrumentalities employed in carrying on the governmental operations of the State.

The exercise of such rights as the establishment of a judiciary, the employment of officers to administer and execute the laws, and similar governmental functions can not be taxed by the Federal Government. (*Collector* v. *Day*, 11 Wall., 113; *U. S.* v. *Railroad*, 17 Wall., 322; *Ambrosini* v. *U. S.*, 187 U. S., 1.)

But this limitation has never been extended to the exclusion of the activities of a merely private business from the Federal taxing power, although the power to exercise them is derived from an act of incorporation by one of the States.

In *Vilas* v. *Manila*, the court said (p. 356):

We are unable to agree with the argument. It loses sight of the dual character of municipal corporations. They exercise powers which are governmental and powers which are of a private or business character. In the one character a municipal corporation is a governmental subdivision, and for that purpose exercises by delegation a part of the sovereignty of the State. In the other character it is a mere legal entity or juristic person. In the latter character it stands for the community in the administration of local affairs wholly beyond the sphere of the public purposes for which its governmental powers are conferred.

The distinction is observed in *South Carolina* v. *U. S.* (199 U. S., 437, 461), where *Lloyd* v. *Mayor of N. Y.* (5 N. Y., 369, 374) and *Western Savings Soc.* v. *Phila.* (31 Pa. St., 175) are cited and approved. In *Lloyd* v. *Mayor of N. Y.*, *supra*, it is said:

"The corporation of the city of New York possesses two kinds of power, one governmental and public and, to the extent they are held and exercised, is clothed with sovereignty, the other private, and to the extent they are held and exercised, is a legal individual. The former are given and used for public purposes, the latter for private purposes. While in the exercise of the former the corporation is a municipal government, and while in the exercise of the latter, is a corporate legal individual."

Reference should also be made to the same distinction in the law of torts, referred to by Justice Brewer in *South Carolina* v. *U. S.*, *supra*, which is the basis of the decisions in the following illustrative cases: *Lynch* v. *City of Springfield* (1899) (174 Mass., 430, 54 N. E., 871); *Bullmaster* v. *City* (1897) (70 Mo. App., 60); *City* v. *Babbitt* (1894) (8 Tex. Civ. App., 432, 28 S. W., 702); *City* v. *Kelly* (1882) (38 Ohio St., 50); *Western Saving Fund Society* v. *City* (1858) (31 Pa. St., 175); *City* v. *Corey* (1861) (9 Mich., 165). See also *Mayor* v. *Birmingham Water Wks. Co.* (1903) (139 Ala., 531, 36 So., 614); *State* v. *Barker* (1902) (116 Iowa, 96, 89 N. W., 204).

With the background of these decisions, it must be regarded as established that there is a consistently recognized distinction between the strictly governmental functions of a city on the one hand and its proprietary or private activities on the other; moreover, that the implied exemption from Federal taxation applies only to the former and does not apply to the latter. Although it may well be that the operation of a street railway in the city of S is a necessity, it could scarcely be contended that it is an instrumentality of the city in the discharge of its ordinary functions as a government, within the limitations of the decisions *supra*. If it is not a means or instrumentality of government, it is not, according to these decisions, removed from the sphere of Federal taxation. This fact is impliedly recognized in the State of T statute (Pub. Acts 191–, No. —), which conferred authority upon the city to insert in its charter provisions for the acquisition of a street railway. It provides in part:

When a transportation utility is so acquired State and county taxes shall be paid thereon as if privately owned, also local taxes on any portion of such property lying outside of the city limits.

As was said in *Boston Elevated Ry. Co.* v. *Malley* (1923) (268 Fed., 864; T. D. 3479, C. B. II–1, p. 251) with reference to a similar provision (p. 869):

> While Federal taxation is not specially mentioned, the fact that the legislature expressly stated that the company should continue to be subject to taxation is strong indication that the legislature intended that the company should be subject to all the obligations to which it was subject before it was placed under the control of trustees appointed by the Commonwealth.

The decisions of the Supreme Court of the United States require the conclusion that the operation of a street railway by the city of S is not a governmental function of the city; that it does not, therefore, fall within any implied exemption from Federal taxation; that, since there is no express exemption of the salaries and wages of officers or employees of such railway either in the sixteenth amendment or in the Revenue Act of 1921, such salaries or wages are taxable income within such Act.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

ARTICLE 89: Additional exclusions from gross income under the Revenue Act of 1921. II–19–1041 I. T. 1749

REVENUE ACT OF 1921.

Persia satisfies the equivalent exemption requirement of section 213(b)8 of the Revenue Act of 1921.

Persia satisfies the equivalent exemption requirement of section 213(b)8 of the Revenue Act of 1921. Consequently, the income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of Persia is exempt from Federal income taxation.

SECTION 214(a)1.—DEDUCTIONS ALLOWED: BUSINESS EXPENSES.

ARTICLE 101: Business expenses. II–13–960 I. T. 1706

REVENUE ACT OF 1921.

A naval officer was under orders to inspect, supervise, and superintend recruiting activities at several stations. Money spent personally by him in pursuance of these orders, including money spent for traveling expenses for which he could not claim reimbursement from the Government, may be deducted as a business expense.

ARTICLE 101: Business expenses. II–14–969 A. R. R. 2688

REVENUE ACT OF 1918.

Where a taxpayer acquired a new factory building and was compelled to make extensive alterations to render the building adaptable to the taxpayer's business, such as changing of heating plant, plumbing system, floors, etc., it is held that, although the actual

market or assessed valuation of the property in question may not have increased in proportion to the amounts expended for alterations, there existed in such expenditures the element of cost or initial investment and that they accordingly represent capital outlay. Their cost is an unusual and extraordinary expense rather than an "ordinary and necessary" expense.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing 14.47x dollars of an item of 16.09x dollars claimed as a deduction in the appellant's return for 1919.

Upon examination of the record it is found that the appellant engaged in the manufacture and sale of a certain device; that in 1919 it became necessary to acquire a new factory building to meet the increased demands of the business; that in 1919 a building for such purpose was purchased; that such building was fully equipped for business of a different character and had previously been operated as such; that in adapting such building to the appellant's manufacturing business large expenditures were made; that the appellant considered such expenditures, 16.09x dollars, as ordinary and necessary expenses of business deductible from gross income in computing taxable net income for 1919; and that the Income Tax Unit disallowed 14.47x dollars of these expenditures upon the ground that the amount so disallowed constituted capital outlay and not a deductible expense.

The purposes for which the expenditures were made are set forth in appellant's memorandum on appeal filed with the Committee at the time of the hearing. In that memorandum it is stated:

(1) The heating units for the department store purposes had been necessarily located in and near the central or interior positions of the various floors in the building. It became necessary to relocate the heating units along the exterior portions of the several floors, so that the interior floor space would be clear and available for factory purposes.

(2) For similar reasons alterations had to be made in the plumbing. Some additions were made to the plumbing system which were required by the factory laws.

(3) For similar reasons the lighting units had to be redistributed.

(4) The power equipment for the elevators and other purposes was all — — equipment and arranged for high-speed service. All alterations had to be made to secure slow-speed elevators for factory service.

(5) The basement floor was a double, hard-wood floor, laid on a cinder base, and was so elastic that it was not suitable for the placing of heavy machinery. This entire floor had to be removed and the cinders removed, and a concrete floor was substituted therefor.

(6) All the special merchandising equipment that could not be used for factory purposes had to be removed. This included removing all the show window partitions and equipment, and various partitions throughout the building, permanent counters, etc., the pneumatic cash and parcel delivery system, etc.

(7) The expense of moving, including tearing down and removing the factory equipment from its former location, transporting it to this property and relocating it here, is included.

The Committee has given thorough consideration to the facts above stated, and particular attention to the appellant's argument that no portion of the amount so expended tended to increase property value for any purpose and, accordingly, such expenditures should properly be treated as an expense. In support of this contention the taxpayer has submitted evidence showing that no increase in the assessed valuation for purposes of local taxes was created by reason of said

expenditures, and that in the rendition of financial statements as a basis for extension of credits or as information to stockholders it would not be proper to include in the valuation set up for such property the amount so expended.

The Committee concludes, while conceding that the actual market or assessed valuation of the property in question may not have increased in proportion to the amounts expended for alterations, that nevertheless there existed in such expenditures the element of cost or initial investment in the building which was acquired, and that the sum of $14.47x$ dollars represented an unusual and extraordinary expense rather than "ordinary and necessary expense" within the meaning of section 234(a)1, Revenue Act of 1918. It appears to the Committee that the benefits to be derived from such expenditures can not properly be allocated in any one taxable year and that such expenditures are more in the nature of a deferred charge against operations for succeeding years. The period of time to which the benefits to be derived from such expenditures is limited can not be estimated with any reasonable degree of accuracy, and it is the Committee's opinion, therefore, that the only logical treatment to be accorded such outlay of money is to add same to the initial purchase price of the property and distribute that cost and the additional cost represented by the expenditures involved over the estimated physical life of the building.

It is, therefore, recommended that the action of the Income Tax Unit be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 101: Business expenses.

(See A. R. R. 3131; sec. 203, art. 1581.) Amounts expended for Christmas presents for buyers of trade customers.

ARTICLE 101: Business expenses.

(See I. T. 1779; sec. 214(a)3, art. 131.) Colorado gasoline tax added to cost of fuel by distributors.

ARTICLE 101: Business expenses. II-27-1125
I. T. 1797

REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

The amounts paid periodically to a trustee by a company to be used for the purpose of compensating injured employees, the amounts so paid being the same as the premiums insurance companies previously charged for carrying the liability insurance, do not constitute allowable deductions. Only claims adjudicated or paid are deductible.

Advice is requested as to whether the amounts paid periodically to a trustee by the M Company and the O Company, for the purpose of compensating injured employees of such companies, were properly claimed as deductions for the years 1916 to 1922, inclusive.

It appears that prior to 1916 the M Company carried liability insurance. During 1916 and subsequent years it has been paying periodically to a trustee the exact amount of premiums which previously had been charged by the insurance companies for carrying the liability insurance and arranged with the trustee to accumulate such payments in a separate bank account, such funds to be used for compensating injured employees of the company. The trustee, since January 1, 1916, has paid out of such fund all claims arising from injuries sustained by the company's employees. The O Company from January 1, 1917, to the present time has followed the same plan with respect to providing a fund for meeting its liabilities to its injured employees.

It is stated that the hazard of the coal mining business is such that losses equal to the amount of the accumulated funds in the hands of the trustees are likely to occur at any time, although the exact amount of such losses can not be definitely determined in advance of the occurrence of the accidents from which the injury claims arise. The amounts paid to the trustees have been considered as being in the nature of additions to a reserve for losses, arising from injury to employees, which, according to past experience are certain to occur. Both companies have consistently deducted the amounts paid to the trustees during each of the taxable years referred to. It is contended that good accounting practice requires that a coal mining company which does not carry liability insurance should in some way set up a reserve to meet losses arising from actual injuries sustained by its employees; that additions to such a reserve should be made periodically; and that the premiums which would have to be paid to an insurance company for carrying such liability, although possibly in excess of the actual losses which may be sustained, fairly represent the sum which should be periodically set aside for the payment of injury claims. It is pointed out that reasonable additions to a reserve for depreciation have been recognized as allowable deductions for the years involved, and that under the Revenue Act of 1921, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts is deductible. It is claimed that the treatment accorded the amounts paid by the coal companies to the trustees is consistent with the accounting practice recognized for the deduction of additions to reserves for depreciation and bad debts, and also is in accord with the rule stated in Treasury Decision 2433 (not published in Bulletin service).

Treasury Decision 2433, promulgated on January 8, 1917, in construing subparagraph (d) of section 13, Title I, of the Act of September 8, 1916, provides in part as follows:

> In cases wherein, pursuant to the consistent practice of accounting of the corporation, or pursuant to the requirements of some Federal, State, or municipal supervising authority, corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which is not definitely determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; * * *.

The reserves contemplated by the foregoing ruling are those reserves only which are set up to meet some actual liability incurred, the amount necessary to discharge which can not at the time be definitely determined, and do not contemplate reserves to meet losses contingent upon shrinkage in value, losses from bad debts, capital investments, etc., which losses are deductible only when definitely determined as the result of a closed or completed transaction and are charged off.

It will be seen that the ruling above quoted specifically limits the deduction of amounts credited to such reserves as are set up to meet some actual liability incurred. Under the Revenue Acts of 1917 and 1918, and the regulations promulgated thereunder, the only reserves, additions to which are deductible, are reserves for depreciation and depletion. Under the Revenue Act of 1921, and Regulations 62, reasonable additions to a reserve for bad debts, in the discretion of the Commissioner, as well as additions to reserves for depreciation and depletion are deductible.

Article 111, Regulations 45 (1920 edition), reads in part as follows:

> Any amount paid pursuant to a judgment or otherwise on account of damages for personal injuries, patent infringement or otherwise, is deductible from gross income when the claim is put in judgment or paid, less any amount of such damages as may have been compensated for by insurance or otherwise.

Article 111 of Regulations 62, relative to the same subject, provides in part as follows:

> Judgments or other binding adjudication, such as decisions of referees and boards of review under workmen's compensation laws. on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, * * *.

After careful consideration of the facts presented, it is the opinion of this office that the liability of the coal companies arising from the injury of their employees can not be determined with the degree of accuracy required to constitute an accrued liability prior to the occurrence of the accident or accidents from which the injury claims arise. The liability arising from the accidental injury of employees prior to the time the amount of the claim is determined is not deemed to be capable of determination in approximate amount as in the case of liability arising from bad debts, or in the case of depreciation or depletion. The premiums charged by insurance companies for liability insurance, which it is stated is represented by the amounts paid to the trustees by the coal companies, do not appear to be even an approximate measure of the companies' liability. This conclusion is supported by figures submitted, which show, in the case of the M Company, that a total of $48x$ dollars was paid to the trustee during the years 1916 to 1922, inclusive, and that only $19x$ dollars was expended by the trustee during such years in satisfaction of injury claims. The O Company, during the years 1917 to 1922, inclusive, paid the sum of $21x$ dollars to the trustee, and during the same period $10x$ dollars was paid out by the trustee.

In view of the foregoing, it is held that the amounts paid to the trustees in the manner and for the purpose stated, during the years 1916 to 1922, inclusive, and claimed as a deduction by the M Company and the O Company, do not constitute allowable deductions in computing the net income of such companies for the years referred to.

The injury claims actually paid or constituting a definite known liability and set up on the corporations' books as such at the close of each of the taxable years in question constitute allowable deductions.

ARTICLE 101: Business expenses. II-28-1138
A. R. R. 3367

REVENUE ACT OF 1918.

Alterations in a bank, ordered by the Comptroller of the Currency, tended to enlarge and improve the banking quarters and increase the bank's facilities for the transaction of its principal business, which quarters and facilities, prior to the making of the alterations, were, in the opinion of the comptroller, inadequate. The expenditures incurred may not be considered an ordinary and necessary expense in carrying on the bank's business even though the alterations made did not increase the sale value of the bank property.

The M Company has appealed from the action of the Income Tax Unit in disallowing a deduction of x dollars claimed for the year 1918 to cover the cost of certain alterations or improvements to its banking quarters.

The records show that in 1918, under a direct order from the Comptroller of the Currency, the appellant company increased its banking quarters by cutting out the center portion of the second floor of its bank building and converting the remainder of that floor into a balcony overlooking its main banking room, which balcony was thereafter used as desk space for certain of its employees. It is claimed that at the time this change was made the officers were contemplating the wrecking of the entire building to make way for a more modern bank building; that they directed that the alteration be made only because they were obliged to do so by the Comptroller of the Currency; that such alteration added nothing to the value of the building and reduced the bank's income because of the fact that previous to the change the said second floor had been used for rental purposes. Due to war conditions, increased cost of construction and the financial condition of the bank after the close of the war, the contemplated destruction of the old building and the erection of a new one has never been carried out, although at the present time steps are being taken to carry out the said plan during the year 1923.

Section 234(a) of the Revenue Act of 1918 provides that in computing the net income of a corporation subject to the tax imposed by section 230 of the said statute there shall be allowed as deductions, among other things, "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."

It is apparent that the said expenditure of x dollars here being considered was not an ordinary and necessary expense incurred in carrying on the bank's business and chargeable as a whole against the income of the bank for the year 1918. Admitting for sake of argument that the alteration made did not increase the sale value of the bank property, yet such alteration did tend to enlarge and improve the banking quarters and increase the bank's facilities for the transaction of its principal business, which quarters and facilities, prior to the making of the said alteration, were in the opinion of the Comptroller of the Currency inadequate.

In the opinion of the Committee, the said alteration constituted a permanent improvement to the banking quarters and, as was held in *Kemper Military School* v. *Crutchley* (274 Fed., 125):

In computing net income no deductions shall be allowed on account of expenditures * * * for permanent improvements or betterments.

In view of the foregoing, the Committee recommends that the action of the Income Tax Unit in disallowing the claimed deduction of x dollars for the year 1918 be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 101: Business expenses. II–34–1205
I. T. 1844

REVENUE ACT OF 1921.

A taxpayer was employed in a business where the greater part of his income was dependent upon the amount of business secured, and he therefore joined a certain athletic club for the purpose of meeting its members in order to obtain business from them. The dues are not deductible.

A taxpayer was employed in a business where the greater part of his income was dependent upon the amount of business secured, and he therefore joined a certain athletic club for the purpose of meeting its members in order to obtain business from them. The question is presented as to whether the dues paid to the club represent ordinary and necessary expenses of the taxpayer within the meaning of section 214(a)1 of the Revenue Act of 1921.

Ordinary and necessary expenses contemplated by paragraph 1 of sections 214 and 234 of the Revenue Act of 1921 were not intended to include all necessary expenses, because the two immediately succeeding paragraphs provide for deducting interest and taxes, both of which are necessary expenses; also the provisions in regard to allowance for salaries, compensation, rentals, etc., indicate that all of the expenses which are contemplated under the terms used in paragraph 1 of these sections are expenses incurred directly in the maintenance and operation of the business, and not those which may be beneficial, and even necessary, in the broader sense.

It is held that the dues paid to the athletic club are not an ordinary and necessary expense within the meaning of the sections of the Act above mentioned and that they are, therefore, not allowable deductions in arriving at the net income subject to income tax.

ARTICLE 109: Rentals. II–14–970
I. T. 1711

REVENUE ACT OF 1921.

The aliquot part of the cost of a lease for business purposes, deductible by the lessee, should be based on the term of the lease without regard to renewal.

A taxpayer in 1922 paid x dollars for a 99-year lease, renewable forever. Inquiry is made as to the amount he may deduct each year under article 109, Regulations 62.

Held, assuming that the leasehold was acquired for business purposes, the cost of the lease should be spread over the stipulated life thereof, regardless of the fact that the lease provides for renewal privileges. It follows that $\frac{1}{99}$ of the amount paid for the lease constitutes an allowable deduction from gross income of each year during which the lease runs.

ARTICLE 109: Rentals. II–27–1126
(Also Section 214(a)8, Article 162.) I. T. 1798

REVENUE ACTS OF 1917 AND 1918.

The instrument under which the State of X grants to an individual the right to plant oysters is held to be a lease and not a franchise. Such a lease held on March 1, 1913, may not be made the subject of a depreciation allowance based on the fair market value as of that date. The taxpayer may, however, recover over the term of the lease any cost which he may have been put to in securing the same.

Inquiry is made relative to the allowance of depreciation of certain rights to plant oysters granted by the State of X. The instruments securing these rights to the taxpayer are designated as leases but are by him claimed to be in effect "franchises."

Article 163 of Regulations 45 and 62 provides as follows:

Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner.

Treasury Decision 3414, promulgated by the Secretary on November 25, 1922 [C. B. I–2, p. 90], reads as follows:

A lessee is not entitled under the Revenue Acts of 1916, 1917, 1918, or 1921 to an allowance for depreciation based on the value of his lease as of March 1, 1913, if acquired prior thereto, but where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run.

If the rights acquired from the State of X are in effect franchises, such franchises may be the subject of a depreciation allowance under article 163, supra. If, however, what the taxpayer has received from the State amounts to a leasehold interest, then, under the above-quoted Treasury decision, depreciation can not be allowed on the March 1, 1913, value of such leasehold rights.

Copies of the instruments under which the rights of the taxpayer are secured from the State have been submitted for the consideration of this office. The instrument states that the "said State doth hereby lease, demise and let unto the said —— a certain piece of land in —— lying and being and covered with tide water, containing about —— acres." The instrument further provides:

TO HAVE AND TO HOLD to —— the said —— executors, administrators and assigns, to their use as a private or several oyster fishery, for the planting

and producing of oysters, for and during the term of —— years from the day of the date hereof, on the terms and conditions (among others) that the said lessee, —— executors or administrators, shall pay therefor to the —— of said State, during the said term, the yearly rent per acre, of —— dollars in manner hereinafter provided. And the said State doth hereby covenant with the said lessee, —— executors, administrators and assigns, that they may and shall occupy the premises hereby leased during the term aforesaid peaceably and quietly, and free from all lawful claim and demand of all persons whomsoever, other than as hereinbefore or hereinafter set forth; the said lessee for —— executors, administrators and assigns (with a reservation of his rights to claim remission or abatement, as by law provided), doth covenant with said State, that —— will pay to the ——, for the use of said State, the sum of —— dollars on the 1st day of January in each year during the term aforesaid.

FURTHERMORE: This lease is made and accepted—subject to the provisions of existing laws relating to oyster fisheries, and to a reserved right of the State to amend said laws as it shall deem expedient (reference to the same being here made); and also *subject to* the further conditions following, to wit: * * * *Fifth*—That in event he shall refuse or neglect to comply with or conform to these conditions, or any or either of them, the said —— may, on the part of said State, reenter upon said leased premises and terminate the lease, and declare the same forfeited, and dispose of the lessee's interest in the said land, together with all the oysters thereon, at public auction to the highest bidder, upon giving one week's notice of such sale in some newspaper printed in the city of ——; and the lessee, executors, administrators or assigns, shall be holden to pay all damage that shall thereby be sustained by said State.

It appears that these rights had on March 1, 1913, a large value. Due to the pollution of the water, beginning about 1915, "the 'sets' or product of embryo oysters rapidly decreased, and some seasons hardly any of the embryos were produced. From 1915 to 1922, instead of crops of the embryos being secured nearly every year, the production was very small, and was in scattered and uncertain locations; therefore, the oyster industry in ——, since 1915 has consisted principally in marketing the large amount of oysters which was upon the beds of the planters in 1915, at that time the oysters being necessarily of different ages, from 1 year to 7 years of age."

The taxpayer urges that while the rights in question are granted in the form of leases for — years, the holder of the lease is given by law the right to renew his lease and consequently the largest portion of the value of these grants at all times consists in the right to renew them indefinitely. It is contended that what the taxpayer in fact has is a perpetual franchise. While as a practical matter, it may be that the lessee has a permanent right to the ground leased to him, it will be noted that the lease itself states that it is subject to the provisions of existing laws and a reserved right on the part of the State to amend said laws as it shall deem expedient.

The question, then, for determination is whether the rights acquired by the taxpayer from the State amount to franchises or simply to leaseholds. In the case of *California* v. *Pacific Railroad Company* (127 U. S., 1–40) the Supreme Court stated:

What is a franchise? Under the English law, Blackstone defines it as "a royal privilege, or branch of the king's prerogative, subsisting in the hands of a subject." (2 Bl. Com., 37.) Generalized, and divested of the special form which it assumes under a monarchical government based on feudal traditions, a franchise is a right, privilege, or power of public concern, which ought not to be exercised by private individuals at their mere will and pleasure, but should be reserved for public control and administration, either by the government directly, or by public agents, acting under such conditions and regulations as the government may impose in the public interest, and

for the public security. Such rights and powers must exist under every form of society. They are always educed by the laws and customs of the community. Under our system, their existence and disposal are under the control of the legislative department of the government and they can not be assumed or exercised without legislative authority. No private person can establish a public highway, or a public ferry, or railroad, or charge tolls for the use of the same, without authority from the legislature, direct or derived. These are franchises. No private person can take another's property, even for a public use, without such authority; which is the same as to say, that the right of eminent domain can only be exercised by virtue of a legislative grant. This is a franchise. No persons can make themselves a body corporate and politic without legislative authority. Corporate capacity is a franchise. The list might be continued indefinitely.

Not every privilege or permission granted by the State rises to the dignity of a franchise, and many such privileges granted for commercial purposes are licenses, as, for instance, a temporary or revocable permission to occupy or use a portion of some street, highway, or other public property, or a right or privilege of such a nature that a private party might grant a like right or privilege upon his property. (*McPhee, etc., Company* v. *Union Pacific Railroad*, 158 Fed., 5; 87 C. C. A., 619.) It was said in *Rinehart* v. *Redfield* (87 N. Y. Sup., 789; affirmed 72 N. E., 1150) that the grant of a franchise the principal object of which is to enable private parties to secure a private gain to themselves will not be upheld. In *East Tennessee, etc., Railroad Company* v. *Hamblen* (102 U. S., 273) the Supreme Court stated that franchises have been construed to mean the positive rights or privileges without the possession of which the holders could not perform legally the public duties which under the franchise they are authorized to perform.

In the case of *New York* v. *Interborough Rapid Transit Company* (104 New York Sup., 157) the court stated that there is a distinction between a lease and a franchise—a lease being a contract for the possession and profits of property in consideration of a rental, and a franchise being a special privilege granted by the government. It was held in *People* v. *State Tax Commissioner* (110 N. Y. Sup., 577; affirmed 89 N. E., 1109) that the right to operate an underground railroad, pursuant to a lease from a city which owns the railroad, is not a franchise.

Where the Government or the State permits the occupancy and use of its public lands for a rental, such rights have never been considered as franchises. The right to extract mineral from the public domain has never been treated as a franchise, but a license or lease, as the case may be. In the instant case, there is no public purpose served by the grant of the rights to the taxpayer other than the benefit which naturally inures to the public in the development and expansion of all private business.

After a most careful consideration of the evidence produced by the taxpayer herein, the conclusion is reached that the instruments executed by the State of X and the taxpayer are essentially leases and not franchises. It follows that such leasehold interests held by the taxpayer on March 1, 1913, may not be made the subject of a depreciation allowance based on their values as of the date. The taxpayer may, of course, recover over the term of the lease any cost which he may have been put to in securing the same.

It may be well to state in passing that if the taxpayer's contention be correct that he in effect had a perpetual franchise from the State,

there would then be no basis for granting the depreciation allowance, for such an allowance is based on the fact that the intangible right has a limited life. The only exception to this rule is where the taxpayer can show that from experience the right granted to him was one that would be valuable only for a limited period. However, in view of the conclusion here reached that the instruments in question are leases and not franchises, a detailed consideration of this point becomes unnecessary.

ARTICLE 109: Rentals. II-28-1139
A. R. R. 3240

REVENUE ACTS OF 1917 AND 1918.

The loss actually sustained by the taxpayer in the purchase and sale of merchandise and fixtures constitutes the cost of acquisition by it of a lease theretofore held by the merchandising company, and such cost may properly be spread over the remaining life of the lease.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in denying deductions aggregating 4.95x dollars claimed as losses in 1917 (4.46x dollars) and 1918 (.49x dollars).

Upon examination of the evidence of record, it is found that in the year 1916 the appellant began to enjoy greatly increased business due to the discovery of oil near the city of S; that it became apparent that it would be necessary to enlarge the business by obtaining additional floor space; that the building adjoining the M Company's rooms was at that time occupied by a general merchandise store in possession under an unexpired lease which had eight years to run; that in the summer of 1917, in order to obtain this space, the appellant purchased the stock in trade and fixtures of the general merchandise store, obtaining an assignment of its lease; that in purchasing such stock in trade and fixtures, appellant paid therefor the inventory value thereof plus a premium or bonus of 25 per cent; and that the M Company proceeded to close out this merchandise, and sustained a total loss computed as follows:

	Dollars.
Original cost	12. 07x
Expenses in 1917	.95x
Total	13. 02x
Loss: Income from sales in 1917	8. 56x
Net loss in 1917	4. 46x
Additional expenses in 1918	.49x
Total loss	4. 95x

It is found also that in December, 1917, and as a wholly separate and distinct transaction from the above, the appellant purchased the building on which it had previously acquired the lease as aforesaid. It is alleged in appellant's sworn statement of facts that there was no intention on its part to acquire the building at the time it acquired the aforementioned lease under the conditions above outlined.

Upon the above statement of facts the appellant contends that this loss should be deducted from its income for the year in which the

loss was sustained, but that if it should be held that the loss is not deductible from the income of that particular year it should be equally divided over the unexpired term of the lease, and that one-eighth of such loss should be deducted from the income of the M Company each year for the remaining eight years of the unexpired term of the lease.

In the Unit's memorandum transmitting the case to the Committee the following conclusion is stated:

> This office has held that any expense connected with acquiring property to become a part of the appellant's building is a part of the cost of the addition and is a capital expenditure.

Careful consideration of the foregoing leads the Committee to conclude that the loss actually sustained in the purchase and sale of merchandise and fixtures constitutes the cost of acquisition by the appellant of the lease theretofore held by the merchandising company, and that such cost should properly be spread over the remaining life of the lease. It is concluded also from the evidence of record that the lease terminated in December of 1917, when the appellant, which at that time was lessee, acquired title by purchase to the leased building. It is obvious, therefore, in line with the foregoing conclusions, that the appellant is entitled to write off as a deductible expense in 1917 so much of the loss, cost of acquiring lease, as was actually sustained in that year, which as shown by the record is $4.46x$ dollars. The remaining $.49x$ dollars, expended in 1918, apparently represents commissions paid to a professional salesman engaged to dispense of the merchandise, and in the opinion of the Committee should be properly treated as a deductible expense of business in 1918.

It is therefore recommended, in the appeal of the M Company, that an adjustment of the point in dispute be made as hereinbefore indicated.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 111: When charges deductible. II–16–998
I. T. 1731

REVENUE ACT OF 1918.

A contract for a vessel having been completed in 1920 by delivery and payment in full, amounts expended in a later year to make the equipment of the vessel acceptable represent expenses incurred in the latter year and are not deductible in the year 1920.

ARTICLE 111: When charges deductible.

(See I. T. 1759; sec. 203, art. 1581.) Postage on C. O. D. parcel-post shipments of merchandise returned unclaimed and included in closing inventory.

SECTION 214(a)2.—DEDUCTIONS ALLOWED: INTEREST.

ARTICLE 121: Interest. II–26–1117
(Also Section 213(b), Article 73.) I. T. 1793

REVENUE ACT OF 1921.

The taxpayer's personal notes were given to his wife in lieu of securities owned by him which he used in his business. The interest paid to her is not deductible but is a gift.

SECTION 214(a)3.—DEDUCTIONS ALLOWED: TAXES.

ARTICLE 131: Taxes. II–24–1095
(Also Section 214(a)1, Article 101.) I. T. 1779

REVENUE ACT OF 1921.

The gasoline tax levied by the State of Colorado as a good-roads tax is assessed against and collected from the distributors of the fuel rather than the consumers. The tax, therefore, is deductible by the distributors. In cases, however, where distributors add the tax to the cost of the fuel or treat it as a business expense, it should not be included in the deduction for the taxes paid but should be deducted as a business expense or as a part of the cost of the fuel. It follows that purchasers of the fuel for business purposes may include in the cost of the fuel to them any addition to the price made by the distributor to cover the tax, but a similar deduction may not be claimed by taxpayers purchasing the fuel for other purposes.

ARTICLE 132: Federal duties and excise taxes. II–22–1069
A. R. R. 3041

REVENUE ACT OF 1918.

The sales tax imposed by section 902, Revenue Act of 1918, is a tax upon the dealer or vendor, and a vendee can not relieve the vendor of such liability and acquire the right to deduct the tax in his own income tax return.

The Committee has considered the appeal of A from the action of the Income Tax Unit in disallowing a deduction of $3x$ dollars claimed under the heading of "taxes" in his 1920 return.

Upon examination of the record, the Committee finds that in December, 1920, appellant purchased from a dealer a certain article at a price of $30x$ dollars; that in April, 1920, appellant made inquiry of the local collector whether, if the purchase were made by him and the sales tax thereon imposed by section 902, Revenue Act of 1918, paid by him, such tax could be deducted in his 1920 income tax return; that on April —, 1920, the collector advised to the effect that if the tax were actually paid by him and evidenced on the bill of sale issued to him by the vendor, the deduction would be allowable; that when the purchase was made, the purchase price and the 10 per cent sales tax were billed to him as separate items on one bill, $30x$ dollars and $3x$ dollars, respectively; that in preparing his income tax return for 1920 he claimed as a deduction the $3x$ dollars tax so paid;

and that the Unit in auditing the return disallowed the deduction claimed upon the ground, as stated in its memorandum of November —, 1922, "in accordance with the schedule shown on page 34 of Bulletin E, which indicates that taxes on such articles are deductible by the dealer or seller."

While section 902 of the Act of February —, 1919, does not expressly provide who shall pay the tax, whether the vendor or the vendee, section 903 does expressly provide:

> That every person liable for any tax imposed by section * * * 902 * * * shall make monthly returns under oath in duplicate and pay the taxes imposed by such sections, * * *.

This clearly implies that this tax is payable by the vendor, since it is hardly to be supposed that the Act was intended to require that every purchaser should make a monthly return under oath in duplicate of any taxes under section 902 paid by him. This construction is the one adopted by the Bureau in article 3 of Regulations 48 and is supported by the fact that paragraph (c) of section 924 and paragraph (b) of section 907 expressly provide that the tax imposed by those sections shall be paid by the purchaser. If, then, the tax is imposed upon the vendor, it seems that it would be unwarranted to hold that a vendee could relieve the vendor, upon whom the liability is imposed by the statute, of such liability and acquire the right himself to deduct the tax in his own income tax return.

The procedure adopted in this case appears to be expressly considered in article 1 of Regulations 48, which provides: "If the price of a taxable article is increased to cover the tax, the tax is on such increased price. Where, however, the tax is billed as a separate item, such amount need not be included in the price of the article in computing the tax;" but no right to shift the tax is recognized.

In summarizing, the Committee is of the opinion that the item involved, $3x$ dollars, does not constitute an allowable deduction under any provisions of the Revenue Act of 1918 in computing the appellant's taxable net income.

Recommended, that the action of the Unit be sustained and the appeal be denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 133: Taxes for local benefits.

II–30–1153
A. R. R. 3111

REVENUE ACT OF 1917.

> Taxes levied under the "conservancy law" of the State of Ohio are held to be assessed against local benefits within the meaning of section 12(a) of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and are not allowable deductions against gross income.

The M Company appeals from the action of the Income Tax Unit in disallowing as a deduction from gross income for the year 1917 x dollars "conservancy" taxes paid to the N district.

The conservancy tax in question was to provide moneys for the construction of dams and reservoirs to protect property from damage by floods. The assessment of this tax was made under the conservancy act of Ohio (2 Page and Adams Supplement to Ohio Gen-

eral Code, sec. 6828–11 to sec. 6828–79). This statute was enacted as an emergency in 1913 to protect lives and property from loss by floods. It provides for the organization of conservancy districts, and authorized such districts, for the purpose of raising funds to defray the cost of erecting a safeguard against floods, to tax all real property within their limits "in proportion to the benefits appraised and not in excess thereof." (Sec. 6828–45.) The nature of these assessments was considered by the Supreme Court of Ohio in *Miami County* v. *Dayton* (92 ch. St., 216, 110 N. E., 726), and they were there held to be special or local assessments levied "according to benefits."

Section 12(a) of the Act of September 8, 1916, as amended by the Act of October 3, 1917, permits corporations to deduct from gross income:

First. All the ordinary expenses paid within the year in the maintenance and operation of its business and properties.

* * * * * * *

Fourth. Taxes paid within the year imposed by the authority of the United States, * * * or by the authority of any State, not including those assessed against local benefits.

The appellant contends that this conservancy tax is of a different nature from the usual improvement tax; that instead of paying for an improvement to the property it covered undetermined flood damages and losses in value sustained during the same year, which tax was primarily assessed against the repetition of similar losses, and since such a hazard had heretofore been unknown, the conservancy work simply brought the property back to its original value.

The Committee is clearly of the opinion that the conservancy tax is a tax "assessed against local benefits" within the meaning of section 12(a) of the Act of September 8, 1916, as amended by the Act of October 3, 1917.

The Committee recommends that the action of the Income Tax Unit in disallowing as a deduction from gross income for 1917 the conservancy tax in question be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 134: Federal estate and State inheritance taxes. II–15–984
I. T. 1721

REVENUE ACT OF 1921.

The inheritance tax imposed by the State of Nebraska is imposed upon the right of the beneficiary to receive property of a decedent and is deductible by the beneficiary only.

ARTICLE 134: Federal estate and State inheritance taxes. II–15–985
I. T. 1722

REVENUE ACTS OF 1918 AND 1921.

The inheritance tax imposed by the State of Nevada is imposed upon the right of the beneficiary to receive property of a decedent and is deductible by the beneficiary only.

ARTICLE 134: Federal estate and State inheritance taxes. II–16–999
I. T. 1732

REVENUE ACT OF 1921.

The inheritance tax imposed by the Territory of Hawaii is imposed upon the right of the beneficiary to receive property of a decedent and is deductible by the beneficiary only.

ARTICLE 134: Federal estate and State inheritance taxes. II–19–1042
I. T. 1750

REVENUE ACT OF 1921.

British legacy duties and succession duties are imposed upon the right of the legatee and successor, respectively, to receive property, and are deductible by the beneficiary.

A British estate duty, imposed upon the property of which the decedent was competent to dispose, is a tax upon the decedent's right to transmit property, and is an allowable deduction from the gross income of the estate.

The British death duties are of three kinds: legacy duties, succession duties, and estate duties. Legacy and succession duties are imposed upon the right of the legatee and the successor, respectively, to receive property and for income tax purposes are allowable deductions from the gross income of the beneficiary of an estate for the taxable period in which they are paid or accrued as the books of such beneficiary are kept on a cash receipts and disbursements basis or on an accrual basis, respectively.

The British estate duty is imposed upon property of which the decedent was either competent to dispose or over which, in certain specified instances, he had no power of disposition. Where imposed upon the first-named class of property it is held for income tax purposes to be a tax upon the decedent's right to transmit and is an allowable deduction from the gross income of the estate for the taxable period in which it is paid or accrued as the books of the estate are kept on a cash receipts and disbursements basis or an accrual basis, respectively.

ARTICLE 134: Federal estate and State inheritance taxes. II–23–1080
I. T. 1772

REVENUE ACT OF 1921.

The income of an estate, to the extent it is freed from tax in the hands of the personal representative by the deduction of the Federal estate tax, deductible whether paid out of the corpus or out of income, is not rendered taxable by reason of the fact that the income is paid over to a trustee under the will who in turn distributes it to the beneficiaries of the trust. Such income is not taxable to the beneficiaries when received.

It is not permissible to diminish the taxable income of each beneficiary of a distributable trust by any proportionate amount of the excess of the Federal estate tax over the income received by the executor while the estate was in process of administration.

The M Company is executor of the estate of A, deceased. The Federal estate tax, amounting to $26x$ dollars, was paid in 1922; during the same taxable period the gross income of the estate was $3x$ dollars, and in 1922 the bulk of the estate, including approxi-

mately $2x$ dollars of the 1922 gross income, was distributed to the M Company as trustee. The income of the trust was distributable and the trustee, treating the $2x$ dollars as income, made distribution thereof to the beneficiaries. The income so paid to the trustee was returned by the estate as income thereof, but there was no taxable income of the estate in 1922, due to the deduction of the Federal estate tax.

Advice is requested whether the $2x$ dollars distributed by the M Company as trustee to the beneficiaries can be considered by the beneficiaries as free from further income tax, and also whether the excess of the Federal estate tax over the income which passed through the hands of the executor may be applied by the beneficiaries against the income which they received from the trust estate.

Since the Federal estate tax is a proper deduction from the gross income of the estate, it is immaterial whether it be paid out of corpus or out of income, and when, as in the instant case, it is paid out of corpus, the income, to the extent freed from tax in the hands of the personal representative by the deduction of Federal estate tax, is not rendered taxable by reason of the fact that it is paid over to a trustee who in turn distributes it to the beneficiaries of the trust.

Accordingly, the $2x$ dollars distributed to the beneficiaries need not be included in their gross income.

Inasmuch as the Federal estate tax constitutes a deduction from the gross income of the estate of a decedent and not from the gross income of any heir, legatee, devisee, or beneficiary, it is not permissible to diminish the taxable income of each beneficiary received from the trust by any proportionate amount of the excess of the Federal estate tax over the income received by the executor while it was in process of administration.

ARTICLE 134: Federal estate and State inheritance taxes. II-23-1081 I. T. 1773

REVENUE ACT OF 1921.

The inheritance tax imposed by the State of Maryland is imposed upon the right to transmit a decedent's property and is deductible from the gross income of the decedent's estate only.

ARTICLE 134: Federal estate and State inheritance taxes. II-25-1111 T. D. 3516

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTIONS—FEDERAL ESTATE TAXES—RIGHT TO DEDUCT FROM INCOME OF DECEDENT.

Where a taxpayer dies during the taxable year, a return of his income for the period in such year during which he was alive is required showing the net income after deducting from the gross income deductions properly allowable by law. However, the occasion of an estate tax being death and it being imposed only after death, such tax would not be available to the taxpayer as a deduction during life and is accordingly not available to his personal representative when making a return, as he is required to do, of the income received by the decedent prior to date of death. As affecting a decedent, the deduction of an estate tax can not have

been contemplated by the word "taxes" in section 214(a)3 of the Revenue Act of 1918. Such tax is from its very nature deductible only from income received after the tax has, following death, come into existence.

2. JUDGMENT OF THE LOWER COURT.

Judgment of the United States District Court for the Eastern District of Pennsylvania (280 Fed., 241) affirmed.

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

To collectors of internal revenue and others concerned:

The following decision of the United States Circuit Court of Appeals for the Third Circuit in the case of *Wilson Catherwood, executor of the will of Emma R. Catherwood, deceased*, v. *United States*, affirming the United States District Court for the Eastern District of Pennsylvania (280 Fed., 241), is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 12, 1923.

A. W. MELLON,
Secretary of the Treasury.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.
No. 2903. OCTOBER TERM, 1923.

Wilson Catherwood, executor of the will of Emma R. Catherwood, deceased, plaintiff in error, v. *United States of America, defendant in error.*

In error to the District Court of the United States for the Eastern District of Pennsylvania.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

WOOLLEY, Circuit Judge: Emma R. Catherwood died August 22, 1920. On February 25, 1921, the plaintiff, her executor, in obedience to the Revenue Act of 1918 (40 Stat., 1057, 1096–11–1), filed a return for Federal tax on her estate and paid the tax. On the same day he filed two income tax returns. One covered income received by the decedent during the taxable year 1920 prior to her death. In computing taxable net income the executor did not deduct the estate tax he had that day paid because, under the regulations of the Department of Internal Revenue then in force, the deduction would not have been allowed. Had the deduction been allowed and made, there would have been no taxable income for that part of the taxable year. The other return covered income of the estate received by the executor during the remainder of the taxable year. This was small and, even without deducting the estate tax, it disclosed no taxable income for that period. Therefore, if the estate tax had been deducted in the first return, there would have been no taxable income shown by the two returns for any part of the taxable year. The executor brought this action to recover the amount of income tax he had paid on income received by the decedent during the part of the taxable year she was alive, calculated without deducting the estate tax. The case was heard as though on demurrer and the court entered judgment for the defendant. (280 Fed., 241.) The plaintiff sued out this writ of error.

The question turns on the interpretation of several sections of the Revenue Act of 1918 and particularly on the interpretation of section 214. (40 Stat., 1058–1082.) We shall approach this section by reviewing the preceding sections to which it relates, freely using italics to direct attention to the points under discussion.

The matter falls first under Title II of the Act, dealing with income tax, and later under Title IV, dealing with estate tax. Section 210, the first provision with which we are concerned, declares that "there shall be levied, collected, and paid *for each taxable year* upon the *net income* of every *individual* a normal tax at the following rates." This provision is relevant to the matter in hand in three particulars: First, it refers to the income of an individual, who in this case was Emma R. Catherwood; second, it shows that the taxable income is the *net* income; and, third, that the period for which such tax shall be levied, collected, and paid is a "taxable year." Section 200 defines "taxable year" to mean, in this instance, the calendar year. Emma R. Catherwood, dying in August, 1920, did not live throughout the calendar, or taxable, year of 1920. Had she lived throughout that year, she would have obeyed section 210 by making a return conformable with section 212, which defines the "net income" on which the tax is levied as meaning "gross income" as defined by section 213, less the deductions allowed by section 214. This is the section, as affected by section 401, which calls for construction. It reads as follows:

"SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * * * *

"(3) Taxes paid or *accrued* within the *taxable year* imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes."

The estate tax, which, by section 401 of the Act, is "imposed upon the transfer of the net estate of every decedent dying after the passage of this Act" is obviously not a tax that could have been "paid" by Emma R. Catherwood, or that could have "accrued within the taxable year" had she lived to file her own return, for such a tax can neither accrue nor be paid until death. So, had Emma R. Catherwood lived, she would not have been affected by, nor could she have deducted, an estate tax. But Emma R. Catherwood did not live throughout the taxable year. Income had been received by her during the part of the year in which she had lived and it was natural to expect that income would be received by her estate during the remainder of the year after her death. For a tax on the income she had received during the taxable year while alive she was liable. Though liable, she could not, as she was dead at the time the tax became due, make return and pay it herself. Anticipating such a case, and for the purpose of gathering a tax on all the income of a decedent for the whole of a taxable year—that which was received before death and that which was received after death—the law requires a return to be made by her personal representative for income received by herself—a fixed liability of her estate—and a return to be made by him for income received by her estate—a liability of his own. To this end the statute, by section 219, provides:

"(a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

"(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

* * * * * * *

"(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts."

In this connection the Act, by section 225, further provides:

"That every fiduciary * * * shall make under oath a return for the individual estate or trust for which he acts. * * * Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals."

Therefore it is, that when an executor makes a tax return of net income received either by the decedent or by himself during the administration of an estate, he, too, is allowed the deduction, named in section 214, of "taxes paid or accrued within the taxable year imposed by authority of the United States, except income, war-profits and excess-profits taxes." But this section conceivably allows an executor, who has himself received income, a deduction which it does not allow a taxable making his own return. And this is so where the death of the taxable has intervened and because, thereupon, the law has raised a new tax, payable solely from the estate of the taxable. This is the

Federal estate tax. Section 401. This tax is not excepted from the allowable deductions under section 214, and, if "paid or *accrued* within the taxable year," it is properly deductible from gross income received by the executor in ascertaining taxable net income. This has been definitely determined in *United States* v. *Woodward* (256 U. S., 632; 41 Sup. Ct., 615; 65 L. Ed., 1131). That case turned primarily on the question whether, in any event, an estate tax is a proper deduction under section 214, and on the facts of the case the Supreme Court held that it was a proper deduction to be made in a return by the executor of income he had received in the taxable year after the decedent's death and during the settlement of the estate. The plaintiff contends that in principle the Woodward case rules the case at bar where the deduction of the estate tax is sought to be made from income received by the decedent while living. To prevail on this contention the plaintiff must show that the Supreme Court, when it held that the estate tax "becomes due not at the time of the decedent's death, * * * but one year thereafter, as the statute plainly provides" (section 406), was wrong in construing the words "Taxes * * * *accrued* within the taxable year," as used in section 214, to mean "taxes (that) became *due* during the taxable year." It is fairly debatable, under the Woodward decision, whether an estate tax accrues when due, or, under the decision in *Hertz* v. *Woodman* (218 U. S., 205), it accrues when imposed. But aside from this question we are of opinion that in construing section 214, the taxes there allowed as a deduction must be read with reference to the person affected. The first return made by the executor was, as we have shown, for income received by the decedent during her lifetime. From such income received by her during that part of the taxable year the deduction of an estate tax can not have been contemplated by the word "taxes" in section 214, because there was as affecting her, when living, no such thing as an estate tax. The occasion of an estate tax is death, and it is imposed only after death. It was, in this instance, imposed upon the transfer of the decedent's estate and the duty of payment was imposed upon her executor. If the estate tax "accrued" when "due" in 1921, it did not accrue within the "taxable year" of 1920, and was not, in any line of reasoning, deductible in either tax return. If it "accrued" when "imposed" in 1920, then it "accrued within the taxable year" within the meaning of section 214 and was, under the decision in the Woodward case, a proper deduction to be made by the executor in ascertaining taxable net income from gross coming into his hands "during the period of administration or settlement of the estate."

It so happens in this case that, because of the small gross income received by the executor during administration, the deduction thus available would be of no use. Therefore, the effort is made to shift the deduction to the executor's return on income received by the decedent during her lifetime. There would be nothing in this position were it not for the breadth of the language in section 214 wherein a deduction is allowed on "taxes paid or accrued within the taxable year," coupled with the plaintiff's claim that the estate tax, paid when "due" in 1920, actually "accrued" within the "taxable year" of 1920. The plaintiff maintains that it makes no difference in what part of the taxable year, whether before or after the decedent's death, the tax accrues. For the reasons already given, we are not impressed with this contention. Assuming without deciding that the estate tax "accrued" within the "taxable year" of 1920, it does not follow that it may be deducted at pleasure from income received by different persons at different times during that year. It is, from its very nature, deductible only from income received after the tax has, following death, come into existence, not on the theory that it is payable out of a segregated part of the estate, for it is not (deduction and payment are different matters), but because the deduction, not being available to the taxable [taxpayer] had she lived, is not available to her personal representative when making a return for her of income she had received when living—a return clearly different from the one an executor is required to make for income received by himself during the settlement of the estate.

Finding no error, we direct that the decree below be affirmed.

ARTICLE 134: Federal estate and State inheritance taxes. II–38–1259
I. T. 1879

REVENUE ACT OF 1921.

The succession duty imposed by the Quebec succession duties' act, Province of Quebec, is imposed upon the right of the beneficiary to receive property and is deductible by the beneficiary only.

Inquiry is made whether the succession duty imposed by the Quebec succession duties' act, Province of Quebec, is an allowable deduction from the gross income of the beneficiary of an estate in computing his individual net income.

The Revised Statutes of Quebec, 1909 (section 20 of chapter 5 of title 4), articles 1374 to 1387, inclusive, as amended by Statutes of Quebec (4 George V, 1914, ch. 9 and 10), impose a succession duty upon property transmitted owing to death or the transmission of property owing to death. The section of the revised statutes which includes articles 1374 and 1387 is entitled "Duties on successions," being cited as the "Quebec succession duties' act." This act provides (arts. 1375, 1376, and 1387b), in effect, that all property situated within the Province of Quebec, and all movable property situated outside the Province when owned by persons domiciled in the Province, which is transmitted owing to death, shall be liable to a tax, calculated upon the value of the property transmitted and varying according to the relationship of the beneficiaries who receive the property. This tax is based not upon the aggregate transfer but upon the shares received by the beneficiaries, the amount of the tax depending upon the amounts passing to the separate beneficiaries and their relationship to the decedent. Each beneficiary is personally liable for the tax due in respect of his share in the succession, and for no more; the trustee, executor, or administrator of the estate is specifically declared not to be personally liable for the tax (arts. 1380 and 1387g). As to the liability of the beneficiary to pay the tax, it is provided in chapter 11, Statutes of Quebec, 4 George V, 1914:

1. The intent and meaning of all the acts of the Legislature imposing succession duties was, and is, that every person to whom property or any interest therein was transmitted owing to death, should pay to the Government directly, and without having a recourse against any other person, a tax calculated upon the value of the property so transmitted.

In *Barthe* v. *Alleyn-Sharples* (54 Dominion Law Reports, 89, 112) the Supreme Court of Canada, in considering the nature of the duty imposed by the Quebec succession duties' act, says:

The transmission is not something that can not be distinguished from the property transmitted. It is a right, derived under the law of the Province, to succeed to property left by a testator or an intestate, and the Province which grants this right can require the payment of a tax as a condition of its grant, such tax being a tax imposed not on the property itself but on the right to succeed to it.

From the foregoing it is clear that the Quebec succession duty is a tax paid by the beneficiary of an estate upon the value of the property received by him in satisfaction of a personal and primary liability. It is held, accordingly, that the succession duty imposed by the Quebec succession duties' act is an allowable deduction from

the gross income of the beneficiary of an estate for the taxable period in which the tax is paid or accrued, and is not deductible by the estate.

SECTION 214(a)4, 5, 6.—DEDUCTIONS ALLOWED: LOSSES.

ARTICLE 141: Losses. II–19–1043
A. R. R. 2849

REVENUE ACT OF 1918.

It has been established by evidence that the taxpayer purchased residential property for the purpose of its subsequent sale for pecuniary profit. He may deduct a loss from its sale, even though he occupied the property as a residence during a part of the time from the date of purchase to the date of sale.

The Committee has had under consideration the appeal of A from the action of the Income Tax Unit in disallowing a deduction for 1919 of $.44x$ dollars, representing claimed loss sustained from the sale of residential property.

An affidavit, dated November —, 1922, submitted on appeal, is to the effect that during the spring of 1911, while appellant was living in the city of S, one B, who was engaged in the real estate business, approached and asked appellant if he would like to make some money, to which appellant agreed; that said real estate agent then stated that certain real estate, containing a 21-room house and large barn situated on 7½ acres of land, being known as a gentleman's estate, could be purchased at a bargain and sold at a very large gain; that negotiations were thereupon entered into by the appellant through the real estate agent and the property purchased during the spring or early summer of 1911; that the appellant talked over with his father the matter of purchase; that he and his father looked over the property and concluded that the low price at which it was offered for sale was a bargain, and that it could be disposed of for more than it would cost; that the appellant immediately began improving the property so that it might be in salable condition; that recognizing the fact that during the fall and winter months there was no demand for country estates, and the further fact that an occupied estate is more salable, the appellant moved in and occupied the estate as a residence until the alterations could be completed and it could be reasonably placed on the market for sale; that after moving in the alterations and improvements were continued, and thereafter in the early spring of 1912, carrying out his intentions when purchasing said estate, the appellant listed the estate for sale with certain real estate agents, the property being so listed until its final sale in 1919; and that the property was listed for sale with said agents at an asking price of $2.5x$ dollars.

In a previous affidavit by the appellant, of record, it is further stated that had he purchased the estate for a home, it would have been in the name of his wife rather than in his own name. The record contains an affidavit by D, the appellant's father, who states that he believes that A was greatly influenced in the purchase of the property by this affiant's advice. The previous affidavit of the appellant is in part to the effect that he moved into the property in

the late fall of 1911, feeling that it would be much more salable if furnished, occupied, and kept in shape with its retinue of servants, than a vacant place would be; that the real estate agents continuously solicited purchasers for the property, but none were found; and that in the year 1917, when it was almost impossible to secure proper servants to maintain the property, the appellant was obliged to rent an apartment and vacate the property; and that the property was purchased not as a residence in any sense of the word, as he needed no such establishment for the maintenance of his wife and two children, the latter at that time being aged 2 and 4 years.

Article 141 of Regulations 45 provides in part that—

> A loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit.

Whether or not a loss is incurred in the sale of residential property in arriving at the net income must be determined by the object or intention of the individual in buying or constructing the property. If the property is occupied by the purchaser as his home during the whole or a greater portion of the period of his ownership, a strong presumption is raised that the property was purchased for his personal use as a residence, and that the transaction was not "entered into for profit" within the meaning of section 214(a)5, and this presumption can not be overcome by the taxpayer's self-serving declaration, uncorroborated, that his purpose was otherwise. It is necessary, therefore, in determining whether the loss claimed is allowable or unallowable to find on the evidence of record either that the appellant's intention in purchasing the property was to resell it at a profit with residence therein during the interim merely incidental, or that his primary intention was to obtain a residence with the making of a profit merely incidental to the moving cause, the acquisition of a home.

The appellant purchased the property in question in the summer of 1911 for $1.4x$ dollars. It appears that he then had knowledge of the fact that in 1906, while being occupied by a previous owner, an addition was made on the rear of the house covering new laundry and large living room with fireplace, etc., which cost in the neighborhood of $1.5x$ dollars.

The Committee is of the opinion that the presumption raised by occupancy as a residence by the appellant during a considerable portion of the period of his ownership of the property has been overcome by the evidence submitted and corroborated by affidavits by other persons on material points, covering the surrounding and attendant circumstances and it is held that it has been reasonably established that at the time of the purchase it was his main intent and purpose to acquire the estate with a view to its subsequent sale for pecuniary profit.

The Committee accordingly recommends that the action of the Income Tax Unit be reversed and the appeal sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 141: Losses. II–22–1070
I. T. 1766

REVENUE ACT OF 1921.

A dam was erected for the purpose of carrying on A's trade or business and was damaged by heavy rains in 1921 prior to A's death. After A's death and during the same year the executors expended the amount of x dollars in making repairs which did not amount to a replacement of the dam.

Held, that the loss was sustained by A as the result of the destruction in part of the dam and that such loss is deductible in computing the net income of A for the year in which such part of the dam was destroyed.

ARTICLE 141: Losses. II–24–1096
I. T. 1780

REVENUE ACT OF 1921.

Land which was subject to a mortgage was accepted in 1915 by the taxpayer in full settlement of a claim for $5x$ dollars existing on March 1, 1913. In 1921 the mortgage was foreclosed and the taxpayer did not receive any amount for his equity. He is entitled to deduct $5x$ dollars in arriving at his net income for that year.

Prior to March 1, 1913, the taxpayer rendered legal services to B and rendered a bill in the amount of $5x$ dollars and considered the claim to be worth $5x$ dollars on March 1, 1913. In 1915 B transferred to the taxpayer $3y$ acres of land subject to a mortgage. The taxpayer accepted the land in full settlement of his bill of $5x$ dollars, considering the land actually worth more than that amount. In 1921 the mortgage was foreclosed and the taxpayer did not receive any amount for his equity therein. He received no interest on his bill and reported no interest as income for any year from March 1, 1913, to 1921, inclusive.

Held, that inasmuch as A's claim was worth $5x$ dollars on March 1, 1913, and he accepted $3y$ acres of land subject to a mortgage in full settlement of the claim in 1915, his loss in the year 1921 at the time the mortgage was foreclosed on the property was $5x$ dollars, which amount is deductible in arriving at his net income subject to tax for that year.

It is further held that the amount of x dollars representing interest claimed as a deduction, which interest had not previously been reported as income, is not an allowable deduction in arriving at the taxpayer's net income for the year 1921.

ARTICLE 141: Losses. II–25–1112
I. T. 1789

REVENUE ACT OF 1918.

After the termination of a partnership engaged in the real estate business, a parcel of the real estate acquired by the partnership was sold by the former partners. Judgment was obtained against them for misrepresentation of the property sold, and the damages paid pursuant thereto by the taxpayer are deductible by him even though he has not been engaged in the real estate business since the dissolution of the partnership.

The taxpayer and his father were partners in the real estate business. The taxpayer later entered the employment of a company in another locality and ceased to have any part in the conduct of the partnership. He told his father that he might dispose of the property which was held by them jointly and retain the proceeds, but no written agreement to this effect was made.

In 1915 the father exchanged a flat, which had been held by him and the taxpayer jointly, for farm land, taking title to the latter in both names. The purchaser of the flat subsequently permitted it to be sold under foreclosure of a mortgage, after deciding that the property was not worth anything more than the claims against it, and he brought suit against the father and son and recovered a judgment of $60x$ dollars against them after they had disposed of the land. The nature of this suit is not disclosed, but it was probably an action for damages for misrepresentation as to the value or some other pertinent fact about the flat property. The father paid his one-half of the judgment, and the taxpayer agreed to pay his portion in three installments during the years 1918, 1919, and 1920.

Inquiry is made as to the allowance of a deduction of $10x$ dollars, claimed by the taxpayer in his return for the year 1920 on account of an installment of his portion of the judgment paid during that year.

Inasmuch as the property which formed the basis of the exchange out of which the action for damages arose was acquired at a time when the taxpayer was still engaged in the real estate business and the transaction was made in closing out his interest in that business, and as title to the land was secured in both names, and judgment was secured against both father and son, it is held that the damages paid by the taxpayer under the judgment in question were deductible as a loss incurred in his business under section 214(a)4 of the Revenue Act of 1918.

ARTICLE 141: Losses. II-30-1154
(Also Section 213(b), Article 73.) I. T. 1811

REVENUE ACT OF 1918.

The payment by a trustee who was chargeable with neither fraud nor negligence to cover the defalcation of a cotrustee is held to have been purely voluntary and should be treated as a gift. It is accordingly not deductible by the donor.

In 1919 A made good to an estate of which he was a trustee certain defalcations of his cotrustee and claimed as a deduction in his individual return the amount covering these defalcations. The record disclosed no grounds upon which A could be held legally liable for the defalcations of his cotrustee.

Held, that in view of the general rule that a trustee is not liable for the defalcations of his cotrustee unless he can be charged with fraud or neglect in the performance of his duties and as there was nothing in the record to indicate the legal liability of A in this connection, that the payment of the amount of x dollars to cover the losses to the trust for the defalcation of his cotrustee was purely voluntary on the part of A and should be treated as a gift and, accordingly, not deductible by the donor.

ARTICLE 141: Losses. II–31–1169
A. R. R. 3699

REVENUE ACT OF 1918.

A mineral lease for 10 years dated 1916 provided for annual minimum royalty payments and that the excess in payment, above that for mineral actually mined, was to be applied against any amount due for mineral mined in any subsequent year.

The lessee may not charge off as a loss for the year 1918, when it was decided that the lease was unprofitable, a balance in its prepaid royalty account after credits were made for mineral actually mined. The amount of royalties paid for each year in excess of the mineral mined during the respective years of the lease should not be allowed as deductions from gross income. The amount of prepaid royalties in excess of mineral mined to the date of cancellation of the lease in 1920 may be allowed as a deduction in 1920.

The Committee has been requested to give its opinion as to the deductibility of a certain claimed loss in the amount of $6.1x$ dollars entered on the tax return of the M Company for the year 1918.

The M Company leased the N mine from the O Company under a lease dated November —, 1916, which was to run for 10 years and provided that a minimum royalty of $5.04x$ dollars was to be paid annually on the basis of $84z$ tons at the rate of $6y$ cents per ton.

Mineral was mined for the first three years as follows:

	Tons.
1916	None.
1917	$28.8z$
1918	$58.23z$

The balances remaining in the prepaid royalty account (asset account) after credits were made for mineral actually mined at the rate of $6y$ cents per ton were as follows:

	Dollars.
1916	$1.5x$
1917	$4.5x$
1918	$6.1x$

The lease dated November —, 1916, provided that the excess in payment above that for mineral actually mined was to be applied against any amount due for mineral mined in any subsequent year.

The appellant found in 1918 that it would be impossible for the company to reach the minimum requirements for the remainder of the lease and thereupon charged off the balance of $6.1x$ dollars as a loss on its tax return for the year 1918.

The amount of minimum royalties for the year 1919 and until November —, 1920, were charged off as part of the costs for the respective years. A new lease was entered into on November —, 1920, changing the royalty rate to $10y$ cents per ton and stating one of the considerations to be that the lessor should "retain as its own personal property any payments which the mineral company may have made under the lease of 1916 in excess of the value of mineral mined to November —, 1920."

The appellant stated in the oral hearing and submitted for examination by the Committee a statement to the effect that there was no value to such consideration, since the appellant had no right to recovery of said prepaid royalties.

The question before the Committee is the correctness of the deduction taken on the return for the year 1918, and if not a proper

deduction for that year. in what period it would be allowable as a deduction.

The Committee has given extended study to the question and has arrived at the conclusion that the loss as claimed is not a proper basis for a deduction from gross income for the year 1918, since there has not been evidenced a closed transaction. The amount of royalties paid for each year until November —, 1920, in excess of the mineral mined during the respective years and periods, should not be allowed as deductions from gross income.

The new lease, which was entered into on November —, 1920, replaced the 1916 lease, which was thereby canceled and became a closed transaction. The amount of prepaid royalties in excess of mineral mined to the date of cancellation of the 1916 lease is a loss and may be allowed as a deduction from the gross income of the year 1920.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 141: Losses. II-35-1218
I. T. 1853

REVENUE ACTS OF 1918 AND 1921.

Judgment was recovered against the taxpayer for the recovery of secret profits arising from the purchase of certain property on behalf of a corporation formed by him and others. The transaction was not prohibited by any statutory enactment of the State. The recovery allowed was based upon the violation of an equitable duty owed the corporation. An amount paid in liquidation of the judgment under a compromise agreement is deductible.

Judgment was recovered against the taxpayer and others in an action instituted for the recovery of secret profits made in the purchase of certain property on behalf of a corporation formed by them. The recovery was had on the theory that taxpayer, and the other defendants, as promoters, occupied a fiduciary relationship to the corporation and those joining with them in the corporate enterprise and were under a duty to make the purchase without special profit to themselves. The taxpayer compromised his liability under the judgment by agreeing to pay to the corporation a stipulated sum in four installments. In his 1920 return the taxpayer deducted as a loss the amount of the first installment paid in 1920. It is contended that the transaction out of which the judgment arose was an "illegal transaction" and for that reason any amounts paid on such judgment are not deductible in computing net income subject to tax, following article 141, Regulations 45.

The illegality of the transaction referred to lies in the violation of the duty which the taxpayer and the other defendants owed to the corporation and its shareholders. In Law Opinion 1092 (C. B. I-1, p. 270) it was said that "it is believed that the term 'illegal transaction' means transactions which are contrary to or violate the law." As evidencing the meaning of this sentence, it was said that whereas an ultra vires contract is one beyond the powers of a corporation and in that sense *illegal*, "it is not necessarily for that reason illegal in the sense that it is *criminal* or *violates some positive law*." It was held that "in the absence of express language in any of the Revenue

Acts refusing deductions to corporations for losses sustained in ultra vires transactions, such losses can not be denied on the theory that they are sustained in illegal transactions." By the term "illegal transactions," used in such opinion, is meant, therefore, something falling within the prohibition of positive enactment, a *malum prohibitum*. This meaning is supported by O. D. 978 (C. B. 5, p. 135), wherein damages paid on a judgment for misrepresentation in a land sale were held to be an allowable deduction. Further support is found in O. D. 1091 (C. B. 5, p. 139), involving a case wherein an amount paid out in compromise of a judgment recovered in a suit against a taxpayer on account of dereliction and neglect of duty while serving as a director of a bank was held to be an allowable deduction. Such transactions were presumably illegal only in the sense that they were breaches of equitable duty and were not *mala prohibita*.

The transaction in the instant case was not prohibited by any statutory enactment of the State of S. The recovery allowed was based upon the violation of an equitable duty not unlike the instances passed upon in Office Decisions 978 and 1091. It is believed, therefore, that the amount paid under the compromise agreement in question was properly deductible in the taxpayer's return for 1920 as a loss under section 214(a)5 of the Revenue Act of 1918. Payments made under such agreement in later years are likewise deductible under section 214(a)5 of the Revenue Act of 1921.

ARTICLE 141: Losses. II–35–1219
I. T. 1854

REVENUE ACT OF 1921.

Losses in illegal transactions are not deductible under the Revenue Act of 1921.

ARTICLE 141: Losses. II–36–1235
I. T. 1865

REVENUE ACTS OF 1918 AND 1921.

Losses on election bets consummated in Louisiana, which are not prohibited by section 31, act 213 of 1912 (Marr's Annotated Revised Statutes of Louisiana, vol. 2, p. 970), defining and prohibiting corrupt practices appertaining to elections, are allowable deductions under the Revenue Acts of 1918 and 1921 as losses sustained in transactions entered into for profit.

ARTICLE 141: Losses.

(See I. T. 1863; sec. 213(b), art. 73.) Transfer of securities to a trust, by the creator of the trust, the creator receiving payment in cash given by him to trust on same day.

ARTICLE 142: Voluntary removal of buildings. II–31–1170
I. T. 1820

REVENUE ACT OF 1918.

A loss arising from the razing of buildings on land subject to a ground rent, acquired by the taxpayer in 1916 as an investment, is deductible in an amount equal to that part of the cost of the property attributable to the buildings less depreciation thereon to date of demolition, plus the cost of remodeling the building for a factory site, less the salvage thereof when demolished.

Advice is requested whether the taxpayer may deduct, in computing his net income for the year 1918, the loss arising from the razing of buildings on land for which he pays ground rent.

Real estate was acquired by the taxpayer as an investment through the purchase of a lease and improvements for $70x$ dollars. After several unsuccessful attempts to rent the dwelling on this property, it was determined advisable to remodel the building as a small factory at a cost of $35x$ dollars. After a time it was found impracticable and impossible to rent the factory and, because of the heavy expenses of taxes and ground rents and because the property produced no revenue, it was decided in 1918 to raze the improvements.

Article 142 of Regulations 45 reads in part as follows:

When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

It is apparent that the above-quoted portion of article 142 of Regulations 45 refers to a case in which real estate is purchased for the purpose of razing the old buildings and erecting new. In the instant case, the taxpayer does not seem to have purchased with any such intention. His purpose in investing in the property was to make a profit, if possible, out of the renting thereof, first as a dwelling and later, when the building was remodeled, as a factory. As disclosed by the evidence, the land was subject to the payment by him of an annual rent of $\frac{1}{8}x$ dollars, while absolute title to the buildings thereon rested in him, and he could demolish or otherwise dispose of them as he saw fit. The land itself was sufficient security for the payment of the annual ground rent.

These being clearly the facts, it is believed that the land and buildings thereon might be treated as two separate and component parts of the transaction, and upon failure to realize profit from rental of the buildings, and their subsequent demolition, the taxpayer sustained a loss in a transaction entered into for profit equal to that part of the cost of the property attributable to the buildings (the property was purchased in 1916), less depreciation thereon to date of demolition, plus the cost of remodeling the buildings for a factory site, less the salvage value thereof when demolished. Such loss is deductible by the taxpayer in the year in which the demolition occurred.

ARTICLE 142: Voluntary removal of buildings. II-38-1260
T. D. 3537

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

To collectors of internal revenue and others concerned:

Article 142, Regulations 62, is amended to read as follows:

Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped, less salvage, and the amount of depreciation sustained with respect to the property prior to its demolition or scrapping, and allowable as a deduction in computing net income. However, if such property was acquired prior to March 1, 1913, and its fair market value as of that date was less than its cost, the deductible loss is the difference between such fair market value, less salvage, and the amount of depreciation sustained prior to the demolition or scrapping and allowable as a deduction in computing net income. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 11, 1923.
A. W. MELLON,
Secretary of the Treasury.

ARTICLE 142: Voluntary removal of buildings. II-38-1261
T. D. 3538

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

To collectors of internal revenue and others concerned:

Article 142, Regulations 45 (1920 edition), is amended to read as follows:

Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income in a sum representing the difference between the cost of such property demolished or scrapped or the March 1, 1913, value thereof if acquired prior to that date, whichever is lower, and the amount of a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost or the March 1, 1913, value, if acquired prior to that date, whichever is lower, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on

account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and building plus the cost of removing the useless building.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 11, 1923.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 142: Voluntary removal of buildings. II-38-1262
T. D. 3539

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

To collectors of internal revenue and others concerned:

Article 155, Regulations 33 (revised), is amended to read as follows:

Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income, in an amount representing the difference between the cost of such property demolished or scrapped or the value thereof as of March 1, 1913, if acquired prior to that date, whichever is lower, and an amount measuring a reasonable allowance for depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost, or March 1, 1913, value, if acquired prior to that date, whichever is lower, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 11, 1923.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 144: Shrinkage in value of stocks. II-23-1082
A. R. R. 2962

REVENUE ACT OF 1918.

A corporation liquidated all its tangible assets in 1914, retaining certain patents but doing no business thereafter. The charter was declared forfeited on proceedings begun by the State in 1919. A's stock, which was given to him by B in 1914, was canceled in 1919 and the loss charged off by him. The loss is deductible in 1919.

The Committee has carefully considered the appeal of A from the action of the Income Tax Unit in denying as a deduction for losses an item of 8.25x dollars claimed in the appellant's return for the year 1919.

Upon examination of the record, the Committee finds that the loss in question represents the cash value, 8.25x dollars, at the time of acquisition of certain stock acquired by the appellant in the M Company; that the M Company was organized on April —, 1912, under

the name of the N Company; that in February, 1914, the company was reorganized as the M Company; that in 1914, B transferred to the appellant 8.25x dollars of his stock as a gift; that during 1914, by reasons of business depression and an unfortunate selection of management, the company failed to earn profits; that during the latter part of the year 1914 practically all of the tangible assets of the M Company were sold at the direction of the board of directors for the purpose of liquidating the corporation's indebtedness; that the remaining unpaid indebtedness was assumed by B; that the company was not at that time involved in any bankruptcy proceedings or any receivership; that the corporate charter was not at that time surrendered, and that the corporation as a legal entity though dormant and inoperative continued in existence; that while the value of the stock after liquidation of indebtedness in 1914 was not susceptible of any acceptable method of determination, some value still existed therein, in that there remained as property of the corporation certain patents; that such stock represented an interest in an existing organization; and that the ownership of such stock was a continuing event so long as the corporation legally existed.

It is further found that the corporation filed its annual report, as required by the statutes of the State of S, for the years 1914, 1915, and 1916; that on April —, 1917, however, the corporation having failed to file its annual report as required by the statutes of the State of S, the secretary of state issued a certificate of cancellation of the charter; that this act of the secretary was not a forfeiture of the charter but merely a step toward a proceeding to effect a forfeiture; that in the fall of 1919, the attorney general for the State of S brought proper court action for the dissolution of the corporation and the forfeiture of the charter; and that the final order of the court granting his petition was entered on November —, 1919.

It was in this year, at which time a dissolution of the corporation was actually effected, that the stock held by A was canceled, and he proceeded to charge off as a loss deduction in that year the cash value of the stock at the time acquired by him in 1914.

The Unit has denied the deduction upon the ground that the stock became worthless in 1914 or 1915 and the loss incurred was actually sustained in that year. In support of this position, the Unit states that the company was liquidated and the assets disposed of in 1914 and 1915, and that, in view of such fact, no loss is determinable in any subsequent year. The grounds stated in support of the Unit's contention appear to be based on an error as to the actual facts. It appears to the Committee that what really occurred in 1914 and 1915 was a liquidation in part of the company's indebtedness by the conversion of its tangible assets into cash, which cash was used for the purposes of such liquidation; that there remained as property of the corporation at that time certain patents, titles to which were vested in it, and that the corporation, though dormant and inoperative after that date, still continued to exist as a legal entity. The regulations promulgated under the taxing Acts of 1913, 1916, and 1917 required that a stock loss of the character here involved must be sustained and determined as the result of a completed and closed transaction, and numerous rulings by the Bureau and Treasury decisions enunciated

this as a principle which was closely adhered to. It was not until the promulgation of Regulations 45 under the Revenue Act of 1918 that a loss sustained in a stock transaction might be deducted under conditions other than where the transaction was completed and closed. This is apparent in that portion of article 144 of Regulations 45 (1920 edition) which states:

> However, if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, *may be deducted* by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. See article 151.

The same regulation, in speaking of losses of the character here provided for, states that:

> The loss allowable in such cases is that actually suffered when the securities mature or are disposed of.

The Committee has considered all of the evidence and arguments submitted by the appellant and by the Unit and has reached the conclusion that the loss herein discussed constitutes a proper deduction in the appellant's return for the year 1919 under section 214(a)5, Revenue Act of 1918.

It is therefore recommended, in the appeal of A, that the action of the Income Tax Unit be reversed and the appeal sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 144: Shrinkage in value of stocks. II-36-1236
I. T. 1866

REVENUE ACTS OF 1918 AND 1921.

> The facts disclose that the stock of the taxpayer in a holding corporation became worthless in 1919, when the property of the corporation was sold in bankruptcy proceedings, and not in 1915, when the property of its subsidiary operating company was sold at a foreclosure sale.

With respect to a claim for a deduction the taxpayer makes the following statement: $20x$ dollars of this deduction was a loss on the stock of the M Company, a holding company, and the remainder, $4x$ dollars, a bad debt owed by the company, which losses were incurred in the following manner: In 19— the taxpayer bought stock of the holding company at a cost of $20x$ dollars, the value of which on March 1, 1913, had not fluctuated according to the best information available. The holding company owned all the stock of a certain subsidiary operating company, the property of which was sold at a foreclosure sale in 1915. However, stockholders were advised to hold their stock in the M Company pending the adjudication of a claim held by it. The taxpayer, therefore, believed it wise to hold his stock in the hope that it would eventually be worth more than he could obtain in 1915 and did not finally dispose of such stock until the property of the M Company was sold in 1919 in bankruptcy proceedings. The loss of $4x$ dollars was that portion of a loan in the amount of $8x$ dollars made by the taxpayer to the M Company not recovered on final liquidation in 1919.

The Revenue Act of 1918 and the Revenue Act of 1921 provide:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

Article 144 of Regulations 62 reads in part as follows:

* * *, if stock of a corporation becomes worthless, its cost or other basis determined under section 202 may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made, as in the case of bad debts.

The taxpayer submits that the worthlessness of his $20x$ dollars holdings in the parent company did not follow from the mere fact that the property of a subsidiary was sold under foreclosure in 1915 and that the worthlessness of the stock could not be determined definitely while the parent company's claim was still being pressed. Nor was it possible for him to predict until upon final liquidation of the parent company in 1919 that portion of his $8x$ dollars loan to the company would be lost.

In the opinion of this office, the taxpayer's contentions relative to the stock loss of $20x$ dollars and the bad debt of $4x$ dollars are not without merit. It is, therefore, recommended that these deductions be allowed for 1919.

ARTICLE 144: Shrinkage in value of stocks.

(See I. T. 1888; sec. 326, art. 831.) Stock owned by a corporation the assets of which and those of another were, prior to March 3, 1917, transferred to an entirely new corporation.

ARTICLE 146: Accounting for losses to reflect income. (Also Section 2, Article 1503.)

II-35-1220
A. R. R. 2503

REVENUE ACTS OF 1913, 1917, AND 1918.

The property of the M Bank is referred to in the articles of agreement as partnership property. The stock of the bank is not transferable without the consent of all the partners. The individual property of the partners was liable for the debts of the partnership. The M Bank is, for income tax purposes, a partnership.

Losses incurred by the bank by reason of the actual thefts and conversion of the moneys of the bank to the use of insolvent debtors in 1913, 1914, and 1915 were not deductible under the income tax law in force during those years. However, the actual losses incurred by the bank in later years, because of the actual thefts and conversion of the funds of the bank by its cashier, are proper deductions by the bank in its return for the year in which the embezzlements actually occurred, to the extent that they were not compensated for by insurance or otherwise, rather than for the year in which the embezzlements were discovered. (Article 111, Regulations 45.)

The Committee has had under consideration the appeal of the M Bank from a proposed assessment of income and profits taxes for the year 1920 amounting to $2.28x$ dollars.

Questions involved in this appeal are (1) whether the M Bank was a partnership or an association taxable as a corporation for income tax purposes, and (2) whether certain losses incurred by the bank through embezzlement and unauthorized and unsecured loans by its cashier, A, are proper deductions for the year in which the embezzlement was discovered or for the years in which the actual embezzlements occurred and loans were made.

The questions involved being of a legal nature were submitted to the Solicitor's office for decision, and under date of February —, 1923, the Solicitor advises as follows:

Reference is made to your memorandum of November —, 1922, transmitting to this office the file in the case of the M Bank. Such bank has appealed from a proposed additional assessment of taxes in the amount of 2,28x dollars for the year 1920, and the disposition of such appeal as well as of claims for refund of excessive taxes paid in prior years by the bank and its president, B, is dependent upon the determination of two questions. These are (1) whether the M Bank was a partnership or an association, taxable as a corporation, for income tax purposes, and (2) whether certain losses incurred by the bank through embezzlement and unauthorized and unsecured loans by its cashier, A, are proper deductions for the year in which the embezzlement was discovered or for the years in which the actual embezzlements occurred and loans were made. These questions will be considered separately.

I.

In 1903, —— persons associated themselves together and formed the alleged partnership under the name and title of the M Bank. —— shares of capital stock, par value $—— per share, were issued to the various persons forming the alleged partnership. The articles of agreement provided that the M Bank was organized for the purpose of dealing in exchange, bills, notes, bonds, mortgages, and other securities, receiving deposits, and doing a general banking business. The articles of agreement provided in part:

"The stock and interest of, and in said bank shall be held as, and in the nature of personal and *partnership property* only, and shall always be liable and deemed to be hypothecated for any and all indebtedness or liability of the holder thereof, to the M Bank, whether presently due or otherwise, and the said stock shall not be assignable or transferable in any manner otherwise than hereinafter named.

"That all the property of and belonging to said bank, as lands, tenements, chattels, rights and credits, and choses in action, shall be held by and in trust for said bank, *as partnership and associate property* and assets and for *partnership* and the purposes of the M Bank only.

"That the stock, shares and interests in the M Bank, shall be assignable and transferable only in the books thereof and *with the assent of the board of directors* * * *.

"None of the stock of the M Bank shall be held by a minor either personally or by guardian, nor by any corporation, and in case of the board of directors refusing assent to the transfer of stock to any person competent to hold stock, then and thereupon the holder thereof shall be entitled to require of the M Bank that they receive an assignment of such share or shares of stock and to pay the holder thereof a sum equal to the cash value of such share or shares, with the additional proportional part of the contingent or surplus fund, as indicated by the last monthly statement of the M Bank.

"The M Bank shall continue in existence until it shall be dissolved by a vote of the majority of the shares of stock, * * * nor shall the death of a stockholder be or operate as a *dissolution of this partnership* * * *.

"The legal title of all the property of the M Bank shall be held by the president thereof, in trust for the time being as his own proper name, with the addition 'president in trust for the M Bank.'

"The administration of the business affairs and interests, and of the property of the M Bank shall be exclusively under the control of and devolve upon and be confided to a board of directors composed of eight stockholders * * * and said board of directors shall have power to appoint and employ a cashier, teller, and such other officers, agents and assistants, as they may deem expedient for the transaction of its business, * * *."

Before 1913, all of the original members of the alleged partnership had dropped out with the exception of two, B and A. Also prior to 1913, C became an owner of a small proportion of shares in the alleged partnership bank. These three members had become the sole owners of the bank through the purchase by the bank of the interests of the other members, either from the members themselves or, in case of their death, from their administrators or executors. It is stated that all of the partners constituted the board of directors and that, therefore, under the provisions of the articles of association, no partner could be admitted without the unanimous consent of all the existing partners and no person could dispose of his interest without the consent of all of the existing partners. Also that the stock certificates held by the so-called partners were of no value other than to show the percentage of interest each partner held, and as the stock was purchased or retired by the bank the holdings of the remaining partners were increased proportionately. It appears there never has been any stock or interest transferred from an individual to an individual, the bank in all instances purchasing or retiring the stock.

It appears that during the years 1913 to 1921 the cashier, A, secretly embezzled funds of the bank and made unsecured loans to persons who were known to be financially irresponsible. In 1922 these embezzlements were discovered and the bank was closed, its assets being transferred to a bank examiner by deed of assignment dated ——, 1922. This deed of assignment stated that it was between B, A, and C, copartners, doing business under the firm name and style of the M Bank, parties of the first part, and D, bank examiner, party of the second part. It purported to convey to the bank examiner "all of the partnership property" and all estate, real, personal, and mixed, of the said parties of the first part and each of them, both individually and as such copartners. The bank examiner was authorized to make distribution of such property among the several creditors of the parties of the first part and he was empowered in the names of the parties of the first part and in the name of the copartnership to collect all debts, to sell all property, etc. This deed of assignment was signed individually by each of the so-called partners and the State bank examiner.

The M Bank did not file a corporation income tax return for the calendar years 1913 and 1914 until the return for the calendar year 1915 was due. The revenue office at —— advised such bank at this time that it should file corporation returns, although it had made a request for copies of partnership returns. It, therefore, has been filing corporation returns for the period 1913 to 1920 without any protest and acquiescing in the ruling of the said revenue office that it should file corporation returns.

In further support of the contention that the bank is, and always has been, a partnership, it is stated that such bank is not taxed under the capital-stock tax of the State of Z, imposed upon all corporations, banks, saving institutions, joint-stock associations, limited partnerships and all other companies whatsoever having capital stock. The bank has, however, paid a State tax on gross receipts under the Z State tax act of ——, which provides for a tax upon the gross receipts of every —— and *private banker* in the State of Z. In support of this statement, there is submitted a copy of telegrams passing between the State bank examiner and a certain officer of the State of Z in June, 1922, in which the bank examiner inquired of the State officer as to whether the M Bank ever paid such capital-stock taxes or any other corporation taxes to the State of Z, except the tax on gross receipts of private banks. To this telegram the officer of the State replied that the M Bank had paid no taxes other than the tax on gross receipts of private banks.

As to the question of the division of profits and losses of the bank, it is stated that there never was any special agreement regarding the same. This was transacted at meetings of the partners when either the profits were distributed as dividends and the balance carried into surplus and loss account or as the partners themselves might agree upon. Dividends or distributions were paid to the partners in proportion to their interests. No partner had authority to act for any other partner personally. The partners met and elected their representative officers whose duty it was to represent the bank. All the partners, however, at all times had an active interest in the management of the affairs of the bank. Since 1913 there have only been three partners, two of whom have lived in the city where the bank was doing business continually and were active officers of the bank and one of whom, B, lived in another city in the same State until 1918 and from then on in a city in another State. It was his custom, however, it appears, to make frequent trips

to the city where the bank was located, meeting with the other two partners and directing the affairs of the bank.

These are the facts upon which it is contended that the M Bank should be regarded for income tax purposes as a partnership and that it should be allowed to prepare amended returns as a partnership for prior years.

This office is of the opinion that the M Bank should be treated, for income tax purposes, as a partnership bank from the date of its formation. All the evidence in the case points to this conclusion. In the articles of agreement the property of the bank is referred to as partnership property, and the stock of the bank is not transferable without the consent of the board of directors, which seems to have been composed of all the partners. This indicates an intention to form a partnership, which should always be looked to as the governing factor. Furthermore, article 1503 of Regulations 45, construing section 1 of the Revenue Act of 1918, states that a partnership bank, the interest of whose members may not be transferred without the consent of the other members, is a partnership. Article 63 of Regulations 33 (revised) states that common law partnerships are not associations within the meaning of the income tax law. It is clear that the interests of the partners associated together under the name of the M Bank were not transferable without the consent of all the other partners. Furthermore, the deed of assignment executed in 1922 refers to the three owners of the bank as copartners and such deed or assignment purports to convey all of the partnership property, together with the individual property of all kinds of the three members of the partnership, for distribution amongst the bank creditors. The fact that the individual property of the partners was liable for the debts of the partnership is another factor leading to the conclusion that the bank in question is undoubtedly a partnership. The M Bank has always been considered a private bank under the tax laws of the State of Z and has not been subject to the tax of that State imposed upon the capital stock of corporations, banks, associations, etc., doing business in that State. There is no doubt in my mind, therefore, that the bank under consideration should be accorded a partnership status for income tax purposes.

II.

The second proposition advanced by the taxpayer is that the losses incurred by the bank by reason of the embezzlements by its cashier, A, and because of unsecured loans made during the several years by such cashier to worthless and irresponsible creditors, which loans were unauthorized by the other members of the bank, were proper deductions by the bank for the several years in which the embezzlements occurred and the loans were made, rather than for the year 1922, in which year these transactions came to light.

Upon the discovery of these embezzlements, the M Bank was closed on ——, 1922, and the assignments referred to were made by the individual partners to the bank examiner. As this bank was a private institution organized prior to the State of Z act of ——, covering bank inspections, it was never subject to any State or national inspection. The audit of the books of the bank since ——, 1922, has resulted in the discovery of a great many embezzlements and improper loans. Such books were so handled by the cashier as to conceal the illegal transactions, and they did not disclose the true condition of the company. One item of 1,284.84x dollars represented unauthorized loans made to the N Company, in which company A was interested. Notes, overdrafts, and trade acceptances of the company were taken for these loans, but the evidence disclosed that no collateral security was given and at no time during the period in which these loans were made was the N Company solvent, which fact was known to A. A receiver of the N Company was appointed in ——, 1922, and it has been ascertained that the creditors of such company will probably receive on their claims about — cents on the dollar. Immediately upon the discovery of these improper loans in 1922, the bank officers renounced them and considered them as embezzlements. In fact, the indictment to which A pleaded guilty charged him with the embezzlement of the funds which he had improperly loaned to insolvent debtors without security. It is stated that at least — per cent of the moneys appropriated by A for the use of the N Company is not claimed as a loss, thereby giving a wide margin over and above the possibility of receiving — cents on the dollar from that company. The other embezzlements for which A was indicted were composed of actual thefts by fraudulent withdrawals, and substitution of fraudulent certificates, forged promissory notes and checks, and thefts of Liberty loan and other bonds from private lock boxes in the bank.

It is contended that inasmuch as the improper and unauthorized loans made by A during this period of years were fraudulent and the debts were worthless at the time they were contracted, which worthlessness was known to A at the time they were made, and inasmuch as they were renounced by the officials of the bank when discovered, they were in fact, under the statutes of the State of Z, embezzlements and, therefore, should be charged off as losses in the same way as are actual thefts.

Upon these facts, the question arises as to the year or years in which the losses occurring to the bank through these various transactions were deductible for income tax purposes.

In the opinion of this office, the facts stated disclose a conversion of the funds of the bank by A for the purpose of loaning them to irresponsible and insolvent debtors, which conversion of funds for the use of another amounts to an embezzlement under the State of Z statutes. The loans, accordingly, should be treated in the same respect as are the actual thefts perpetrated by A.

The Revenue Act of 1913 provides that losses actually sustained during the year incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise, are allowable deductions in computing net income. (Section II–5.) No provision was made for losses arising from theft, and this office has held that losses from theft were not comprehended within the phrases "incurred in trade." The Revenue Act of 1916, as amended by the Act of October 3, 1917, enlarged the provisions of the 1913 Act relative to deductions for losses so as to include losses from theft, if not compensated for by insurance or otherwise. (Section 5–a–Fourth.) The Revenue Act of 1918 continued the provisions as to the deductibility of losses arising from theft if not compensated for by insurance or otherwise.

Applying these provisions of the various laws to the facts in the present case, it is apparent that any losses incurred by the bank by reason of the actual thefts and conversion of the moneys of the bank to the use of insolvent debtors in 1913, 1914, and 1915 were not deductible under the income tax law in force during those years. However, the actual losses incurred by the bank in later years because of the actual thefts and conversion of the funds of the bank by its cashier are proper deductions by the bank in its return for the year in which the embezzlements actually occurred to the extent that they were not compensated for by insurance or otherwise rather than for the year in which the embezzlements were discovered. (Article 111, Regulations 45.)

It is, accordingly, suggested that the claims of the taxpayer as to the right of the bank to file amended returns as a partnership and the claims for refund of excessive taxes paid in prior years be disposed of in accordance with the rulings above made, due regard being given to the provisions of the statute of limitations.

The Committee concurs in the conclusions of the Solicitor and recommends that the action of the Income Tax Unit in assessing an additional tax for the year 1920 be reversed and the appeal sustained, and also that the claim for refund of taxes paid be adjusted in accordance with the conclusion that the appellant is liable to tax as a common law partnership.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 147: Losses from the sale and repurchase of securities.

(See Mim. 3156; sec. 202, art. 1564.) Application of the 30-day limitation to the losses from the sale of securities purchased on the margin.

SECTION 214(a)7.—DEDUCTIONS ALLOWED: BAD DEBTS.

ARTICLE 151: Bad debts. II–24–1097
A. R. R. 3211

REVENUE ACT OF 1918.

A, in 1919, loaned B x dollars, taking his note therefor payable in 1924. In 1920 a petition in bankruptcy was filed against B. However, he was not adjudicated a bankrupt, a compromise having been agreed upon by the creditors in that year.

Held, that the amount was not deductible as a bad debt for that year.

A has appealed from the action of the Income Tax Unit in disallowing as a deduction in 1920 an alleged bad debt in the amount of x dollars.

It appears that in May, 1919, the appellant loaned x dollars to B, and took B's note in that amount due May —, 1924. In August, 1920, the M Company, of which B was a partner, was suspended from the Y Stock Exchange and a petition in bankruptcy was filed in the same month against the members of the firm individually and as partners. This petition, however, was not followed by adjudication in bankruptcy. On the contrary, a composition is alleged to have been agreed upon by the creditors in November, 1920, and it is certain that the composition agreement was approved by the court and became effective in the following year. B, therefore, never became a bankrupt in these proceedings. Furthermore, there is a letter in evidence from him to the appellant, dated March —, 1921, in which he recognizes his liability to the appellant. He is still living and actively engaged in business.

Inasmuch as the note in question did not mature in 1920 and in fact will not mature until 1924, the Committee is of the opinion that it was not, and under the facts of this case could not have been, ascertained to be worthless in 1920. Admitting that, not only on account of its terms but also on account of B's financial condition, the note could not have been collected in 1920, it does not follow that it was worthless in that year.

Article 151, Regulations 45, provides in part:

> Where all the surrounding and attendant circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce the payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction.

Since the note does not mature until 1924, it could not have been collected by suit in 1920, and in fact no legal action can be brought to enforce payment until 1924. The Committee is unable to find in the law or regulations or precedents of the Bureau any authority for the deduction claimed by the appellant.

The Committee, therefore, recommends that the action of the Income Tax Unit be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 151: Bad debts. II-26-1118
A. R. R. 3385

REVENUE ACT OF 1918.

Where a note was secured by a chattel mortgage on live stock and a part of the stock died, the taxpayer may not charge off as a bad debt that portion of the note approximating the amount of the loss sustained through the loss of the collateral. Any deductible loss that may be allowed in the case can only be determined after final disposition of the collateral security.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in disallowing bad debts in the amount of $4.25x$ dollars as deductions from gross income of the taxable year 1920.

The amount in question involves the partial charging off of two notes, secured by collateral, against the gross income of 1920, the circumstances in each case being set out in appellant company's brief as follows:

That on May —, 1919, the M Company loaned to the N Company the sum of $5.92x$ dollars as evidenced by a promissory note of that date and amount secured by a chattel mortgage covering $.4y$ head of cattle and horses and second mortgage on real estate.

That during the following winter approximately $.1y$ head of the cattle securing said loan died from exposure and shortage of feed; that the market value of the cattle lost was approximately x dollars and that amount was charged off the loan. That the amount charged off the loan was determined by the directors of the M Company to be a total loss, owing to the absolute loss of $.1y$ head of cattle, which the mortgagor was unable to repay with money or replace with security of a like value.

That after charging off the above amount the note was reduced to the sum of $4.92x$ dollars, and that the principal sum so remaining unpaid was secured by chattel mortgage on cattle and horses and second mortgage on real estate, the value of which did not exceed $4.92x$ dollars.

That the true value of the loan was impaired to the extent of x dollars through the loss by death of $.1y$ head of cattle and that these cattle disappeared entirely as security to the loan, and that the amount of x dollars representing the value of said security was written off the books of the M Company and disappeared entirely as an asset.

* * * * * * *

That on November —, 1919, the M Company loaned to A, administrator, the sum of $8.175x$ dollars as evidenced by a promissory note of that date and amount, secured by chattel mortgage covering cattle and horses.

That during the following winter approximately $.25y$ head of cattle securing the above indebtedness died from exposure to severe weather and shortage of feed; that the market value of the cattle lost was approximately $3.25x$ dollars and that amount was charged off the loan. That the amount charged off the loan was determined by the directors of the M Company to be a loss through the irreparable loss of $.25y$ head of cattle, which the mortgagor was unable to repay or replace with security of like value.

That after charging off the above amount the note was reduced to the sum of $4.92x$ dollars, and during the taxable year 1920 this principal sum was reduced to $1.5x$ dollars by the payment on principal of the sum of $3.42x$ dollars covering the proceeds of sale of the balance of the cattle securing the loan. That the principal sum of $1.5x$ dollars remaining unpaid was secured by horses and second mortgage on real estate, the collateral value of which does not exceed $1.5x$ dollars.

That due to the fact that the mortgagor was an estate and owing to the nature of the security to the loan, it was not deemed practicable to close the transaction by foreclosure, and that to have done so would have caused further pecuniary loss to the M Company. But as set forth above, the true value of the loan was impaired the full amount of the loss charged off—not through depreciation of

security or values, but through the actual death of cattle securing the loan, and that the M Company sustained an actual loss of 3.25x dollars, which amount was written off the books of the corporation and disappeared entirely as an asset.

The Income Tax Unit disallowed both of these deductions as bad debts on the ground that the loss sustained could not be ascertained until all collateral had been finally disposed of.

On the above statement of facts the Committee has reached the conclusion that no deduction may be allowed against the gross income of the taxable year 1920 on account of the partial writing off of these two notes. The fact that the debtor has sustained a loss of cattle or merchandise pledged as collateral for the security of notes does not warrant the creditor in charging off as a bad debt a portion of the notes approximating the amount of the loss sustained by the pledgee, nor is the loss of a part of the collateral conclusive evidence of the worthlessness of any part of the debt. Any loss deduction which may be allowed in the instant case can only be determined after final disposition of the collateral security.

Accordingly, it is recommended that the action of the Income Tax Unit be sustained and the appeal be denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 151: Bad debts. II-31-1171
A. R. R. 4237

REVENUE ACT OF 1918.

A bank charged off the amount of a note secured by collateral in 1919 pursuant to a ruling of a supervisory authority. In that year it could not be determined whether any loss in respect of the note would be sustained. The amount of the loss was determined in 1920. The debt is not properly deductible in the year 1919 and in an amended return may be excluded from the deductions from gross income.

The M Bank appeals from the action of the Income Tax Unit in adding to the net income reported for the year 1920 the amount of 9.71x dollars recovered upon a note charged off as worthless in 1919 and deducted from the gross income reported in the tax return for 1919.

At the beginning of 1919 the appellant held a note for 9.88x dollars, which was secured by a warehouse receipt upon a quantity of goods. Interest upon the note was not paid for a period of six months and under the rulings of the Comptroller of the Currency the note was charged off, although it was known to the appellant that the warehouse receipt held as collateral was worth approximately the face value of the note.

In its income tax return for 1919 the appellant deducted from gross income the amount of the note which had been charged off its books of account. When it came time to file its income tax return for 1920, it failed to include in the gross income the amount of 9.71x dollars, which was realized in 1920, upon the sale of the goods, but filed an amended return for 1919, and excluded from the deductions from gross income the amount of the note which had been charged off in 1919.

After careful consideration, the Committee is of the opinion that the original return of the appellant for 1919 was in error. The note held by the appellant was secured by collateral which had a value approximately equal to its face. In 1919 it could not be determined whether the appellant would sustain any loss in respect of the note. The amount of that loss was determined in 1920. The Committee is of the opinion that this case is essentially different from that considered in A. R. R. 806 (C. B. I–1, p. 156). In the instant case, the debt was charged off in pursuance of a ruling of a supervisory authority, and not upon an ascertainment of worthlessness.

The Committee recommends that the action of the Income Tax Unit, in adding to the appellant's net income the amount realized upon the note in 1920, be reversed and the appeal sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 151: Bad debts. II–35–1221
I. T. 1855

REVENUE ACT OF 1918.

An executor may not deduct in his personal return as a bad debt due from the estate of a deceased an amount which the executor paid out of his personal funds and without legal liability to creditors of a corporation of which the testator was virtually the sole owner.

A died in June, 1918, leaving a substantial estate and appointing B, his nephew, one of the executors. A was practically the sole owner of the M Company. The finances of the company were in such precarious condition at the time of A's death that it was necessary to close out the business. The company was heavily indebted and in order to keep A's name out of bankruptcy proceedings B advanced $3x$ dollars to pay certain of the company's creditors. Two x dollars of this sum was bequeathed to B by A, and the remaining x dollars B borrowed from the estate against executor's fees.

This payment of B's, it is stated, was necessitated by B's relation to the deceased, by the fact that B was executor of his estate and his trusted companion, and because of a verbal promise made by B shortly before his death.

In B's return for 1919 a deduction of $3x$ dollars was claimed in Block "I," based on this payment, as "loss by liquidation of M Company."

Section 214 of the Revenue Act of 1918 provides for certain deductions from gross income in arriving at the taxable net income of taxpayer. Subdivisions (a), (4), (5), and (6) of that section allow as deductions losses incurred in trade or business, losses incurred in transactions entered into for profit, and losses arising from fires, storms, shipwreck, or other casualty, or from theft, if, in each case, such loss is not compensated for by insurance or otherwise. Subdivision (a) (7) of the same section allows as a deduction debts ascertained to be worthless and charged off within the taxable year. Subdivision (a) (11) allows the deductibility of contributions or gifts made to corporations organized exclusively for religious, charitable, scientific, or educational purposes.

In order for the payment in question to be an allowable deduction, it is necessary that such payment be brought within the pro-

visions of at least one of the aforementioned subdivisions of the law. It is clear that a loss such as is contemplated by subdivisions (4), (5), and (6) has not been sustained. Neither is the payment a contribution or gift such as is contemplated by subdivision (a) (11) of section 214.

The debt paid by B personally was a debt of the estate of A. There rested no legal obligation upon B to make such payment and consequently no legal liability of the estate for reimbursement to B has arisen. There can not, therefore, be said to be a debt on the part of the estate to B, which in 1919 proved to be uncollectible and was charged off. Accordingly, the deduction can not be allowed as a bad debt under the provisions of subdivisions (a) (7) of section 214 of the Revenue Act of 1918.

ARTICLE 151: Bad debts. II-36-1237
A. R. R. 4666

REVENUE ACT OF 1917.

All the surrounding and attendant circumstances were such in 1917 that no recovery could be had of any part of amounts due from A and B to the appellant corporation, and that a suit at law would prove unsuccessful. The amounts were charged off the appellant's books in that year and were properly deductible from gross income.

The M Company has appealed from the proposal of the Income Tax Unit to disallow for the year 1917 a claimed bad debt deduction of 4.13x dollars.

* * * * * * *

The records show that in 1916, A, the appellant company's agent at a certain city, and B, a —— broker with an office in the same city, were desirous of chartering a tugboat and entering into a certain contract. They had, however, no funds with which to finance the venture, and in order to secure the contract it was necessary for them to associate themselves with some other person or concern able to finance the undertaking. They, therefore, presented the matter to C, president of the M Company, who, after an informal conference with the directors of his company, decided that the company should take no part in the venture. It is claimed, however, that after this refusal, C agreed to personally take a one-fourth interest in the venture, if the appellant company would guarantee payment of the expense of the undertaking, including the chartering of the tugboat. This was agreed to by the directors of the said company, and it is further claimed that such directors in taking such action were influenced to do so by the fact that they realized the company had not been paying A an adequate salary for the services rendered by him in behalf of the company, and thought that were he able to make some money outside of his regular agency employment he would be better satisfied to remain in the employ of the appellant company. It was also thought that such a favor shown to B would assist in securing the good will of his brother, D, president of the N Company, which company was in a position to throw a great deal of business to the appellant company. Such being the case, it would appear that the appellant company did not undertake to help finance the undertaking proposed by A and B to benefit its president, C, but to benefit itself.

With the understanding that the appellant company would guarantee payment of the expense incident thereto, C took, in the name of his brother, E, a one-fourth interest in the undertaking, and as president obliged the appellant company to guarantee the expense of such venture. A took a similar one-fourth interest and B a one-half interest.

The records in the case further show that the said undertaking was completed late in 1916, and that it resulted in a loss, determined early in 1917, of $5.64x$ dollars, being the excess of the expenses paid by the appellant company over the receipts from the undertaking, which sum was charged on the appellant company's books as follows:

	Dollars.
½ to B	$2.82x$
¼ to A	$1.41x$
¼ to C	$1.41x$
	$5.64x$

During the year 1917 it is claimed every effort was made to collect the sums due from A and B, but such efforts were unsuccessful, and it was ascertained that neither had any asset which might be seized to satisfy a judgment, if one were obtained, and that a suit for collection would be unavailing. The charge against B was, however, reduced to $2.72x$ dollars by application thereto of a credit to his account standing on the books of the appellant company, and this latter amount and the amount due from A, or a total of $4.13x$ dollars, charged off during 1917 as uncollectible.

In 1917, after a determination of the loss had been reached and it was ascertained that no portion thereof could be recovered from A and B, some question was raised by the directors of the appellant company as to C's authority to obligate the company to guarantee the expense of the said undertaking and whether or not the full amount of that loss could be recovered from him on the theory that he was a member of a partnership composed of A, B, and C. The company's attorney, who was also one of its directors, F, held that the association of A, B, and C did not constitute a partnership, but was a joint venture, analogous, as he states in his affidavit of March —, 1923, "to the very wide practice that exists ——— in the shipping business, where vessels are owned in shares, and the owners engage in business not as copartners, but as tenants in common. (See *Spedden* v. *Koenig*, 78 Federal Reporter, p. 504.)"

This decision of F, it is claimed, was fully discussed with all the company's directors, and with it before them, they agreed to accept C's offer to settle his proportionate share of the loss on an installment basis, provided the appellant company's books were cleared of the said account so far as he was concerned.

During the oral hearing of September —, 1923, the opinion was advanced that the above referred to decision of F was in error; that a partnership probably did exist between A, B, and C; but that even were such the case, the company could not have recovered from C by suit any amount advanced to finance the undertaking in question.

Whether or not the appellant company could by a suit at law have recovered from C more than a proportionate share of the total amount advanced and lost on the legal proposition that he, as a member of a partnership, was liable for the debts of that partnership,

the fact remains that during 1917 the directors of the appellant company decided, after investigation and careful consideration of the whole question and upon the advice of the company's legal counsel, that all the surrounding and attendant circumstances were such that no recovery could be had from C of any part of the amount due from A and B, and that a suit at law would prove unsuccessful. Such being the case, the appellant company was justified in considering the accounts due from the said A and B as worthless and uncollectible, and in claiming the total of such accounts as a bad debt deduction for the year 1917. The evidence submitted in the case indicates that had the directors of the appellant company considered that the amount due from A and B would have been recovered from C by suit at law, such suit would have been instituted, and that there was not a voluntary forgiveness on the part of the said company of any debt thought to be due from the said C.

In view of the foregoing, the Committee recommends that the action of the Income Tax Unit in proposing to disallow for the year 1917 a claimed deduction of 4.13x dollars * * * be reversed. * * *

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 152: Examples of bad debts. (Also Section 215, Article 293.)

II–19–1044
I. T. 1751

REVENUE ACT OF 1921.

Stockholders who, in proportion to their stock holdings, purchase paper of the corporation known by them to be worthless, may not deduct the amounts so paid as bad debts. These amounts are held to be an additional price paid for the stock pursuant to a voluntary assessment.

The taxpayer is a stockholder in a State bank. Late in the year 1921 the bank examiner ordered several thousand dollars worth of paper which the bank was carrying, and which was admitted to be worthless at the time, gotten rid of. Instead of the bank charging it off as bad debts, the stockholders agreed among themselves to take it off the bank's hands at its face value in proportion to the amount of stock each held. The taxpayer paid the bank x dollars for a like amount of worthless paper, which amount was deducted as a bad debt in his return for 1921.

Inasmuch as it appears that the paper was worthless at the time it was acquired by the stockholder, and that the stockholders were aware of its worthlessness, the x dollars paid by the taxpayer in question for his proportionate share of the worthless paper is not deductible as a bad debt. It would appear that the stockholders took over the worthless paper in order to prevent the impairment of the capital of the bank, and the consequent effect such impairment would have upon the stock held by them. It is accordingly held that the x dollars expenditure referred to was in the nature of a voluntary assessment upon, and represented an additional price paid for, the shares of stock of the bank held by the taxpayer.

ARTICLE 155: Reserve for bad debts. II-18-1031
I. T. 1743

REVENUE ACT OF 1921.

The addition to the reserve for bad debts for 1922 in the case of the M Company should be computed upon the basis of the accounts and notes receivable. In such computation, there are ascertained (*a*) the total of the bad debts determined to be worthless and charged off (less the bad debts so charged off which were recovered) for the four-year period ended December 31, 1921, and (*b*) the total of the accounts and notes receivable for the four-year period ended December 31, 1920. The percentage of (*a*) to (*b*) is then ascertained, and the reserve for bad debts as of December 31, 1921, is determined by taking this percentage of the accounts and notes receivable outstanding on that date. The addition to the reserve for bad debts for 1922 is determined by taking this same percentage of the accounts and notes receivable outstanding as at December 31, 1922. The computation is as follows:

Date.	Accounts and notes receivable.	Debts ascertained worthless and charged off.	Bad debts recovered.	Percentage.
Dec. 31—	*Dollars.*	*Dollars.*	*Dollars.*	
1917	63x			
1918	61x	4x		
1919	86x	1x	.68x	
1920	147x	12x	.02x	
1921		5x	2.8x	
1922			2.5x	
Total	357x	22x	6x	
	$\frac{(22x \text{ dollars} - 6x \text{ dollars})}{357x \text{ dollars}}$ or $\frac{16x \text{ dollars}}{357x \text{ dollars}}$			4.48

	Dollars.
Reserve for bad debts to be set up on books as at December 31, 1921, 4.48 per cent of accounts and notes receivable as at December 31, 1921 (4.48 per cent of 100x dollars)	4.48x
Addition to reserve for bad debts for 1922, 4.48 per cent of accounts and notes receivable as at December 31, 1922 (4.48 per cent of 125x dollars)	5.6x

Not only is the addition to the reserve for 1922 deductible from gross income for that year, but the amount of bad debts ascertained to be worthless and charged off during that year which were outstanding on December 31, 1921, are also deductible from gross income for 1922, in accordance with articles 151 and 155 of Regulations 62.

Held, also, that the amount of the addition to the reserve for bad debts, claimed as a deduction in the return of the taxpayer for any year, as well as the computation of such deduction, will be subject to review by the Bureau in the audit of the taxpayer's returns, and that in determining the reasonableness of the addition to the reserve for bad debts for any year consideration should also be given to any abnormal business conditions which may affect the collection of the accounts and notes receivable of the taxpayer for such year.

ARTICLE 155: Reserve for bad debts. II–23–1083
I. T. 1774

REVENUE ACT OF 1921.

The taxpayer deducted from gross income for 1921 a reserve for bad debts in the amount of x dollars, but inasmuch as the taxpayer sustained a net loss of y dollars for that year the tax liability was not affected and in the return for 1922 the taxpayer deducted as a net loss for 1921 only z dollars (y minus x dollars). Permission is requested to change the method of claiming deductions for bad debts from the reserve method to that of accounts ascertained to be worthless and actually charged off for the reason that the former method is much more difficult than anticipated, due to the fact that the taxpayer had two widely separated branches besides the main office.

Held, that inasmuch as application was not made prior to the close of the taxable year 1922 for permission to change the method of treating deductions for bad debts, an amended return should be filed for that year, in which there should be deducted only the addition to such reserve. There should be deducted from the net income shown on the return the statutory net loss sustained during the calendar year 1921. Permission is granted for the taxable year 1923 and subsequent years to change from the reserve method to that of reporting bad debts actually ascertained to be worthless and charged off during the year. Debts ascertained to be worthless on or after January 1, 1923, are deductible only if they arose after December 31, 1922, or were outstanding at the time the reserve method was adopted. Those which arose during the years in which the taxpayer claimed as a deduction an addition to a reserve for bad debts are chargeable against the reserve and are not deductible for the purpose of computing net income.

ARTICLE 155: Reserve for bad debts. II–32–1177
I. T. 1825

REVENUE ACT OF 1921.

A taxpayer with a fiscal year ending November 30, which is granted permission for the taxable year 1923 to change to the reserve method of treating bad debts, should report as income for the year in which received amounts collected on account of bad debts which arose prior to the taxable year 1923 and were charged off. Those amounts received which represent bad debts arising during the taxable year 1923 and subsequent years and are charged off should be credited to the reserve and not reported separately.

SECTION 214(a)8.—DEDUCTIONS ALLOWED: DEPRECIATION.

ARTICLE 161: Depreciation. II-37-1252
A. R. R. 4530

REVENUE ACTS OF 1916, 1917, AND 1918.

While one may not for tax purposes be limited as to the amount he is to expend for office furniture, works of art and curios are not, in the case of A, a motion-picture director, to be classed as business assets. Depreciation on such articles, which ordinarily increase in value with age, is disallowed.

A has appealed from the action of the Income Tax Unit in disallowing certain deductions claimed for the years 1916 to 1919, both inclusive.

* * * * * * *

It appears that A, being a man of artistic temperament, has furnished his office with furniture, etc., not of a style usually found in business offices; that such furnishings are of a very expensive type and among them are works of art and curios; it is claimed that the furnishings are only such as are proper in the office of a man following A's profession (motion-picture director). While it is not believed that anyone may for tax purposes be limited as to the amount he is to expend for office furniture, it is the opinion of the Committee that works of art and curios are not, in A's case, properly to be classed as business assets, and that such articles are not subject to such depreciation as is allowable as a deduction from gross income for income tax purposes, the value and desirability of such articles, as a general rule, increasing with age, and inasmuch as the cost of such furniture as may properly be classed as "business assets" has not been shown separate from the cost of the works of art and curios, the Committee recommends that the action of the Income Tax Unit in disallowing depreciation in the amount of —— dollars be sustained until such time as the taxpayer may furnish evidence that depreciation is properly to be allowed.

* * * * * * *

ARTICLE 162: Depreciable property. II-23-1084
I. T. 1775

REVENUE ACT OF 1921.

The cost of an abstract plant, found upon trial to be inefficient and to which additions were not made in order to keep it up-to-date, may be recovered through depreciation or obsolescence allowances.

In 1921 the taxpayer purchased the abstract plant of the M Company. At the time this plant was purchased it was thought it could be used to advantage in the abstract and title guaranty work of the taxpayer but was found upon trial to be inefficient and the records in part a duplication of the records of the taxpayer. It was then decided not to continue additions thereto from day to day in order to keep it up-to-date.

Advice is requested as to whether the taxpayer may take as a deduction depreciation sustained to the plant in view of the fact that it has not been added to or kept up-to-date since its purchase.

Held, that it is a proper case for depreciation or obsolescence allowances and the cost of the plant less the salvage value thereof should be spread equally over the period from the date the permanent abandonment of the plant was foreseen to the date of the permanent abandonment and deductions allowed each year in such amounts for income tax purposes.

ARTICLE 162: Depreciable property.

(See I. T. 1798; sec. 214(a)1, art. 109.) Right to plant oysters granted by the State of X.

ARTICLE 164: Capital sum recoverable through depreciation allowances.

(See I. T. 1848; sec. 326, art. 831.) Property acquired by a corporation or organization with borrowed money.

SECTION 214(a)9.—DEDUCTIONS ALLOWED: AMORTIZATION.

ARTICLE 183: Property cost of which may be amortized. II-27-1127 I. T. 1799

REVENUE ACTS OF 1918 AND 1921.

There was a prosecution of the war after the signing of the armistice in the sense in which the word " prosecution " is used in the provisions of the Revenue Acts pertaining to amortization. However, the taxpayer had no contract for the transportation of men or war supplies at the time of its purchase of a vessel subsequent to November 11, 1918, and only two voyages were made for the transportation of war materials. Held, that the vessel is not considered as having been acquired for the transportation of articles or men for the prosecution of the war.

ARTICLE 183: Property cost of which may be amortized. II-29-1146 A. R. R. 3920

REVENUE ACT OF 1918.

> Coal used in the manufacture of war materials is an article which contributed to the prosecution of the war. Buildings erected for the use of miners of such coal were " buildings constructed for the production " of that article.

The Committee has reconsidered its former recommendation in the appeal of the M Company in so far as it denied amortization on miners' houses built during the year 1918.

As the question involved is one of law rather than fact, it was referred to the Solicitor for consideration and the expression of an opinion. The requested opinion is now before the Committee and is as follows:

The facts upon which the claim for amortization is based are as follows: In 1918 the M Company erected a number of houses at a cost of 15.10x dollars for the purpose of accommodating its miners. Before that time the accommo-

ations at the mine were adequate, but the action of the draft made it necesary in order to respond to the call of the Government for coal to build houses or men with families. Most of the coal was sold to by-product plants for use in the manufacture of ingredients for high explosives. Upon the signing of the armistice, the contracts with the by-product plants were canceled and the chief benefits to be derived from these houses were lost.

Section 234(a)8 of the Revenue Act of 1918, in so far as material, reads as follows:

"SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, * * *, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities * * * as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income. * * *"

Article 184 of Regulations 45 reads in part as follows:

"The total amount subject to amortization shall be the difference between the original cost of the property if constructed, erected, installed, or acquired on or after April 6, 1917; * * * and the value of the property on either of the bases indicated below:

"(2) In the case of property not included in (1) above—(property useful to the taxpayer only during the period of its operation as a war facility)—the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business; such value to be not less than the sale or salvage value of the property; * * *"

The determination of the present question rests upon two propositions: First, whether coal used in the manufacture of war materials is an article which contributed to the prosecution of the war; second, whether buildings erected for the use of miners were "*buildings constructed for the production*" of that article, within the meaning of the above section of the revenue Act.

The urgent demand of the Government during the war for increased coal production and the priority of coal shipments are conclusive of its importance in the prosecution of the war. The increased output of the mine in the instant case was used directly for war purposes in that it was sold to by-product plants that furnished high explosives to the Government. When the demand for the explosives ceased following the signing of the armistice, the contracts with the by-product plants were rescinded and the production went back to normal. The section of the revenue Act in question has not been limited to the implements of war but has been given a liberal interpretation by the Department. (See O. D. 59, C. B. 1, p. 221.)

Production of coal depends upon the number of miners that can be secured. By reason of the isolated locations of coal mines and the large extent of such properties, that number is dependent upon the number of houses available for their use. The houses of the M Company were sufficient to take care of the normal production before the war, but by reason of the draft which necessitated the employment of the married men and the Government's demand for increased production, such accommodations were totally inadequate. The erection of the additional buildings was just as essential to the increased production as the installation of additional machinery or an additional warehouse. It is apparent that such an expenditure could be amortized under the section of the revenue act under consideration. The fact that the buildings were used after the emergency was over would not preclude the amortization allowance. The revenue act contemplates such a use and provides a basis upon which the allowance is to be computed in such cases.

* * * it is the opinion of this office that the M Company is entitled to an amortization allowance on the buildings erected for the use of the miners during the war, the amount of which should be computed in accordance with article 184 of Regulations 45.

In view of the foregoing opinion of the Solicitor, in which the Committee concurs, it is, therefore, recommended that the former recommendation in the instant case be revoked in so far as it applies to the amortization of miners' houses and that the amortization allow-

able for the year 1918 be computed in accordance with article 184 of Regulations 45 (1920 edition) as amended by T. D. 3123 (C. B. 4, p. 184).

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 214(a)10.—DEDUCTIONS ALLOWED: DEPLETION.

ARTICLE 201: Depletion of mines, oil and gas wells; depreciation of improvements. II–33–1193 I. T. 1835

REVENUE ACTS OF 1918 AND 1921.

Oyster beds are not natural deposits within the meaning of section 214(a)10 of the Revenue Act of 1918 and the Revenue Act of 1921, and no deduction for depletion of oyster beds is allowable.

SECTION 214(a)11.—DEDUCTIONS ALLOWED: CHARITABLE CONTRIBUTIONS.

ARTICLE 251: Charitable contributions. II–14–971 L. O. 1118

INCOME TAX—DEDUCTIONS—CHARITABLE CONTRIBUTIONS—SECTION 214(a)11 OF THE REVENUE ACT OF 1918.

Where a charitable contribution is other than money, the basis of the calculation of the amount thereof for the purpose of the deduction allowed under section 214(a)11 of the Revenue Act of 1918 shall be the fair market value of the property at the time of the gift.

Law Opinion 979 (C. B. 2, p. 148), in so far as it is inconsistent with the views herein expressed, is hereby revoked. Article 251, Regulations 45 (1920 edition), and article 251, Regulations 62, should be amended to accord with this holding.

The question is raised as to the amount of the deduction allowable under section 214(a)11 of the Revenue Act of 1918 where the gift is other than money. That section provides as follows:

That in computing net income there shall be allowed as deductions: (11) Contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes * * * to an amount not in excess of 15 per centum of the taxpayer's net income * * *.

In so far as the amount of the deduction is concerned, the provision for the deduction of charitable contributions in the 1918 Act is the same as that contained in the Revenue Act approved October 3, 1917.

After the enactment of the Revenue Act of 1917, Regulations 33 (revised) were promulgated, article 8, section 9, of which was as follows:

Where the gift is other than in money, the basis for calculation of the amount of the gift is the fair market value of the property, the subject of a gift, at the time of the gift.

The above article of Regulations 33, containing the Bureau's interpretation of the 1917 Act, was in effect when the Revenue Act of 1918 was passed, which contained the language above quoted. After the approval of the Revenue Act of 1918, Regulations 45 were promulgated by the Treasury Department, which placed the same interpretation upon the charitable contributions section that the Bureau had placed upon that provision in the former Act.

After the passage of the 1918 Act and the promulgation of Regulations 45, Treasury Decision 2966 [not published in Bulletin service], based upon Law Opinion 979, was issued, which provided as follows:

> Where the gift is other than in money, the basis for calculation of the amount of the gift shall be the cost of the property if acquired after February 28, 1913, or its fair market value as of March 1, 1913, if acquired prior thereto * * *.

It is conceded in Law Opinion 979 that:

> Appreciation in the value of property is not considered income to the taxpayer prior to realization through the conversion of the property (article 23, Regulations 45), and, on the other hand, losses are only deductible when they have been realized, that is to say, when evidenced by closed and completed transactions. A gift of property by the taxpayer is not a realization of gain or loss.

In view of the fact that no gain or loss is realized by a gift of property (article 141, Regulations 45), the question is presented as to whether Congress intended to tax indirectly the unrealized appreciation in value of property, the subject of a charitable gift, by not permitting a deduction therefor to the extent of the appreciation in value.

The statute does not specifically state that the "amount" of the charitable gift should be deducted, but provides that such gifts to an amount not exceeding 15 per cent of the net income should be allowed as a deduction. Senator Hollis, who introduced the charitable contributions amendment, however, stated to the Senate that it meant that the deduction should be for the "amount" which had been contributed to such charitable institutions, subject to the prescribed limitation. This is the interpretation which the Department has uniformly placed upon that provision of the statute in the Revenue Acts of 1917, 1918, and 1921, and the only question has been the determination of the "amount" of the gift for the purpose of the deduction.

Article 8, section 9, of Regulations 33, and also article 251 of Regulations 45, stated that the calculation of the "amount" of the gift shall be the fair market value of the property at the time of the gift. The Bureau subsequently changed the basis for the calculation of the "amount" of the gift in Regulations 45, revised edition. In every instance, however, the Bureau has referred to the deduction as being the "amount" of the gift. It is elementary that a gift is that which is given. When a gift is other than in money, it must be reduced to money value in order that the deduction authorized by statute may be made. No technical language is used in the charitable contributions section of the statute, and it must be interpreted in accordance with the ordinary use and common understanding of the words used. Certainly, according to ordinary usage and common understanding, the "amount" of a gift and the value of a gift have the same meaning and effect.

The provision in the statute relating to deductions in determining the net estate subject to the estate tax first appears in the Revenue Act of 1918. In support of such provision, there appeared before the committees of Congress representatives of charitable institutions, who asked that Congress provide for estate tax purposes deductions for charitable bequests and gifts as had been provided for in the case of gifts or contributions for income tax purposes. The Revenue Act of 1918 provided in section 403(a) for a deduction for—

the amount of all bequests, legacies, devises, or gifts to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes * * *.

The Bureau, in article 53, Regulations 37, held that the amount of the deduction provided for in the above section was the value at the date of decedent's death of such property. The same interpretation was placed upon the same language in the 1921 Act by Regulations 63.

Unless there is some provision in the statute or a clear inference was intended by Congress from the context which would indicate that the language used was intended to have a different meaning, it seems clear that the "amount" of a gift is the value of that which is parted with. An examination of the statute clearly shows that there is no language used from which an inference can be drawn that Congress intended a meaning different from that ordinarily attributed to the language used. It is obvious that where property has increased in value, a gift thereof includes not only the cost or March 1, 1913, value thereof, but also the unrealized appreciation in value of such property. The statute authorizes a deduction for the entire gift, subject only to the 15 per cent limitation.

The charitable contributions section of the 1917 Act was placed in the statute for the purpose of encouraging contributions to charitable organizations during the war. In support of the charitable contributions amendment Senator Hollis, who introduced it, said:

I believe that the Senate will see the necessity for voting that exemption in war times * * *.

It will work in this way—usually people contribute to charities and educational objects out of their surplus, after they have done everything else they want to do, after they have educated their children and traveled and spent their money on everything they really want or think they want, then if they have something left over, they will contribute it to a college or to the Red Cross or some scientific purposes. Now when war comes and we impose these heavy taxes on incomes, that will be the first place where the wealthy men will be tempted to economize, namely, donations to charity, * * *.

Look at it this way: For every dollar that a man contributes for these public charities, educational, scientific, or otherwise, the public gets 100 per cent. It is all donated to that public purpose. (Vol. 55, Cong. Rec., 6728.)

It was clearly the intent of Congress to encourage such gifts. Such encouragement was extended by allowing the donor as a deduction, as Senator Hollis said, "the amount he has contributed for these purposes," subject to the 15 per cent limitation.

On account of the clear purpose of Congress in enacting the charitable contributions section and the express language used permitting a taxpayer to deduct charitable gifts to the amount of 15 per cent of his net income, it is not considered that Congress intended to tax indirectly any unrealized appreciation in the value of property given to charitable organizations by allowing as a deduction something

less than the amount of the property given (subject to the 15 per cent limitation), nor, in the opinion of this office, was it the intention of Congress to allow as a deduction any unrealized loss or decline in value where the property has decreased in value subsequent to its acquisition.

It is therefore held that where a gift to a charitable organization, as provided in section 214(a)11 of the Revenue Act of 1918, is other than money, the basis of the calculation of the amount of the gift for the purpose of the deduction allowed by said section, shall be the fair market value of the property at the time given.

Law Opinion 979, in so far as it is inconsistent with the views herein expressed, is hereby revoked. Article 251, Regulations 45 (1920 edition), and article 251, Regulations 62, should be amended to accord with the views herein expressed.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

NOTE.—Treasury Decision 3490 (C. B. II–1, ruling 953, p. 118), amending article 251, Regulations 45 (1920 edition), and Treasury Decision 3491 (C. B. II–1, ruling 954, p. 119), amending article 251, Regulations 62, were based on Law Opinion 1118.

ARTICLE 251· Charitable contributions. II–23–1085
I. T. 1776

REVENUE ACT OF 1921.

The donor, by written instrument, gave, first, a life estate in bonds to the beneficiary, and, second, a remainder to a church. The gift to the church is within the provisions of section 214(a)11.

The taxpayer by a written instrument dated in 1922 conveyed to a trustee and a donee certain bonds. The trustee, under the instrument, was to pay the income from the bonds to the beneficiary of the trust during his lifetime, and upon his death to deliver the bonds to the donee, an incorporated church. The trust terminates on the death of the beneficiary and the gift of the remainder to the church is absolute. The donor has parted with all her interest in and control over the bonds.

The taxpayer states that the remainder interest acquired by the church has a present cash value and claims that he is entitled to deduct the cash value of his gift to the church under section 214(a)11 of the Revenue Act of 1921. It is contended that, inasmuch as the gift was not made direct to the church, it may not be deducted under section 214(a)11, above referred to.

The donor by the instrument gave, first, a life estate in the bonds to the beneficiary, and, second, the remainder interest to the church. The church has a vested remainder interest in the bonds. There was an immediate gift to the church of a definite right which has a present cash value. It is held that the gift to the church is within the provisions of section 214(a)11 of the Revenue Act of 1921 and that the donor may deduct the cash value (computed as of the date of the gift) in accordance with the provisions of said section.

ARTICLE 251: Charitable contributions. (Also Section 231, Article 519.)

II-27-1128
I. T. 1800

REVENUE ACTS OF 1918 AND 1921.

Civic leagues and social welfare organizations, being specifically exempted under section 231(8) of the Revenue Acts of 1918 and 1921, are not charitable organizations within the meaning of section 231(6), and contributions to such leagues or organizations are not deductible in the individual income tax returns of donors under the provisions of section 214(a)11 of the said Acts.

Inquiry is made as to whether contributions to the M Association are deductible in the individual returns of donors in the manner and to the extent provided in section 214(a)11 of the Revenue Act of 1918.

An examination of the evidence submitted shows that the association in question was incorporated under the laws of the State of S in 18— without capital stock. The management of the corporation is vested in a board of nine trustees.

The articles of incorporation provide among other things—

The object for which it is formed is to provide a center for a higher civic and social life * * *

And the affidavit of the secretary of the association states:

* * * that the work of the association includes the operation of boys' clubs, summer camp, cooking school, girls' clubs, kindergarten, men's clubs and citizenship organizations, day nursery, summer outings, playground work and social work.

In a letter from the president of the association the following statement as to the purpose of the organization is made:

As the founder and volunteer president of the association, who has directed its work since it was started in 18—, I hereby attest that its sole purpose is and always has been civic, educational, and philanthropic, as exemplified in all its work in this cosmopolitan neighborhood—in training for American citizenship, helping immigrant families to help themselves, and in its day nursery, kindergarten, and many educational and social activities for boys, girls, men, and women, as itemized in the inclosed folder.

Assuming that the evidence presented establishes that the association does not contribute to civic and social welfare organizations, it does not affect in any respect the evidence submitted which shows that the association is itself a civic and social welfare organization rather than an association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, which, therefore, does not come within section 231(6) of the Revenue Acts of 1918 or 1921.

It is the opinion of this office that organizations which come within section 231(8) of the Revenue Acts of 1918 and 1921 as "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare" can not be properly classified as charitable organizations within section 231(6), and that the term "charitable" in that section does not include either civic or social welfare organizations.

The term "charitable" has been given various meanings, the meaning in each case depending upon the particular use which is made of the term. In a broad sense, it has been held to apply "to almost anything that tends to promote the well-doing and well-being of

social man." (*Ould* v. *Washington Hospital for Foundlings*, 95 U. S., 303; Perry on Trusts, sec. 687.) Particularly in dealing with charitable trusts or uses the courts have tended to give a very broad meaning to the term "charitable," on the ground that it was expedient to uphold such trusts or uses where a construction of the law would possibly permit it. Thus in *Jackson* v. *Phillips* (14 Allen (Mass.), 539), a case involving the validity of a testamentary trust, the court defined the term "charity," as applied to a trust, as follows:

> A charity, in legal sense, may be more fully defined as a gift to be applied, consistently with existing laws, for the benefit of an indefinite number of persons, either by bringing their minds or hearts under the influence of education or religion; by relieving their bodies from disease, suffering, or constraint; by assisting them to establish themselves in life; or by erecting or maintaining public buildings or works, or otherwise lessening the burdens of government.

It will be seen that "charitable" in this broad sense includes, among other things, education, religion, relief of the poor, social service, and civic or public benefactions. On the other hand, "charitable" in its popular and ordinary sense pertains to the relief of the poor. As so used, "charitable" is defined (11 Corpus Juris, 296) as follows:

> Charitable. In its usual and ordinary sense, pertaining to almsgiving or the relief of the poor, springing from charity, or intended for charity; pertaining to or characterized by charity; benevolence, and kindness; eleemosynary. This word, in the expressions "charitable uses," "charitable trusts," is understood in a very large sense as comprising not only gifts for the benefit of the poor, but also endowments for the advancement of learning, or institutions for the encouragement of science and art, and for any other useful and public purpose, as well as donations for pious or religious objects.

In section 231(6) of the Revenue Acts of 1918 and 1921 the organizations enumerated are religious, charitable, scientific, literary, and educational, while in section 231(8) Congress specifically mentions civic leagues and organizations operated exclusively for the promotion of social welfare. It seems obvious that the intent must have been to use the word "charitable" in section 231(6) in its more restricted and common meaning and not to include either religious, scientific, literary, educational, civic, or social welfare organizations. Otherwise, the word "charitable" would have been used by itself as an all-inclusive term, for in its broadest sense it includes all of the specific purposes enumerated. That the word "charitable" was used in a restricted sense is also shown from its position in the section. The language is "religious, charitable, scientific, literary, or educational * * *."

Considering subdivisions (6) and (8) of section 231 together, it is seen that a distinction is made between religious, charitable (in its ordinary sense), scientific, literary, and educational organizations, on the one hand, and civic and social welfare organizations, on the other hand. All of these organizations would be included within the term "charitable" in its broadest sense, but, in making this distinction between organizations, according to their various purposes, Congress was necessarily precluded from using the word in its broad sense.

It follows, therefore, that civic leagues and social welfare organizations, being specifically exempted under section 231(8) of the Rev-

enue Acts of 1918 and 1921, are not charitable organizations within the meaning of section 231(6), and that contributions to such leagues or organizations are not deductible in the individual income tax returns of donors under the provisions of section 214(a)11 of the said Acts.

ARTICLE 251: Charitable contributions. II-32-1179
(Also Section 231, Article 517.) I. T. 1827

REVENUE ACT OF 1918.

The term "charitable" in section 231(6) of the Revenue Act of 1918 was used in a restricted sense, and if an organization is properly classified within a paragraph of section 231 other than (6), it will not be given a classification under that paragraph. Contributions to an organization not specified in section 231(6) are not deductible.

Advice is requested relative to the deductibility in the return of the taxpayer for the year 1920 of contributions to the M Community Club.

The M Community Club was incorporated under "An act to incorporate associations not for pecuniary profit." The certificate of incorporation signed by the various incorporators, among them the taxpayer, contains the following paragraph:

7. None of the objects of this corporation as hereinabove expressed are intended to be those included within the designation eleemosynary or charitable as such terms are used in the act under which this corporation is organized.

The evidence presented indicates that the club is "operated for pleasure, recreation, fire prevention, preserving health, preservation of order, advancement of civic ideals, promotion of worthy objects, and the development of good citizenship"; that it accomplishes these objects by maintaining a fire department and a community club house and by promoting entertainments and athletic games; that the income of the organization is derived from dues and donations by members and friends and from various entertainments; and that all of said income is used for the purposes set forth.

Since Congress enumerated several types of organizations in section 231 of the Revenue Act of 1918, some of which would be termed "charitable" under a broad definition of that word, it is evident that the term "charitable" in section 231(6) was used in a restricted sense, for otherwise there would have been no occasion for the specific exemption of these other organizations. This office has held, therefore, that if an organization is properly classified within some paragraph of section 231 other than (6), it will not be given a classification under that paragraph.

The activities of the M Community Club appear to be civic and recreational rather than strictly charitable. This distinction was apparently recognized by its incorporators when the paragraph quoted above was inserted in its certificate of incorporation. It follows, then, that the club does not fall within the provisions of section 231(6) of the Revenue Act of 1918. Consequently, contributions to it are not deductible in the returns of individual donors under the provisions of section 214(a)11.

ARTICLE 251: Charitable contributions. II-36-1238
I. T. 1867

REVENUE ACT OF 1921.

A contribution made to a volunteer fire company, a private corporation, to be used by that corporation, although for the benefit of the inhabitants of the municipal corporation in which the fire company was located, is not a contribution "for the use of" the municipal corporation, an entity distinct from the members that compose it. No part of the contribution is deductible.

The question is raised as to whether a contribution made to an incorporated volunteer fire company in the M Township is deductible, under the provisions of section 214(a)11 of the Revenue Act of 1921, as a contribution to or for the use of a political subdivision of a State for exclusively public purposes. It is contended that such a contribution was made "for the use of" a municipality, and, therefore, it falls within the provisions of the section of the Act referred to.

This office does not concur in such interpretation of the phrase "for the use of," as used in section 214(a)11. It is believed that such words were intended to convey a similar meaning as "in trust for." A case is conceivable where property or money might be placed in trust to the use of a State or political subdivision thereof, and, in the opinion of this office, the words "for the use of" were meant to cover such a case.

It should be noted that in the instant case the contribution is made to a private corporation, to be used by that corporation, although for the benefit of the inhabitants of the municipal corporation. The donation is not for the use of such inhabitants, but for their benefit, and clearly it can not be claimed that it is for the use of the municipal corporation, which is a distinct entity from the members who compose it. The words "for the use of" a person or corporation imply a user by or service to that person or corporation. It does not appear that the municipality in any way has any control over the property of the incorporated volunteer fire company or that it has any voice in the manner in which such property should be used. Upon dissolution of the company, the property would not escheat to the State. A right of appropriation or enjoyment of the property of the fire company does not rest in the municipality. A few cases appear in the reports in which the courts have endeavored to interpret the phrase now under consideration. In *Stockbridge Iron Co.* v. *Hudson Iron Co.* (107 Mass., 290) it was held that the phrase "for the use of," as used in a deed by a corporation of land containing a bed of iron ore, reserving the right to the grantor of mining on the granted premises "for the use of" said company, is expressive of the right of appropriation or enjoyment rather than descriptive of the purpose or mode of use and hence the company could assign such right.

And in *Wademan* v. *Albany S. R. Co.* (51 N. Y., 568) it was held that the statute requiring railroads to erect and maintain fences on the side of their road, with farm crossings "for the use of" proprietors of lands adjoining such roads, implies an exclusion of any right in others than the proprietors to use the farm crossings and openings, gates, or bars through the railroad fence.

Accordingly, the phrase "for the use of" seems to carry with it a right of exclusive appropriation or enjoyment of the thing donated. The municipality does not seem to entertain such a right with respect to the property of the fire company and it would necessitate an extremely broad and dangerous construction of the law to hold that the contribution was made "for the use of" a municipality.

ARTICLE 251: Charitable contributions. II-38-1263
I. T. 1880

REVENUE ACT OF 1921.

The university of the State of S is an arm or agency of the State created and operated for a public purpose, namely, providing proper educational facilities—a purely governmental function. Contributions to the State for the use of the university are deductible to the extent provided by section 214(a)11.

An individual, a citizen of the United States, proposes to donate a sum of money to the State of S for the use of the State university sufficient to reimburse the State for the amount expended by it for the purchase of certain real estate, and additional sums for the development of such real estate for the use of the university for educational purposes. The university is supported by the State and is managed and operated by the State board of education, the members of which are appointed by the governor with the consent of the senate. The State has and will retain title to such property and now uses and proposes to use the property for educational purposes under the control of the State board of education.

Under the provisions of section 214(a)11 of the Revenue Act of 1921 and article 251, Regulations 62, contributions or gifts made within the taxable year are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income, including such contributions, if made to or for the use of any State or political subdivision thereof for exclusively public purposes.

The facts submitted clearly show that title to the property, the purchase price of which is to be contributed to the State, is and will remain in the State of S, and that the university is an arm or agency of the State created and operated for a public purpose, namely, providing proper educational facilities—a purely governmental function of the State. It is held, therefore, that the proposed contributions to be made for the purpose stated will constitute contributions made to the State of S for exclusively public purposes, and as such will be deductible to the extent provided by section 214(a)11 of the Revenue Act of 1921 and article 251, Regulations 62.

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses. II-22-1071
I. T. 1767

REVENUE ACT OF 1921.

In a joint return, the husband deducted from his wife's salary the cost of the board and wages of a nurse employed to care for their baby. The wife could not have performed the work for which she

received a salary had not other care been provided for the baby. It was claimed that the amount paid for the nurse was a proper charge as an expense incurred in producing income.

Held, that it was a personal, living, or family expense under section 215(a)1 of the Revenue Act of 1921; therefore not an allowable deduction in the computation of net income.

ARTICLE 293: Capital expenditures.

(See I. T. 1751; sec. 214(a)7, art. 152.) Purchases in proportion to stock holdings made by stockholders of paper of the corporation known by them to be worthless.

ARTICLE 293: Capital expenditures. II–24–1098
I. T. 1781

REVENUE ACT OF 1921.

A payment of indebtedness, incurred prior to bankruptcy, after a discharge in bankruptcy is a capital transaction.

A was a member of the partnership of A & B, which went into bankruptcy during the year 1913 and was absolved from all legal liability as to its creditors. In 1921, A paid x dollars to certain creditors of the old firm.

Held, the theory of the bankruptcy law is that a discharge after an adjudication of bankruptcy destroys only the remedy of the creditors, but does not extinguish the indebtedness. (*Zevalo* v. *Reeves*, 227 U. S., 629.) Consequently, the payment by A can not be considered a gift. It should be treated as a capital transaction and is, therefore, not an allowable deduction in computing his net income for the year 1921.

ARTICLE 293: Capital expenditures. II–32–1180
I. T. 1828

REVENUE ACT OF 1918.

During the year 1918 the balance due a wholesaler, the taxpayer, by a retailer, the debt being evidenced by a note, was canceled on the agreement of the retailer to buy all of his goods in the future from the wholesaler.

Held, that this sum does not constitute an allowable deduction, but that it is a capital expenditure, from which benefit will be derived as long as the retailer fulfills his agreement.

Since 1903 the taxpayer, which is engaged in a wholesale business, has sold goods to a certain firm. In 1915 the retailer owed the taxpayer about $11x$ dollars, for which he gave a promissory note, and by the end of 1917 the note had been reduced to $9x$ dollars. During these years, 1903 to 1917, inclusive, the retailer had purchased about 30 per cent of his merchandise requirements from the taxpayer, and in 1918, in order to induce the retailer to buy all of his goods from it, the taxpayer agreed to cancel the balance of $9x$ dollars due on the

note, provided the retailer would buy all of his goods from the taxpayer in the future.

The retailer accepted this proposition, and for the years 1918, 1919, and 1920 he purchased from the taxpayer goods to the value of $45x$ dollars, $47x$ dollars, and $50x$ dollars, on which the taxpayer's profit amounted to about $5x$ dollars, $6x$ dollars, and $7x$ dollars, respectively. The taxpayer is of the opinion that if it had not entered into this agreement it would not have been able to sell the retailer his entire stock requirements and very likely would not have been able to collect the balance on the note, as the debtor was not in a sound financial condition in 1918. In 1920 the taxpayer charged the item of $9x$ dollars against surplus.

Advice is requested as to whether this sum would constitute an allowable deduction in an amended return for the year 1920, or whether it should be spread over the years 1918, 1919, and 1920 in amended returns for those years.

The amount of $9x$ dollars may not be deducted as a bad debt in the return of the corporation for the year 1918, or any subsequent year, for the reason that the debt was not determined to be uncollectible and charged off during that year or a subsequent year. While the taxpayer regarded the retailer as not being financially sound during 1918, when the agreement to cancel the debt was made, there was apparently no reason for its considering the obligation absolutely worthless.

The taxpayer considers that this amount represented an allowance on the goods sold to the retailer during the years 1918, 1919, and 1920, and as such that it is deductible from gross income. There is no reason, however, for limiting to these years the benefit to be derived by the taxpayer from the agreement of the retailer to purchase goods in consideration of the cancellation of the debt. It is considered that the cancellation represents a capital expenditure from which benefit will be derived as long as the retailer continues to buy all of his merchandise requirements from the wholesaler. Therefore, the amount is not deductible for any of the years 1918, 1919, or 1920.

ARTICLE 293: Capital expenditures. II–33–1194
(Also Section 234, Article 561.) I. T. 1836

REVENUE ACT OF 1921.

The fee paid by a corporation to a stock exchange for purpose of listing its stock is considered a capital expenditure and is not deductible as a business expense.

SECTION 216.—CREDITS ALLOWED INDIVIDUALS.

ARTICLE 306: Credits to citizen entitled to benefits of section 262 and nonresident alien individual.

(See I. T. 1724; sec. 223, art. 404.) Requirement for claiming exemption and credits for nonresident alien whose income has been turned over by the Alien Property Custodian to an attorney in fact.

ARTICLE 306: Credits to citizen entitled to benefits of section 262 and nonresident alien individual. II–32–1181 I. T. 1829

REVENUE ACT OF 1918.

Turkey satisfies the similar credit requirement of section 216(e) of the Revenue Act of 1918.

SECTION 217.—NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

ARTICLE 325: Apportionment of deductions. II–13–961 I. T. 1707

REVENUE ACT OF 1921.

Inasmuch as the British income tax is paid on their entire incomes, British subjects residing in England who file Forms 1040B in the United States should include the entire British tax in the deductions to be allocated under item 18, Form 1040B, and determine the portion of such deductions which may be allocated to income from sources within the United States, in accordance with instructions contained on the form. Any items of tax-exempt income from sources in the United States which were included in the income on which British tax was paid should be included in total gross income from all sources in computing the ratable part of deductions allocable to income from sources in the United States, but must not be included in gross income from sources in the United States, inasmuch as such income is not an item of gross income for purposes of Federal income tax.

SECTION 218.—PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS.

ARTICLE 332: Distributive shares of partners. II–21–1061 A. R. R. 2859

REVENUE ACT OF 1918.

> A was a member of a partnership which had a fiscal year ending January 31. He died in June. His books were kept on the basis of cash receipts and disbursements and the executor made a return for him on that basis. In the return for him for the period from January 1 to the date of his death, his accrued share of the partnership's profits from February 1 to the date of his death should be included.

The taxpayer appeals from the action of the Income Tax Unit in proposing the assessment of an additional tax against A, deceased, for the period January 1 to June 26, 1918, and from the action of the Income Tax Unit in making certain adjustments in the return filed by the estate of A for the period June 27 to December 31, 1918.

A was the principal partner in the partnership of the M Company. The partnership had a fiscal year ending January 31. A died June 26, 1918. Immediately upon his death, or as soon after as was practicable, the partnership caused an inventory to be taken to determine the profits which had accrued to the decedent from the

beginning of its fiscal year, February 1, 1918, to the date of his death. The inventory was taken as of June 30, 1918, and counsel for the appellant has admitted that the profits shown by the inventory are the same as those for the period February 1 to June 26, 1918. The executor made a return for the decedent for the period January 1 to June 26, 1918, and included therein the portion of the partnership profits placed to the credit of the decedent on January 31, 1918, but did not include therein the profits of the partnership from February 1, 1918, to the date of the decedent's death. The Income Tax Unit has amended the return made for the decedent by including therein not only the pro rata share of the year's profits placed to the decedent's credit on January 31, 1918, but also his share of the partnership's profits determined as of June 30, 1918. Attorney for the appellant states in his letter of December 30, 1922:

> We hereby enter an appeal from the Department's decision that the income distributable from the partnership (the M Company) to the taxpayer, A, deceased, for the period ending June 26, 1918, should be included in the return filed for him for that period.

Clause — of the decedent's will reads as follows:

> It is my wish and desire that the business of the M Company, as now conducted, unless previously incorporated, shall be carried on until the expiration of three years from the date of my death by my two sons, B and C, as copartners. In such event, I authorize and direct my executors to allow the capital which I may have at my death invested in the business of the M Company to remain in said business and at the risk of said business until the expiration of three years from the date of my death; and I direct that during such period the interest on my capital therein invested (subject to the transfer, absolutely, to each of my said sons of interests in said business at the time and to the amounts specified in subdivisions (a) and (b) of clause second of this will) at the rate of 6 per cent per annum, without profits, shall be paid to my executors hereinafter named; the profits attaching to the interest of my estate in said business, if any over and above 6 per cent per annum, to be divided equally between my two said sons or the whole to the survivor of them, if one should die before the expiration of said three-year period. At the expiration of said three-year period, I direct my executors to withdraw from said business the capital belonging to my estate invested therein: *Provided, however*, That I authorize and empower my executors, in their discretion, at or before the expiration of said period, to join in forming a corporation of the business of the M Company and to take payment for the whole or any part of the interest of my estate therein, in the shares of stock of said corporation, and I direct that said shares may be held as a proper trust investment under any and all trusts created by this will.

It will be noted from the above that the decedent's interest in the partnership was allowed to remain in the partnership "at the risk" of the business. It is contended that under the decision of the courts of the State of S, the estate of A was a partner in the business of the M Company from the date of the death of A until the expiration of a period of three years, as provided in the will. It was the practice of the partners from and after the date of the death of A to credit the estate monthly with interest upon the assets of the estate left with the business. The attorney for the estate of A claims that this was only a memorandum entry and that it could not be known until an inventory was taken whether the estate would be entitled to any interest. It therefore contends that the income tax return filed by the estate for the period June 26 to December 31, 1918, should not include any interest placed to the credit of the estate upon the partnership's books.

Relative to the first point involved, the attorney for A, deceased, states in his brief of July —, 1922, as follows:

Objection to the proposed additional tax shown above is made for the following reasons:

(1) The examining officer has included in the return for the period prior to the date of death A's accrued share of partnership profits from February 1, 1918, to June 30, 1918. In accordance with a ruling made by former Commissioner of Internal Revenue, Hon. Daniel C. Roper, with relation to the method of reporting a decedent's accrued share of partnership profits, we contend that such accrued share of profits should be reported in the first return filed by the executors. In this connection, we quote as follows from telegram received from Hon. Daniel C. Roper, addressed to the N Company:

"In case decedent kept his books on basis of cash receipts and disbursements, amount received by executors representing his proportion of partnership profits accrued during his lifetime should be accounted for by executors in return for estate in process of administration."

It is submitted that A's books, as well as those of the executors of his estate, are kept on the basis of cash receipts and disbursements. We, therefore, protest against the examining officer's method of including A's accrued share of partnership profits from February 1, 1918, to June 30, 1918, in the decedent's return for the period from January 1 to June 26, 1918.

(2) We claim that the tax for the period from January 1 to June 30, 1918, should be assessed in accordance with the recomputation shown in Exhibit A, annexed hereto, which indicates that A, deceased, has overpaid taxes for that period to the extent of 1.82x dollars, instead of having underpaid 2.53x dollars, indicated by the Treasury Department.

Section 218(a) of the Revenue Act of 1918 provides in part as follows:

That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

I. T. 1383 (C. B. I–2, p. 157) reads as follows:

As the effect of the death of a member of a copartnership is to capitalize his property rights and interests, only the excess received by his executor over and above the value of the decedent's interest in the partnership business at the time of his death is to be treated as a part of the gross income of the estate.

The appellant contends that I. T. 1383 is not the law; that the estate of a deceased partner, keeping its books of account upon the basis of cash receipts and disbursements, should be required to include as a part of its taxable income the decedent's share of partnership profits, the amount of which was determined after the date of decedent's death.

The Committee is clearly of the opinion that I. T. 1383 correctly states the law applicable to the situation under consideration. The status of a partner under the Income Tax Law of 1913 has been defined as follows:

This law, therefore, ignores for taxing purposes the existence of a partnership. The law is so framed as to deal with the gains and profits of a partnership as if they were the gains and profits of the individual partner. * * * The law looks through the fiction of a partnership and treats its profits and its earnings as those of the individual taxpayer. Unlike a corporation, a partnership has no legal existence aside from the members who compose it. The

Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name.

United States v. *Coulby* (251 Fed., 982, affirmed 258 Fed., 27) (C. B. 1, p. 166). This language is equally applicable to the Revenue Act of 1918.

Relative to the second point in issue, the Committee is of the opinion that the estate of A should not be required to include in the income tax return filed for the period June 27 to December 31, 1918, so-called interest placed to the credit of the estate at the close of each month upon the partnership books of the M Company. It was never the intention of the partners that said amounts should be available to the estate prior to the end of the partnership's fiscal year. They were not withdrawn by the estate as they accrued month by month, and it could not be definitely known until the end of the fiscal year or until an inventory was taken whether there had been profits which would warrant the payment of interest upon the assets of the estate left with the partnership.

The Committee recommends that the action of the Income Tax Unit upon the first point in issue be sustained and that its action upon the second point be reversed, and accordingly that the appeal be sustained in part and denied in part.

KINGMAN BREWSTER.
Chairman Committee on Appeals and Review.

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 341: Estates and trusts.

(See I. T. 1720; sec. 213(a), art. 31.) Deductibility of interest required to be paid by the law of the State upon specific legacies when their payment is deferred.

ARTICLE 341: Estates and trusts. II–32–1182
A. R. R. 3959

REVENUE ACTS OF 1916, 1917, AND 1918.

Where, under the provisions of a will, trustees are required to keep the corpus of an estate intact, and the physical property forming a part of the corpus of such estate has suffered depreciation through its employment in business, a deduction from gross income for the purpose of caring for this depreciation where the deduction is applied or held by the fiduciary for making good such depreciation may be claimed by the fiduciary. This is true whether a portion of the income from the trust is distributed periodically or whether the whole thereof is retained for final distribution at the termination of the trust.

The Committee has considered the appeal of the estate of A from the action of the Income Tax Unit in (1) disallowing depreciation on buildings from 1916 to 1919, inclusive.

As a question of law was involved, the case was submitted to the Solicitor for an opinion. The opinion of the Solicitor is as follows:

The essential facts are as follows:

A died testate, and by his will he devised and bequeathed certain property, real and personal, to different persons, and then provided that the remainder of his estate should be held in trust. A copy of the will is in the file.

The portions of the will, commencing at paragraph 16, which deal with the creation, continuance, and conclusion of the trust are very clear and specific, and they provide that the remainder of the estate shall become the property of the trustees subject to the powers and provisions of the will; that out of the *net income* from the estate certain specific payments shall be made; that the trustees shall have full power in the management of the trust estate and the investment of the funds thereof, excepting that investments of personal property shall be made only in the classes of property authorized for investments by savings banks in that State; and that upon the death of the last descendant of the deceased who shall have been born within the deceased's lifetime the entire trust estate shall be distributed. The will contains no provision for the distribution of the corpus of the estate prior to the termination of the trust.

The revenue agent in his report disallowing depreciation said:

"Inasmuch as the will does not provide for keeping intact the corpus of the estate or its later acquirements of all depreciable assets, and there has been no court decree making such provision, it does not appear that the trustees have met the conditions of paragraph 199, providing for a deduction under the circumstances."

A careful consideration of the will shows that the conclusion of the revenue agent is clearly wrong. As pointed out above, the will provides for the maintenance or the continuation of the trust estate for a period of years and contains no provision for the distribution of the corpus.

Paragraph 199 of Regulations 33 (revised) in part reads as follows:

"In the case of a trust estate where the terms of the will or trust or the decree of a court of competent jurisdiction provides for keeping the corpus of the estate intact, and where physical property forming a part of the corpus of such estate has suffered depreciation through its employment in business, a deduction from gross income for the purpose of caring for this depreciation, where the deduction is applied or held by the fiduciary for making good such depreciation, may be claimed by the fiduciary in his return of income."

The terms of the regulations just quoted are clear and comprehensive. The provisions of the will in the instant case require the trustees to keep the corpus of the estate intact, and the physical property forming a part of the corpus of such estate has suffered depreciation through its employment in business. The taxpayer states that there was annually added to the corpus a sum more than sufficient to cover the depreciation claimed.

Under the regulation quoted it is immaterial whether a portion of the income from the trust estate is distributed periodically or whether the whole thereof is retained for final distribution at the termination of the trust, so long as the amount of the deduction is not distributed to the beneficiaries.

I am of the opinion that the case falls squarely within the provisions of the regulation above quoted, and that the estate is entitled to deduct any depreciation actually sustained.

The Committee concurs in the above opinion, and accordingly recommends that the appeal be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 341: Estates and trusts. II-39-1269
I. T. 1885

REVENUE ACTS OF 1918 AND 1921.

The income of the trust estate, a nonresident alien entity, from sources within the United States is not distributable and no deduction may be made on account of any income actually paid a beneficiary.

The testator, a citizen and resident of Canada, at the time of his death in 191—, was the owner of real and personal property in the Dominion of Canada and also of certain real property in the State of S. By his will he devised and bequeathed all his property, real and personal, wheresoever situated, to three trustees, of whom B, also a citizen and resident of Canada, is the sole survivor. The trustees were directed to convert the estate into money but were empowered, pending advantageous sales of the testator's real estate, to lease it, to erect improvements, and to keep the improvements in repair.

The testator directed that until such of his estate as was not already in the form of money or securities for money should be sold or converted into money, all the rents, issues, and profits thereof and all other income of his estate should be invested by the trustees in first mortgages of real estate or in Canadian or British securities. All surplus income of the fund so formed was directed to be reinvested in like manner, and the accumulations were to continue for a period of 21 years after the testator's death. The testator further provided that "out of the income of the *fund so formed* and after the payment of the necessary expenses of management" certain legacies or annuities were to be paid to his widow and children.

Letters testamentary upon the decedent's estate were issued by a surrogate court in Canada and ancillary administration of the real estate in the State of S was had in a probate court of said State. The ancillary estate was closed and the executors were discharged in 191—, and since that time the testator's real estate in the State of S has formed part of the trust estate provided for in the will.

The nonresident alien trustee maintains an office in the State of S for convenience in collecting the income from the property in this country and has appointed a resident agent, whom he visits several times a week.

During the year 1921 there was paid, pursuant to the terms of the will, out of the income of the trust an amount of x dollars to an alien resident in the United States.

The following inquiries are submitted: (1) Whether the trustee should be classed as a resident or nonresident fiduciary; and (2) whether the x dollars paid to the resident alien beneficiary out of the income of the trust may be deducted from the gross income of the trust.

The status of the fiduciary as a citizen or an alien, a resident or a nonresident, has nothing to do with the status of the trust. In case of a trust which is treated as a taxable entity the tax is imposed upon the income of the trust, not of the trustee, although the trustee is required to pay it on behalf of the trust for which he acts. The status of such a trust depends upon where it was created. If it owes its existence to the laws of a foreign country or of a political subdivision thereof, it is to be regarded as a nonresident alien entity.

The trust estate now under discussion is obviously a nonresident alien entity because it owes its existence to the laws of a foreign jurisdiction. Such being the case, the only income subject to the taxing power of the United States is that derived from sources within the United States. Since this income is, under the terms of the will, not distributable but is directed to be reinvested in foreign securities, it is clear that the trust, in so far as it is within the purview of the Federal Income Tax Act, is not one whose income is distributable in part, but is one whose income is to be held for future distribution. From the fact that the income of the trust from sources within the United States is not distributable it follows that no deduction may be made on account of any income actually paid a beneficiary.

ARTICLE 343: Decedent's estate during administration. II–24–1099 I. T. 1782

REVENUE ACT OF 1921.

In the case of an estate in process of administration or settlement where all of the income is paid or credited to the beneficiary, the executors may not, in their return on Form 1040 for the estate deduct the specific exemption of $1,000 and report as paid or credited to the beneficiary (to be reported by her in her return) the amount actually shown on their books less such $1,000. The beneficiary must report in gross income in her individual return the entire amount of the income of the estate so paid or credited to her.

The estate of A is in the process of administration or settlement and all of the income is paid or credited to the widow.

The question has been presented as to whether, in the returns on Form 1040 for the estate, the executors may deduct the specific exemption of $1,000 and report as paid or credited to the beneficiary (to be reported by her in her return) the amount actually shown on their books less such $1,000.

Under the provisions of section 219 of the Revenue Act of 1921 any portion of the income of an estate of a decedent before final settlement which is properly paid or credited as such to a beneficiary is taxable directly to the beneficiary. While the credit of $1,000 specific exemption for the purpose of the normal tax is allowed in determining the amount of normal tax payable by the fiduciary upon the portion of the net income, if any, taxable to the fiduciary, such credit can not be taken against the portion of the income properly paid or credited to the beneficiary but the beneficiary must report in gross income in her individual return the entire amount of the income of the estate so paid or credited to her regardless of the amount of such portion.

ARTICLE 343: Decedent's estate during administration. II–30–1155 A. R. R. 3293

REVENUE ACTS OF 1916, 1917, AND 1918.

The portion of the income of an estate of a deceased person, received during the period of administration, which accrued to an exempt corporation, the residuary legatee, is not exempt from income tax. *Lederer* v. *Stockton* (C. B. I–1, p. 156) distinguished.

The Committee has considered the appeal of the estate of A from the action of the Income Tax Unit in proposing to reject claims for the refund of portions of the taxes paid for the years 1915 to 1920, inclusive, and from its action in proposing an assessment of additional taxes for certain of the years involved.

A died October —, 1915, leaving a last will and testament in which he bequeathed large amounts of money and other property to specific legatees and his entire residuary estate to a university in the city of S, an educational corporation, the income of which is exempt from taxation imposed by the United States Revenue Acts. Clauses of his will read as follows:

> After all other legacies given by this will are paid and all trusts hereby created are established, then out of the rest, residue and remainder of my estate which shall remain, I give and bequeath to the M Company, incorporated in the year —, the sum of x dollars, or so much of that sum as my estate will suffice to pay, to be applied to the uses and purposes of said company. It is my desire that a portion of said fund be used for elementary instruction and that such instruction be made available not only for those who are able to take extended courses, but also for relatively short courses of instruction for those whose circumstances so require.
>
> All the rest, residue, and remainder of my estate, real and personal, including all property given by any devise or bequest herein contained which shall lapse or fail to take effect, I give, devise, and bequeath to the university in the city of S.

Upon the presentation of A's will for probate, objections to the probate were filed by certain of his heirs at law and next of kin. As a result thereof, temporary administrators were appointed by the surrogate's court of the city of S by an order dated November —, 1915. Letters of temporary administration were issued thereunder on December —, 1915. In trial before the surrogate and a jury in 1916, the jury found against the will, and an appeal was taken by the residuary legatee, of said university. The appeal was argued in April, 1920, and the appellate division handed down its decision in April, 1921, reversing the findings of the jury in the surrogate's court and directing a new trial. A new trial was had in January and in February, 1922, the jury again found against A's will.

This finding, however, was set aside by the surrogate. Before a new trial was had, objections to the probate of the will were withdrawn, and it was admitted to probate on June —, 1922, and letters testamentary were issued to the sole surviving executor named in the will.

The temporary administrators made income tax returns for the estate for each of the years 1915 to 1920, inclusive, and paid the income taxes assessed thereon. During all of this period the residuary legatee, said university, received no portion of the income from the estate and had no control over it.

Contention is now made that inasmuch as the income of an educational institution, such as this university admittedly is, is exempt from tax upon its income, such portion of the income of the estate during the period of administration as accrued to the residuary legatee should also be held to be exempt from tax.

The Revenue Act of 1916 provides, in section 2(b), that:

> Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the

benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: *Provided*, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

Question arose as to whether the contributors to the Pennsylvania Hospital, a corporation of Pennsylvania, created for charitable uses and purposes, were liable to income tax upon income actually received by it in 1916 and 1917 under the will of Alexander J. Derbyshire. The facts in the case were that the corporation was actually receiving the income. The United States Supreme Court held in *Lederer* v. *Stockton* (vol. 43, No. 1, Supreme Court Reporter, p. 5) (C. B. I–2, p. 156) that " this residuary fund was vested in the hospital. The death of the annuitant would completely end the trust. For this reason, the trustee was able safely to make the arrangement by which the hospital has really received the benefit of the income subject to the annuity. As the hospital is admitted to be a corporation whose income when received is exempted from taxation under section 11(a), we see no reason why the exemption should not be given effect under the circumstances. To allow the technical formality of the trust, which does not prevent the hospital from really enjoying the income, would be to defeat the beneficent purpose of Congress."

In view of the decision of the Supreme Court in that case, the appellant contends that the income accruing upon the residuary legatee's interest under the will of A was likewise exempt from tax during the period of administration.

The Committee is clearly of the opinion that the situation of the university in question is materially different from that of the contributors to the Pennsylvania Hospital considered in the case of *Lederer* v. *Stockton*. In that case the income which the United States tried to tax was actually received and enjoyed by a corporation the income of which was clearly exempt from tax. In the instant case, the income was not only not received or enjoyed by this university but during the years in question there was only a possibility that it would ever be enjoyed by it.

The Revenue Act of 1918 is more specific than the Revenue Act of 1916 in holding that the income of an estate during the period of administration is liable to income tax. It is specifically provided in section 219(b) of the Act that " the net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212 * * *."

In view of the specific language of the taxing Acts and of the dissimilarity between this case and *Lederer* v. *Stockton*, the Committee is of the opinion that the estate is subject to tax upon its entire net income for the years 1916 to 1920, inclusive.

The Committee recommends that the action of the Income Tax Unit be modified as above indicated and, accordingly, that the appeal be allowed in part and denied in part.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 343: Decedent's estate during administration. II–36–1239 I. T. 1868

REVENUE ACT OF 1921.

Dividends were declared prior to the close of the calendar year, payable in the following year. The taxpayer died early in the following year, and prior to the date on which the dividends were payable.

The dividends in question are subject to tax to his estate only to the extent they exceed the value of decedent's right to receive such dividends (when payable) at the time of his death. No report of such dividends should be made in either return filed for the decedent for the taxable periods during which he was alive.

ARTICLE 344: Incidence of tax on estate or trust. II–30–1156 I. T. 1812

REVENUE ACT OF 1918.

The Government has a right in equity to follow the assets of the estate into the hands of the heirs, devisees, legatees, and distributees, as a trust fund for the payment of tax. Story's Equity Jurisprudence, section 1251; Perry on Trusts and Trustees, section 244; *Williams* v. *Gibbes* (17 How., 239); *Continental Nat'l Bank* v. *Heilman* (81 Fed., 36); *Union Trust Co.* v. *Shoemaker* (101 N. E. (Ill.), 1050).

The fact that assessment was made in the name of the decedent does not prevent the Government from instituting a suit in equity against the beneficiaries of the estate for income taxes due from the decedent. *New York Life Insurance Co.* v. *Anderson* (257 Fed., 576).

A State statute prescribing the time and procedure for presenting claims against the estate of deceased persons does not bar a suit by the United States against beneficiaries of the estate to recover Federal taxes due from the decedent. (*United States* v. *Hoar*, Fed. Cases 15, 373; *United States* v. *Backus*, Fed. Cases 14, 491; *Pond* v. *United States*, 111 Fed., 989.)

ARTICLE 345: Estates and trusts taxed to beneficiaries. II–13–962 I. T. 1708

REVENUE ACT OF 1921.

A trust created by a will provided for the periodical distribution of income of stipulated amounts and the accumulation of the residue. The testator provided for the termination of the trust in 20 years in 1920. By agreement of the beneficiaries the assets of the trust were distributed in 1916, except a claim which was in litigation and which was not settled till 1922, when the principal and accrued interest were received by the trustee.

The trustee was bound to distribute the income received in 1922, and it is taxable to the beneficiaries.

The decedent died in 1900, leaving a will by which he devised his estate to trustees, to be held and invested by them for a period of 20 years; monthly payments of $2x$ dollars each to be made to two beneficiaries; the residue of the income to be accumulated; at the expiration of 20 years the estate to pass to his two children, if then living; if not, to their issue, if any. This trust expired in 1920.

In 1916, by agreement between the beneficiaries, the assets of the estate were distributed between the beneficiaries with the exception of a claim for about $50x$ dollars, with accrued interest, covering some 10 or 15 years prior thereto, which claim was in litigation. This litigation was not settled and the principal, with interest, recovered until 1922.

Inquiry is made whether the interest accrued since March 1, 1913, represents income taxable to the trustees or to the beneficiaries.

In 1920 the directions of the testator for the termination of the trust had been executed in so far as it was practicable to do so and but for the claim in question, no trust would have existed after that date. When the claim and interest were collected, therefore, the trustees had no authority to accumulate this income but were bound to distribute it in accordance with the directions contained in the testator's will. The income, therefore, being distributable was not taxable to the trustees but was taxable to the beneficiaries. (Article 345, Regulations 62.)

ARTICLE 345: Estates and trusts taxed to beneficiaries.

(See I. T. 1834; sec. 213(a), art. 31.) Share of income from mineral lands of each member of Osage Tribe of Indians received from United States as trustee.

ARTICLE 347: Estates and trusts with income which is distributed periodically and other income. II-16-1000 I. T. 1733

REVENUE ACT OF 1921.

Where there is a legal dispute as to the proper distribution of a portion of the income of a trust, which trust, on its face, provides for the periodical distribution of the entire net income, the portion of the income of the trust withheld by the trustee pending the termination of the litigation is not in fact distributable to either beneficiary, and is to be accounted for by the trustee in a return on Form 1040 or 1040A filed by him for the trust estate as an entity.

By the terms of the will of A, a trust was created for the benefit of B during his lifetime. The will provided that after the death of B the trust estate was to be divided into four equal parts, to be held under separate trusts for the benefit of B's four children, if they should survive their father. B was, however, given power under the terms of the will of A to change, by his own will, the proportions in which the trust fund was to be divided among his four children.

B died in January, 1922, having made a will whereby, as is contended by his son, C, he directed that the share of his son, C, should

be increased to 40 per cent of the whole fund and that the share of his son, D, should be decreased to 10 per cent. D contends that his father had no power to decrease his share and increase that of C, and has filed suit for a construction of his father's will.

Pending the termination of this suit, the trustee has paid to C 25 per cent of the net income of the trust and to D 10 per cent. The remaining 15 per cent is held by the trustee, and will be paid to the person found by the court to be entitled thereto.

The trustee has requested instructions as to how the amounts retained pending the determination of the suit are to be treated for income tax purposes.

This office is of the opinion that because of the dispute as to the ownership of the 15 per cent of the income in question, the trust in this case is one of the sort described in section 219(e) of the Revenue Act of 1921, one whose income consists both of income which is distributable among the beneficiaries and other income.

Section 219(a) of the Revenue Act of 1921 provides:

> That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—(1) Income received by estates of deceased persons during the period of administration or settlement of the estate; (2) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests; (3) income held for future distribution under the terms of the will or trust; and (4) income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

Subdivision (c) of this section provides:

> In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

It is clear from the wording of the subdivision immediately above quoted that the enumeration contained in subdivision (a) is not exhaustive, for subdivision (c) provides that "in cases under paragraphs (1), (2), or (3) of subdivision (a) *or in any other case within subdivision (a)* of this section except paragraph (4) thereof" the tax is to be imposed upon the net income of the estate or trust and is to be paid by the fiduciary.

Paragraph (4) of subdivision (a) taxes "income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, * * *." It is true that subdivision (d) of section 219 provides that "in cases under paragraph (4) of subdivision (a), * * * the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust * * * which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, * * *." It seems clear, however, that in order to be taxable to the beneficiary the income must be in fact distributable to him, it must be his for the mere asking; that is, the income must be at least constructively received by him. It is not believed that the courts would look with

favor upon an attempt to tax as income to the beneficiary any income of a trust of which he could not, by any act of his own, obtain possession. With regard to the income withheld by the trustee pending the termination of the dispute as to its ownership, it can not be said, therefore, that such income is in fact distributable either to D or to C.

It is clear, however, that this amount of 15 per cent is income to some one. It must be treated in one of three ways: First, the Department must construe the will independently of the court and decide which person is entitled to the 15 per cent in question; or, second, the amount must be held to be income to no one until the litigation is terminated; or, third, the income must be taxed in the hands of the trustee as income of a trust which falls within none of the enumerated classes. It is not considered politic for the Department to make its own construction of the will, for the rights of the parties will be determined by the decision of the court. Neither is it thought to be proper to leave the question of income in suspense, for the payments are being received by the trustee and are obviously income to some one, either the trust or a beneficiary, each year. The only remaining alternative is to treat the amount so withheld each year by the trustee as undistributable income and to subject it to tax in the trustee's hands.

It is therefore held that the trustee should, for each year prior to the final decision of the question which one of the children is entitled to the 15 per cent withheld, make a return under section 219(e) of the Revenue Act of 1921 and article 347 of Regulations 62 of the income of the trust. The 15 per cent withheld pending the termination of the litigation will be taxable in the hands of the trustee and the balance of the net income of the trust will be subject to tax in the hands of the beneficiaries. The amounts of 15 per cent previously withheld in each year will not, when they shall have been paid by the trustee to the successful litigant, be income in the hands of such beneficiary.

ARTICLE 347: Estates and trusts with income which is distributed periodically and other income. II-26-1119 I. T. 1794

REVENUE ACT OF 1918.

Prior to June 1, 1920, a trust was a discretionary trust, the income of which was distributable or not in the discretion of the trustees. On that date it was modified so that the income was partly distributable periodically and partly distributable or accumulative in the discretion of the trustees.

For the year 1920, therefore, if the net income of the trust equaled or exceeded $1,000 per annum the trustees must file a return on Form 1041 showing the amounts of trust income distributable to the beneficiaries under the terms of the trust as modified by the trust agreement of June 1, 1920, whether such amounts were actually distributed or not; and also the excess, if any, of the net income over the aggregate distributive shares of the individual beneficiaries, together with the entire net income of the trust for that part of 1920 prior to June 1 of said year. If the amount of said excess plus the net income for that part of the year 1920 prior to June 1 thereof equaled or was greater than $1,000 for the year, the trustees must also file a return for the trust on Form 1040 or Form 1040A, as the case may be, and pay the tax thereon, if any. Any amounts of trust income shown on Form 1041

filed by the trustees as distributable to the beneficiaries under the terms of the trust as modified by the trust agreement of June 1, 1920, must be reported by the beneficiaries in their individual income tax returns, whether such amounts were actually distributed to them or not.

A partnership was dissolved and its assets placed in a trust fund of which a new partnership of the same name was made trustee with absolute control. In 1890 the trust instrument was amended authorizing the trustees in their discretion to declare dividends out of earnings or out of such part thereof as they might determine proper. In June, 1920, the trust instrument was further amended so as to provide that a certain proportion of the earnings should be distributed to the beneficial owners, but if such proportion was less than a stated amount then the trustees were to distribute the said stated amount. From any income remaining, the trustees might also in their discretion distribute additional dividends.

Held, that prior to 1920 the trust was a discretionary trust, the income of which was distributable or not in the discretion of the trustees; under the trust instrument of 1920, the trust is one of which the income is partly distributable periodically and partly accumulative in the discretion of the trustees.

For the year 1920, therefore, if the net income of the trust equaled or exceeded $1,000 per annum, the trustees must file a return on Form 1041 showing the amounts of trust income distributable to the beneficiaries under the terms of the trust as modified by the trust agreement of June 1, 1920, whether such amounts were actually distributed or not; and also the excess, if any, of the net income over the aggregate distributive shares of the individual beneficiaries, together with the entire net income of the trust for that part of 1920 prior to June 1 of said year. If the amount of said excess plus the net income for that part of the year 1920 prior to June 1 thereof equaled or was greater than $1,000 for the year, the trustees must also file a return for the trust on Form 1040 or Form 1040A, as the case may be, and pay the tax thereon, if any. Any amounts of trust income shown on Form 1041 filed by the trustees as distributable to the beneficiaries under the terms of the trust as modified by the trust agreement of June 1, 1920, must be reported by the beneficiaries in their individual income tax returns, whether such amounts were actually distributed to them or not.

ARTICLE 347: Estates and trusts with income which is distributed periodically and other income. II–30–1157 A. R. R. 3421

REVENUE ACT OF 1918.

Income was payable to several beneficiaries periodically on June 15 and December 15, the will providing that the payments be made to such beneficiaries only "as may be living at the time of payment." The highest court of the State decided that a beneficiary dying between the dates of semiannual distribution was entitled to no apportionment of the income received by the trustee subsequent to the last preceding distribution date.

Held, that the income of the trust from December 16 to December 31, inclusive of each year, was accumulated for persons with contingent interest and should be reported in the calendar-year returns of the trustee and the tax thereon paid by him.

The Committee has considered the appeal of A from the action of the Income Tax Unit in proposing the assessment of additional taxes for the years 1918 to 1920, inclusive.

The question involved in this appeal is whether the income of a trust fund from December 16 to December 31 of each of the years 1918, 1919, and 1920 is taxable to the appellant, a beneficiary of the trust.

The appellant is the beneficiary under the will of B, who died June —, 187–. The will provided for the payment out of income of certain annuities and stipulated that the "said annuities shall begin to run from my death, and shall be paid in equal semiannual payments, and the first payment thereof to be made at the end of six months next after my death." This will further provided that the remaining income shall be paid "by semiannual payments in every year, in equal shares, to such of the said four persons, namely, my wife and three children, *as may be living at the time of payment*, and to the lawful issue then living of any child who has then deceased." The trustees, pursuant to their interpretation of these provisions of the will, made the first semiannual payment to the beneficiaries under the trust six months after the death of the testator—namely, on December 15, 187–, and from that time continuously thereafter have made semiannual distributions on each June 15 and December 15.

On March —, 1894, one of the beneficiaries under the trust, namely, the widow of the decedent, died. The question then arose whether a beneficiary dying between the semiannual distribution dates was entitled to any prorating of the income received by the trustees subsequent to the last preceding semiannual distribution date. The trustees appealed to the Supreme Court of the State of S for instructions and were instructed that under the instant will a beneficiary dying between semiannual distribution dates was entitled to no apportionment of the income received by the trustees subsequent to the last distribution date preceding.

For the years 1918, 1919, and 1920 the trustees of the above-named estate filed returns upon a calendar-year basis and considered the income received by the estate from January 1 to December 15 distributable income and the income received by the estate from December 16 to December 31, inclusive, as undistributable income. They made a separate return of the income received for the period December 16 to December 31, inclusive, and paid the tax shown to be due by that return. The appellant receiving the income on the following June 15 did not include it as taxable income in his individual return. A revenue agent examining the appellant's book of account has added to the income reported the income received from the estate which was accumulated by it from December 16 to December 31, inclusive (upon which tax was paid by the estate), and has recommended the refund to the estate of the tax paid by him upon such income.

Provisions of the Revenue Act of 1918 bearing upon the question here at issue are as follows:

(*a*) Section 210: That * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.

(*b*) Section 211: That * * * in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax * * *.

(*c*) Section 219: That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including * * * (2) income accumulated in trust, for the benefit of unborn or unascertained persons or persons with contingent interests. * * *

In cases under paragraph * * * (2) * * * the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary * * *.

(*d*) Section 200: The term "taxable year" means the calendar year or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 222. The terms "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December.

(*e*) Section 212: * * * If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period * * * the net income shall be computed on the basis of the calendar year.

After careful consideration, the Committee is of the opinion that the action of the revenue agent in holding the income of the estate collected each year from December 16 to December 31, inclusive, taxable in the hands of the beneficiary is in error. The income of the estate during that period was being accumulated for persons with contingent interests. The income was not distributable to them unless they lived until the next distribution date, June 15. This is in accordance with the opinion of the Supreme Court of the State of S in the case above cited. The reason for this holding is solely that the will of the decedent specifically provided that the payments were to be made to only such beneficiaries "as may be living at the time of payment."

The Committee recommends that the action of the Income Tax Unit be modified as indicated above and that the appeal be allowed in part.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 221.—PAYMENT OF INDIVIDUAL'S TAX AT SOURCE.

ARTICLE 361: Withholding tax at source. II–30–1158
I. T. 1813

REVENUE ACT OF 1921.

Example of a provision in a bond which is held not to be a tax-free covenant clause.

The following provision is not a tax-free covenant clause within the meaning of section 221(b) of the Revenue Act of 1921:

The principal and interest of this bond to be paid in gold coin of the present standard of weight and fineness as fixed by the laws of the United States now in force without deduction of any tax or taxes now imposed by the laws of the United States or by any State, county, or municipality therein. Nothing herein contained shall be construed as imposing any obligation upon the maker of this bond to pay any income tax on account of the holder of this bond under any Federal, State, or municipal law.

ARTICLE 361: Withholding tax at source. II–33–1196
I. T. 1838

REVENUE ACT OF 1921.

Example of a provision in a bond which is held to be a tax-free covenant clause.

The following provision is a tax-free covenant clause within the meaning of section 221(b) of the Revenue Act of 1921:

The company hereby covenants and agrees to pay said bonds, and the interest thereon, in accordance with the terms of said bonds and annexed coupons, and of the mortgage securing the same, without deduction for or on account of any tax, other than succession or inheritance taxes, which, under any present or future law, the company may be required to pay, or retain from or on account of the principal or interest of said bonds; * * *.

ARTICLE 364: Exemption certificates of nonresident aliens. II–35–1222
I. T. 1856

REVENUE ACT OF 1921.

The words "exemption not claimed" on Form 1000, revised August, 1923, do not affect the right of an individual signing such form to claim the amount of personal exemption to which he is entitled by law. The words "exemption not claimed" have the same effect as the words on the old form of the certificate, "Tax to be paid at source." In the case of nonresident alien owners, the term referred to does not deprive a nonresident alien of his right to file Form 1001B or Form 1001C in order to enjoy the benefit of the personal exemption of $1,000, or to claim such exemption on his individual income tax return, Form 1040B.

The words "exemption not claimed" on Form 1000, revised August, 1923, do not affect the right of an individual signing such form to claim the amount of personal exemption to which he is entitled by law. In the case of nonresident alien owners, the term referred to does not deprive a nonresident alien of his right to file Form 1001B or Form 1001C, in order to enjoy the benefit of the personal exemption of $1,000, or to claim such exemption on his individual income tax return, Form 1040B.

It is deemed inadvisable, for administrative purposes, to authorize the elimination of "exemption not claimed" from the certificate, as upon such elimination the question as to whether exemption was actually claimed would immediately be raised. The use of the form altered in this manner would cause confusion as to whether or not any tax should be paid at the sources on the interest reported on the certificates, and would necessitate correspondence between withholding agents and the bond owners in order to ascertain that fact.

ARTICLE 365: Ownership certificates for interest coupons. II–16–1007 T. D. 3497

INCOME TAX—REVENUE ACT OF 1921.

Ownership certificates: Articles 365, 367, 369, 370, 1074, 1076, 1077, 1078, and 1079 of Regulations 62 amended.

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

To collectors of internal revenue and others concerned:

Articles 365 * * * of Regulations 62 are hereby amended to read as follows:

ART. 365. *Ownership certificates for interest coupons.*—The owners, except domestic and resident corporations, of bonds or other obligations containing a tax-free covenant clause, issued by a domestic or resident foreign corporation, when presenting interest coupons for payment, shall file a certificate of ownership for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, the nature of the obligations, the amount of interest and its due date, and the amount of any tax withheld. In case of bonds not containing a tax-free covenant clause, no ownership certificates are required unless the owner of such bonds is a nonresident alien individual, fiduciary, partnership, or corporation. No ownership certificates need be filed in the case of interest payments on bonds the income from which is not required to be included in gross income, nor in the case of any obligations of the United States. See section 213(b) of the statute and articles 74–84. Where in connection with the sale of its property payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, corporation, or a State or political subdivision thereof, must deduct and withhold such taxes as would have been required to be withheld by the assignor had no such sale and transfer been made. As to ownership certificates in the case of bonds of foreign countries, or bonds of nonresident foreign corporations, see article 1077.

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ARTICLE 365: Ownership certificates for interest coupons. II–22–1072 I. T. 1768

REVENUE ACT OF 1921.

Treasury Decision 3497 (C. B. II–2, pp. 250–253) became effective July 16, 1923. Certificates received after that date which are not required under new regulations should be forwarded to the Bureau of Internal Revenue through regular channels.

ARTICLE 365: Ownership certificates for interest coupons. II–33–1197 I. T. 1839

REVENUE ACT OF 1921.

The following is a schedule of ownership certificates required to be filed according to the provisions of Regulations 62, as amended by T. D. 3497 (see p. 253):

Classification of owner.	Bonds of domestic or resident corporations.	
	Containing tax-free clause.	Not containing tax-free clause.
Citizen or resident of the United States (individual, fiduciary, or partnership): Personal exemption not claimed	Form 1000, line 1	No certificate required.
Citizen or resident of United States (individual or fiduciary): Personal exemption claimed	Form 1001	Do.
Nonresident alien (individual, fiduciary, or partnership)	Form 1000, line 2	Form 1000, line 2.
Foreign corporation not having an office or place of business in United States and not engaged in trade or business therein	Form 1000, line 3	Form 1000, line 3.
Unknown owner	Form 1000, line 4	Form 1000, line 4.

Classification of owner.	Bonds of foreign corporations or foreign governments containing tax-free clause and having paying agent in United States.
Citizen or resident of United States (individual, fiduciary, or partnership): Personal exemption not claimed	Form 1000, line 1.
Citizen or resident of United States (individual or fiduciary): Personal exemption claimed	Form 1001.
Unknown owner	Form 1000, line 4.

ARTICLE 367: Form of certificate where no withholding required. II–16–1008 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 367 * * * of Regulations 62 are hereby amended to read as follows:

ART. 367. *Form of certificate where no withholding required.*—For the purposes of article 365, Form 1001 shall be used by citizens or residents of the United States when personal exemption is claimed against interest on bonds containing a tax-free covenant clause. In case a citizen or resident alien individual receives interest on bonds containing a tax-free covenant clause in excess of the amount of personal exemption which the individual may claim, any such excess must be reported on Form 1000.

* * * * * * *

ARTICLE 369: Interest coupons without ownership certificates. II–16–1009 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 369 * * * of Regulations 62 are hereby amended to read as follows:

ART. 369. *Interest coupons without ownership certificates.*—When interest coupons are received unaccompanied by certificates of ownership, unless the first bank be satisfied that the owner is a citizen of the United States or a resident individual, fiduciary, partnership or corporation, the first bank shall require of the payee a statement showing the name and address of the payee, the name and address of the debtor corporation, the date of the maturity of the interest, the name and address of the person from whom the coupons were received, the amount of the interest, and a statement that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The first bank receiv-

ing such coupons shall also prepare a certificate on Form 1000, crossing out "owner" and inserting "payee" and entering the amount of interest on line 6, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

* * * * * * *

ARTICLE 370: Interest on registered bonds. II-16-1010
T. D. 3497

REVENUE ACT OF 1921.

To collectors of internal revenue and others concerned:

Articles * * * 370 * * * of Regulations 62 are hereby amended to read as follows:

ART. 370. *Interest on registered bonds.*—Ownership certificates are required in connection with interest upon registered bonds, as in the case of coupon bonds, if such bonds contain a tax-free covenant clause or if such bonds are owned by a nonresident alien individual, fiduciary, partnership or corporation. If ownership certificates are not furnished by the owner of the bonds, such certificates must be prepared by the debtor corporation or its withholding agent. (*a*) If the bonds contain a tax-free covenant clause, ownership certificates must be prepared on Form 1000 for the following classes of bondholders: Citizens or residents of the United States, nonresident alien individuals, partnerships, whether foreign or domestic, foreign corporations having no office or place of business within the United States. (*b*) If the bonds do not contain a tax-free covenant clause, Form 1000 shall be prepared in the case of nonresident alien individuals, partnerships composed in whole or in part of nonresident aliens and not having an office or place of business within the United States, or in case the owner is a foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein.

Regardless of whether the registered bonds do or do not contain a tax-free covenant clause, no ownership certificate is required in connection with such bonds owned by domestic or resident corporations.

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SECTION 223.—INDIVIDUAL RETURNS.

ARTICLE 401: Individual returns. II-14-972
I. T. 1712

REVENUE ACT OF 1918.

Upon marriage the wife takes the domicile of the husband. For the part of the taxable year subsequent to the date of marriage the income from community property in Louisiana may be divided between them, even though the wife resided during that period in New York.

A and B were married in August, 1918. A was domiciled in the State of Louisiana during the entire year 1918, and is still domiciled in that State, and B resided in the State of New York during 1918 and filed her return for that year with the collector of internal revenue in New York.

The question is raised whether the taxpayers' income for 1918 was divisible between them in accordance with the provisions of Treasury Decision 3138 (C. B. 4, p. 238).

Under the provisions of Treasury Decision 3138, a husband and wife domiciled in the State of Louisiana, in rendering separate returns, may each report as gross income one-half of the income which,

under the laws of that State, becomes simultaneously with its receipt, community property. Upon her marriage to A in August, 1918, B took the domicile of her husband, namely, Louisiana, notwithstanding the fact that she resided in the State of New York during 1918 and filed her return for that year in New York. The income of A and B, prior to their marriage, does not constitute community property, and, therefore, is not divisible between them. Their income from August, 1918, to December 31, 1918, which, under the laws of the State of Louisiana became community property simultaneously with its receipt, is divisible between them in accordance with the provisions of Treasury Decision 3138.

ARTICLE 401: Individual returns. II–18–1032
I. T. 1744

REVENUE ACT OF 1921.

Under the provisions of section 158 of the Civil Code of California, a husband and wife may enter into a partnership in California, and if there is an agreement which shows that the intention of the parties is to create in the wife a vested interest in the partnership as her separate property, such intention will change the character of their property from community to separate property. In such cases the wife is entitled to report as her separate income all amounts earned by her under such agreement.

Advice is requested whether a written agreement entered into January 1, 1920, between A and his wife and son, residents of California, constituted the parties thereto partners; and if so, whether the earnings which the wife received from the partnership formed her separate property.

It seems clear from the facts presented that the intention of the spouses was to create in the wife a vested interest in the partnership as her separate property. The attorney who drew up the agreement advised them at the time that the interest of the wife would be her separate property, and likewise the profits therefrom. Since the organization of the partnership, all profits arising therefrom have been divided from month to month and paid to the respective partners according to the terms of the agreement. The wife's portion has been regularly paid to her by the partnership and deposited in her separate bank account. She has had exclusive control of such funds, and used the same to make investments on her own account. Both spouses state under oath that such funds have, at all times, been treated and considered by them as the separate property of the wife, and that no agreement between them, express or implied, has existed or does exist to the effect that such earnings or investments shall belong to the taxpayer, or that he shall have any interest whatsoever in the same.

It has been held by the Bureau that a husband and wife may enter into partnership in California, but that, without an agreement to the contrary, the earnings of the wife from such partnership are community property.

It has been held by the Supreme Court of California that a husband and wife may, by contract, change the character of their property from community to separate, if they see fit to do so. (*Title Insurance Company* v. *Ingersoll*, 94 Pac., 94; *Perkins* v. *Sunset Telephone and Telegraph Company*, 103 Pac., 190; *Ives* v. *Connacher*,

121 Pac., 394; In re *Klumpke's Estate*, 139 Pac., 1062; *Fay* v. *Fay*, 132 Pac., 1040; *Kaltschmidt* v. *Weber*, 79 Pac., 272.) In the last case cited the following language is used:

> There can be no doubt that the husband may make a gift of the community property to the wife, and that the effect of such gift will be to transmute it into her separate estate. The provision in section 172 of the civil code that he can not make a gift of community property unless the wife, in writing, consent thereto, is a provision for her benefit and protection, and it has no application to the case of a gift by the husband directly to the wife. And so, also, he may, under sections 158 and 159 of the civil code, contract with her by an agreement that her personal earnings shall be her separate property, and this may apply to future as well as past earnings, and the effect of such an agreement will be to convert such earnings from the status of community property to that of separate property of the wife.

With regard to the amount of formality required in a contract or agreement by which the husband may agree that the earnings of the wife shall be her separate property, it was stated in *Perkins* v. *Sunset Telephone and Telegraph Company*, *supra:*

> It will be seen, by an examination of the authorities cited above, that the utmost freedom of contract exists in California between husband and wife, and that the courts will resort to circumstantial evidence furnished by the general conduct of the spouses with reference to their property in determining the existence or nonexistence of a contract where the exact terms of the alleged agreement have escaped the memory of one or both of the parties to it.

In *Wren* v. *Wren* (Cal.) (34 Pac., 775) it was stated:

> There can be no doubt that a husband and wife may agree between themselves, without any other consideration than their mutual consent, that money earned by the wife in performing any work or service which does not devolve upon her by reason of the marriage relation shall belong to her as her own, and, when money has been earned by the wife under such an understanding and agreement with the husband, it is her separate property * * *.

It is clear from the facts in the instant case that the taxpayer did intend to give to his wife, as her separate property, a vested interest in the partnership formed; and from the California decisions cited, it is apparent that the courts of that State will not hesitate to give effect to the intention of the spouses, where such intention is plainly evidenced. The conclusion is reached that the wife of the taxpayer is entitled to report as her separate income all amounts earned by her since January 1, 1920, through her interest in the partnership.

ARTICLE 401: Individual returns. II-21-1062
I. T. 1763

REVENUE ACT OF 1921.

Inasmuch as the wife's interest in community property, as understood and applied in the Virgin Islands, is deferred until the community has been dissolved, being merely a contingency or expectancy rather than a vested proprietary interest, the income from community property can not be reported in separate returns by husband and wife domiciled in the Virgin Islands.

ARTICLE 401: Individual returns.

(See T. D. 3519; sec. 250, art. 1004.) Requirement of separate excess profits tax return of individual under Revenue Act of 1917 in addition to income tax return.

ARTICLE 401: Individual returns.

(See I. T. 1834; sec. 213(a), art. 31.) Shares of income from mineral lands of members of Osage Tribe of Indians having certificates of competency.

ARTICLE 404: Return of income of nonresident alien. II-15-987
(Also Section 216, Article 306.) I. T. 1724

REVENUE ACTS OF 1918 AND 1921.

An attorney in fact to whom property and income have been turned over by the Alien Property Custodian for transmission to the nonresident alien owner may not assume that such income constitutes the entire income from sources within the United States of such nonresident alien individual for the years during which the property was in the hands of the Alien Property Custodian. In order to claim the exemption, deductions and credits to which such alien is entitled, the attorney in fact must have affirmative information that such income constitutes the entire income of the alien from sources in the United States.

SECTION 224.—PARTNERSHIP RETURNS.

ARTICLE 411: Partnership returns. II-29-1147
A. R. R. 3552

REVENUE ACT OF 1917.

A and B, members of a partnership which was dissolved, engaged each in the same kind of business in an individual capacity, B continuing business at the old place and A in a different location, each retaining the firm name. Held, that as no partnership actually existed, they were not liable as partners in filing income tax returns for 1917, although they held themselves out to the public as partners and under the laws of the particular State were liable as such to third persons.

A and B, each of whom did business under the firm name of the "M Company," have appealed jointly from the action of the Income Tax Unit in holding that a copartnership existed between them during the year 1917 and that the income of such partnership is subject to excess-profits tax.

It appears from the records in the case, that in ——, 188—, A and B formed a partnership at the city of S, under the name of the "M Company," for the purpose of conducting a retail business, and that they conducted such partnership business until March —, 189—, on which date A sold and transferred his interest in the business to B and the copartnership dissolved. Thereafter B continued the business at the city of S, under the old name of the "M Company,"

while A removed to the city of V, and established a retail business which he has since conducted under the name of the "M Company." It is claimed, and such claim is set forth in an affidavit executed by A and B, that since the dissolution of the old partnership of "the M Company," A has been the sole owner of the business at the city of V, and B the sole owner of the business at S, and there is no evidence on file which controverts the claim that as between themselves no partnership existed. It appears, however, and it is admitted, that since the date of dissolution each of the said individuals has conducted his own business under the old firm name—the M Company—and A admits that reports to mercantile and credit agencies have been made in which the total gross worth of the individual businesses of A and B have been combined and reported as the total gross worth of the partnership of the M Company; this in order that merchandise might be purchased from wholesalers "upon better terms and at better prices than if he had simply made an individual report of his own business."

For the year 1917, A and B each originally reported his income and deduction on an individual basis, but some weeks later, acting upon advice given by an individual engaged in tax work, a partnership return was executed in which the gross income and deductions of each of these individuals was consolidated, which latter return was accepted by the Income Tax Unit and excess-profits tax assessed against the net income shown thereon. It is claimed that the taxpayers were told by their adviser that a partnership return was necessary because of the fact that they had held themselves out to be partners.

It appears clear from the evidence in the case that no partnership actually existed between A and B during the year 1917, although they held themselves out to be partners. Section 1749 of the Civil Code of South Dakota, 1913, provides that:

> Anyone permitting himself to be represented as a partner, general or special, is liable as such to third persons to whom representation is communicated who on the faith thereof gave credit to the partnership.

Section 1750 of the same code further provides that:

> No one is liable as a partner, who is not such in fact, except as provided by the last section.

In view of the above-quoted sections of the South Dakota Code, the Committee concludes that even though as to third persons to whom representations were made, a partnership existed, and to those relying on such representations and extending credit to the alleged partnership, A and B might be liable as partners, it is, however, concluded that for Federal taxation purposes they are not so liable, and inasmuch as no partnership actually existed between such individuals in the year 1917 they are not liable as partners to an excess-profits tax computed on their combined net incomes.

The Committee, therefore, recommends that the action of the Income Tax Unit in holding that a copartnership existed between A and B during the year 1917 and that the income of such partnership is subject to excess-profits tax be reversed and the appeal of the said individuals be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 225.—FIDUCIARY RETURNS.

ARTICLE 421: Fiduciary returns.

(See I. T. 1727; sec. 250, art. 1004.) Penalty where an executor or administrator is delinquent, without reasonable cause, in making a required return for his decedent's estate.

ARTICLE 421: Fiduciary returns. II-20-1051
I. T. 1754

REVENUE ACT OF 1921.

The amount of the gross income of an estate in process of administration is immaterial in determining whether a return of the income of the estate should be filed. It is only in cases where the annual net income of the estate is $1,000 or over, or in case of returns for a fractional part of a year where the net income for a period of less than one year placed on an annual basis is at the rate of $1,000 or over that a return is required to be filed. (I. T. 1358, C. B. I-1, p. 241, revoked.)

ARTICLE 422: Return by guardian or committee.

(See I. T. 1834; sec. 213(a), art. 31.) Return of shares of members of Osage Tribe of Indians who are minors or who do not have certificates of competency.

ARTICLE 424: Return by receiver. II-31-1172
I. T. 1821

ALL REVENUE ACTS.

An amended return is not required of a bank in the hands of a receiver where the assets of the bank are not sufficient to pay its depositors.

The Act of March 1, 1879 (20 Stat., 351), which has been incorporated into the National Banking Act, provides:

Whenever and after any bank has ceased to do business by reason of insolvency or bankruptcy, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank, 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 Commissioner of Internal Revenue, when the facts shall so appear to him, is authorized to remit so much of said tax against insolvent State and savings banks as shall be found to affect the claims of their depositors.

In view of the affidavit of the receiver of the M Bank, to the effect that the assets of the bank are not sufficient to pay the claims of the depositors, no recovery of any taxes which might be due under the amended return can be effected. The collector should therefore discontinue all efforts to secure an amended return and steps should be taken to abate any outstanding assessment against the bank.

SECTION 226.—RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

ARTICLE 431: Returns for periods of less than 12 months. II-14-973 I. T. 1713

REVENUE ACT OF 1921.

The closing date of the period of a return for less than one year for the purpose of placing on an annual basis the net income of the estate of a decedent is the date of the final decree of the probate court upon an application for a final accounting and not the date of the application.

ARTICLE 431: Returns for periods of less than 12 months. II-27-1129 T. D. 3521
(Also Section 211, Article 11.)

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. RETURNS OF INCOME FOR PERIOD OF LESS THAN 12 MONTHS—SECTION 226(c)—RETURNS OF INCOME OF DECEDENT AND OF HIS ESTATE FOR YEAR IN WHICH HE DIES.

When a taxpayer dies during his taxable year, the return of his income and the return of the income of his estate for the said year are returns for a period of less than 12 months within the meaning of section 226(c) of the Revenue Act of 1921, and the respective incomes must be placed upon an annual basis, as required thereby.

2. SECTION 226(c)—CONSTITUTIONALITY.

The provisions of section 226(c) of the Revenue Act of 1921 requiring incomes for a period of less than 12 months to be placed upon an annual basis do not violate the constitutional requirements of uniformity.

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

To collectors of internal revenue and others concerned:

The following decision of the United States District Court for the Southern District of New York in the case of *Bankers Trust Company and Frederick H. Pearce, as executors of the last will and testament of John Glackner, deceased*, v. *Frank K. Bowers, as collector of internal revenue for the second district of New York*, sustaining the defendant's motion for a dismissal of the complaint, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 26, 1923.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Bankers Trust Company and Frederick H. Pearce, as executors of the last will and testament of John Glackner, deceased, plaintiffs, v. Frank K. Bowers, as collector of internal revenue for the second district of New York, defendant.

[August 13, 1923.]

GODDARD, District Judge: This is a motion to dismiss a complaint on the ground that it failed to state facts sufficient for a cause of action. The complaint alleges two causes of actions to recover Federal income taxes paid by the plaintiffs under protest and duress.

The decedent died a resident of the city, county, and State of New York on April 4, 1921. On or about March 15, 1922, plaintiffs, as his executors, filed two income tax returns, reporting in one return the net income received by the decedent during the calendar year 1921, and in the other return the net income received by plaintiffs, as said executors, during said calendar year. The first cause of action has to do with the tax paid upon the basis of the return filed for the decedent. The complaint alleges, in substance, that the correct tax liability of the decedent for the calendar year 1921 was $369.44; that the defendant demanded and the plaintiffs paid on account of said tax liability the sum of $1,560.04; that $1,290.60 of said tax was paid under protest and duress, and a claim for the refund thereof was subsequently rejected and denied by the Commissioner of Internal Revenue. The second cause of action relates to the tax paid upon the basis of the return reporting the net income received by the executors in 1921. The correct tax liability is alleged as $2,050.27, whereas the defendant demanded and the plaintiffs paid the sum of $2,633.85. Of such amount, $583.58 was paid under protest, and a claim for the refund thereof was subsequently rejected and denied by the Commissioner of Internal Revenue. The complaint alleges, with respect to each cause of action, that the tax demanded was determined and computed in the manner prescribed in section 226(c) of the Revenue Act of 1921 for the computation of the tax in the case of returns "made for a portion of the calendar year or for a period of less than 12 months"; whereas plaintiffs claim with respect to each cause of action that the tax "should be determined and computed as if the said return was made for a full calendar year." Judgment is demanded for the sum representing the difference between the amount of the taxes computed in the method contended for by the defendant and the tax liability computed in the method alleged and claimed by the plaintiffs.

The question is—whether the taxes should have been determined in the manner prescribed in section 226(c) of the Revenue Act of 1921, which provided as follows:

"(c) In the case of a return for a period of less than one year the net income shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of 12 months."

The defendant contends that the returns filed by plaintiffs were such returns and has determined the tax liability thereunder by—

(1) Multiplying the net income by 12;

(2) Dividing the product so obtained by the number of months and fraction thereof in the period covered by the return;

(3) Computing the normal and sur tax on the quotient; and

(4) Dividing the total tax so computed by 12, and multiplying the quotient by the number of months and fraction thereof in the period covered by the return.

The plaintiffs contend that the returns were not returns "for a period of less than one year," within the meaning of section 226(c), and that the taxes, therefore, should have been computed in the ordinary method prescribed for the computation of income taxes.

The questions, therefore, involved are:

(1) In the first cause of action, is section 226(c) applicable to returns filed for decedents;

(2) In the second cause of action, is section 226(c) applicable to returns covering income received by the estates of decedents;

(3) If thus applicable, is section 226(c) constitutional.

The first two questions involve the interpretation of section 226(c) of the Revenue Act of 1921, and because of their similarity, the answer to one will determine the other.

Section 226 is as follows:

"RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

"SEC. 226. (a) That if a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year, a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

"(b) In all cases where a separate return is made for a part of a taxable year, the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included.

"(c) In the case of a return for a period of less than one year the net income shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of 12 months."

Subdivision (c) is complete in itself; its language and meaning are clear. The title of the section is "Returns for a period of less than 12 months." It refers to tax returns for a period of less than a year. I see no reason to believe that it is intended to refer only to cases in which there has been a voluntary change of accounting or cases in which the Commissioner declares the taxable period terminated under section 250(g). It is under a heading dealing with returns for a less period than 12 months, and because subdivision (a) refers only to change from calendar to fiscal year, or change of fiscal year, to say that sections (b) and (c) are limited to returns that occur from changes of plan of accounting, is to read into the sections something that is not there. It seems to me merely an orderly method of uniting under the one title provisions relating to all returns covering a period of less than a year whatever may be the cause for such period. Such an interpretation is emphasized by comparing this section 226 with its corresponding section of the Revenue Act of 1918, section 226, which reads as follows:

"RETURNS WHEN ACCOUNTING PERIOD CHANGED.

"SEC. 226. That if a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31st. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made, and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year, he shall make a separate return for the period between the beginning of the calendar year in which such fiscal year ends and the end of such fiscal year.

"In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the credits provided in subdivisions (c) and (d) of section 216 shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to 12 months."

So that the title and scope of the section has been enlarged. The only subject dealt with under the earlier Act was *Change of accounting period*, instead

of *Returns for a period of less than 12 months* with the subdivisions (a), (b), and (c) of the present Act. The earlier Act contained two paragraphs, the first of which was substantially the same as subdivision (a) of the later Act, and the second paragraph which begins "In all the *above cases* * * *." In the later Act, however, section 226 after prescribing in subdivision (a) the different periods to be covered by separate returns in cases where accounting periods are changed deals in subdivision (b) and (c) with all cases of separate returns for a period of less than 12 months. Thus subdivision (b) reads:

"In all cases where a separate return is made for a part of a taxable year * * *."

Subdivision (c) begins:

"In the case of a return for a period of less than one year * * *."

These changes are significant and indicate an intention to have section (c) apply to the returns of all incomes for a period of less than 12 months, whether the accounting period is changed or not. Congress recognized that formerly whenever there was a return covering a fractional part of a year the Government lost considerable revenue to which it was equitably entitled. This was due to the fact that the rates of both normal and sur tax were graduated and the rate of tax was necessarily lower in all cases of returns for a period of less than 12 months than a rate of tax for a full year. This was just as true in the case of decedents as in the case of a change in accounting period. The amounts of tax upon income of part of a year should be less than the amount for a full year, but equitably both as between the Government and the taxpayer and as between different taxpayers the rates should be the same in either case. Section 226(c) of the Revenue Act of 1921 secures this desired uniformity by providing that the net income shall be placed upon an annual basis and that the tax upon such annual income shall be proportionate to the period covered by the return. There is another significant addition to the 1918 Act by the 1921 Act which indicates an intention to apply section 226(c) in the manner contended for by the Government and that is the addition of subdivision (f) to section 216. Section 216(f) of the 1921 Act provides that—

"The credits allowed * * * shall be determined by the status of the taxpayer on the last day of the period for which the return of income is made; but in the case of an individual who dies during the taxable year, such credits shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the period for which such survivor makes return of income."

The credits allowed, under the law, against a taxpayer's net income, for the purpose of determining his net taxable income, are $1,000 for a single person, and $2,000 to a married person, with an additional amount for each minor child. The subdivision just quoted allows the full annual credits. Under section 226 of the Act of 1918 full annual credits were specifically denied, but were to be prorated. The last paragraph of this section provided, inter alia:

"* * * the credits * * * shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to 12 months."

The full paragraph was omitted in the 1921 Act, and, as heretofore stated, subdivision (f) was added to section 216, thus clearly indicating that where full annual credits are to be allowed, the income against which these credits are to be taken must be placed on an annual basis. It is contrary to the theory of the income tax laws to allow full annual credits against incomes for less than 12 months unless the incomes are placed upon an annual basis.

The plaintiffs contend that section 226(c) does not apply to returns of decedents or of their estates for the reason that such return is a return not for a fractional part of a year, but for an entire year. This because the statute nowhere specifically declares that such a return is a return for a fractional part of a year and nowhere explicitly requires a separate return in case of a decedent and of the income received by his estate. That the fundamental scheme of Title II of the Act is that of a tax upon the net income of a taxpayer during a period of 12 successive months, that the taxing sections of the Act, sections

210 and 211, respectively, impose a normal and sur tax "for each taxable year upon the net income of every individual."

That "taxable year," the term applied to the general accounting period, is defined in section 200 as follows:

"(1) The term 'taxable year' means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term 'fiscal year' means an accounting period of 12 months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1921, shall be the calendar year 1921 or any fiscal year ending during the calendar year 1921;"

Section 212, which provides for the basis of computing the net income of individuals, states:

"(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

"(c) If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226."

However, under the prior Revenue Acts, and under these Acts, the Treasury Department has, by regulations which were reasonable and within the scope of its authority, required separate returns of income received by the decedent during the fractional period prior to death and of income of the estate during the fractional period from the date of death to the end of the year. The regulation referred to is article 421 of Regulations 45, and, so far as it is material, reads as follows:

"Every fiduciary, * * * must make a return of income (a) for the individual whose income is in his charge, if the net income of such individual is $2,000 or over if married and living with husband or wife, or is $1,000 or over in other cases, * * * If the net income of a decedent from the beginning of the taxable year to the date of his death was $1,000 or more, if unmarried, or $2,000 or more, if married, the executor or administrator shall make a return for such decedent."

When Congress enacted the 1921 Act it was cognizant of the foregoing regulation requiring separate returns to be made of the income of decedents and the income of their estates, and that in every such instance there would of necessity be a return for a period of less than 12 months. Therefore, knowing of this regulation, Congress must have intended to apply section 226(c) to the income of decedents and their estates.

The class of returns which are under consideration are those which actually do cover a period which is less than a year and if 226(c) is to be regarded meaning just what it says, it must refer to them.

It is contended that section 226(c), if construed to be applicable to returns filed for decedents and their estates, is unconstitutional upon two grounds:

"1. That in operation, section 226(c) would tax as income that which does not constitute income within the meaning of the sixteenth amendment to the Constitution, and therefore violates the provisions of Article I, section 2, clause 3, and Article I, section 9, clause 4, of the Constitution."

It is urged in support of this that to tax decedents and their estates by multiplying net income by 12 and dividing by the number of months included in the period covered by the return, has the effect of imposing a tax based upon a supposititious income and not real income. It is said, for instance, that this is what happens if section 226 is applied to an individual whose net income during January is $1,000 and who dies January 31, that he is being taxed upon a net income of $12,000, $11,000 of which by no stretch of the imag-

ination would be considered income. The first and entirely obvious answer to this argument is that he is not being taxed upon $12,000 for one month which is his taxable period, but upon $1,000 for one month; that is to say, he is being taxed upon his actual income for the part of the year during which he was alive.

It would seem extraordinary for a decedent to be taxed on the basis of an annual period during part of which he is in his grave. And a construction does not seem reasonable which allows to a taxpayer whose taxable period is less than a year the same credits and exemptions that are allowed to one whose taxable period covers a full year. It is possible to conceive some rare instances when the application seems harsh for the decedent, but, on the other hand, it is possible to conceive instances where the decedent would benefit. But unfortunately this is true of most tax laws.

The second ground upon which plaintiffs assert the unconstitutionality of section 226(c) is that it is violative of the fifth amendment to the Constitution. More particularly, that it operates to determine the net income of decedents by a rule different from that of living persons by denying the former substantial deductions accorded to the latter and taxing a decedent a substantially larger amount than a living person on exactly the same amount of net income.

Under the Constitution the general power is given to Congress to lay and collect taxes, but they must be uniform. The rule of uniformity prescribed is the territorial uniformity required by Article I, section 8, of the Constitution (*La Belle Iron Works* v. *U. S.*, 256 U. S., 392). The mere fact that the income of the decedent and the income of his estate are made subject to the higher rates—surtaxes—does not result in oppressive or discriminatory taxation such as the Constitution forbids. Even though a statute may operate oppressively upon some taxpayers, or even all, is no reason for the judicial department to declare the same void. From time immemorial the imposition of taxes has been a burden and never has that burden been evenly distributed or equalized, although that is the aim of political science. Taxing statutes may, and almost always do, operate more oppressively upon some persons than upon others.

The State of Illinois enacted an inheritance tax law providing that a tax of 3 per cent should be paid by everyone receiving a legacy of $10,000 and a tax of 4 per cent should be paid by everyone receiving more than $10,000. An action was instituted to contest the constitutionality of this statute, the plaintiff contending that the statute was oppressive and unreasonable, discriminatory in that a person receiving $10,000 would be compelled to pay only $300 as a tax and would receive as his net legacy the sum of $9,700, while one receiving $10,001 would pay $400.04 and his net legacy would be $9,600.96, just $99.04 less than the one whose legacy was actually only one more dollar than the other. In answer to this contention, the Supreme Court of the United States, in *Magoun* v. *Illinois Trust and Savings Bank* (170 U. S., 283, at page 300), said:

"If there is unsoundness it must be in the classification. The members of each class are treated alike, that is to say, all who inherit $10,000 are treated alike—all who inherit any other sum are treated alike. There is equality therefore within the classes. If there is inequality it must be because the members of a class are arbitrarily made such and burdened as such upon no distinctions justifying it. This is claimed. It is said that the tax is not in proportion to the amount but varies with the amounts arbitrarily fixed, and hence that an inheritance of $10,000 or less pays 3 per cent, and that one over $10,000 pays not 3 per cent on $10,000 and an increased percentage on the excess over $10,000 but an increased percentage on the $10,000 as well as on the excess, and it is said, as we have seen, that in consequence one who is given a legacy of ten thousand and one dollars by the deduction of the tax receives $99.04 less than one who is given a legacy of $10,000. But neither case can be said to be contrary to the rule of equality of the fourteenth amendment. That rule does not require, as we have seen, exact equality of taxation. It only requires that the law imposing it shall operate on all alike under the same circumstances."

If a classification based upon a difference of $1 in the amount of income received by taxpayers otherwise similarly situated is a reasonable classification, then unquestionably the classification here involved is not unreasonable.

In the case of *Spencer* v. *Merchant* (125 U. S., 345) the court said:

"In the words of Chief Justice Chase, condensing what had been said long before by Chief Justice Marshall, 'the judicial department can not prescribe to the legislative department limitations upon the exercise of its acknowledged

powers. The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected.'"

See also *Stanton* v. *Baltic Mining Co.* (240 U. S., 103); *Billings* v. *United States* (232 U. S., 261); *Flint* v. *Stone-Tracy Co.* (220 U. S., 107).

The application of section 226(c) of the Revenue Act of 1921 to the decedent's income and the income of his estate does not render the Act unconstitutional, although in some instances, placing those incomes upon an annual basis, as provided by the section, may subject the incomes to the higher surtaxes. The rates imposed are uniform. Every taxpayer under the same circumstances pays the same tax and therefore there is no discrimination. From the foregoing it can not be questioned that Congress has the power to tax the income of a decedent as well as the income of his estate, and it may devise any reasonable methods for the computation of those taxes. The method provided by section 226(c) is reasonable.

The motion to dismiss the complaint is granted.

ARTICLE 431: Returns for periods of less than 12 months. II-30-1159 A. R. R. 3092

REVENUE ACT OF 1917.

A taxpayer which closed its books on December 20 of each year filed its income tax return for 1917 on a calendar-year basis, showing income and deductions for the year ended December 20 of that year.

Held, that taxable net income for the calendar year 1917 should be computed by adding together that part of the income for each of the years ended December 20, 1917, and December 20, 1918, which falls in the calendar year 1917. Such income for the calendar year 1917 will be obtained by dividing taxable net income for the year ended December 20, 1917, by 12 and multiplying such one-twelfth by $11\frac{20}{365}$, to which should be added $\frac{11}{365}$ of the taxable net income for the year ended December 20, 1918.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in adjusting taxable net income for the year 1917, resulting in additional taxes of $6.38x$ dollars.

Appellant was organized in 1910. It is its practice to close its books on December 20 of each year. Its income tax returns, while filed on a calendar-year basis, show income and deductions from income for the year ended December 20.

The Income Tax Unit, upon the recommendation of the revenue agent, computed taxable net income for the calendar year 1917 by adding to the taxable net income for the year ended December 20, 1917, the difference between the balances of certain assets, except inventory, and liabilities for the period December 20 to December 31, 1917. The Unit ignored showing the change in inventory for that same period for the reason that no inventory was taken December 31, 1917.

Appellant states that the taxable net income for the calendar year as computed by the Income Tax Unit is erroneous for the reason that adjustment was made for changes in certain assets and liabilities from December 20 to December 31, 1917, but no adjustment made for the change in inventory for that same period. It is also claimed that $5.03x$ dollars, representing expenditures ranging from $.013x$ dollars to $1.29x$ dollars, were capitalized by appellant, whereas the items are actually allowable deductions from gross income in the nature of repairs.

It is the opinion of the Committee, since appellant closes its books on December 20 of each year, that taxable net income for the calendar year 1917 should be computed by adding that part of the income for each of the years ended December 20, 1917, and December 20, 1918, which falls in the calendar year 1917. Such income for the calendar year 1917 will be obtained by dividing taxable net income for the year ended December 20, 1917, by 12 and multiplying such one-twelfth by $11\frac{20}{31}$, to which should be added $\frac{11}{365}$ of the taxable net income for the year ended December 20, 1918. Expenditures of $5.03x$ dollars, representing repair costs, should be allowed as a deduction from gross income.

Accordingly, it is recommended that the Income Tax Unit revise its audit in conformity with the above.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 227.—TIME AND PLACE FOR FILING INDIVIDUAL, PARTNERSHIP, AND FIDUCIARY RETURNS.

ARTICLE 442: Time for filing return upon death or termination of trust. II–16–1001 I. T. 1734

REVENUE ACT OF 1921.

A died on February 14, 1923. Under the provisions of section 227(a), the 1922 calendar year return for A was due on March 15, 1923. The return for the decedent for the period from January 1, 1923, to the date of his death, February 14, 1923, will be due on March 15, 1924.

ARTICLE 444: Extension of time by Commissioner. II–19–1046 I. T. 1752

REVENUE ACTS OF 1917, 1918, AND 1921.

Table relating to general extensions of time within which to file income and profits tax returns covering 1917 and subsequent years.

General extensions of date for filing returns.

Year.	Extended to—	Authority.
Corporations: 1917 fiscal-year returns due under Act of Oct. 3, 1917.	Mar. 1, 1918. (This extension, as amended by T. D. 2650, applies to fiscal year 1917 returns up to and including the fiscal year ended July 31, 1917.)	T. D. 2633, dated Jan. 22, 1918 (amending T. Ds. 2561 and 2615).
Corporations: Returns due after Oct. 16, 1917, and on or before Mar. 1, 1918, pursuant to Acts of Sept. 8, 1916, and Oct. 3, 1917, whether made on basis of the calendar year or of a fiscal year ended during the year 1917.	Apr. 1, 1918. (This extension applies to fiscal year 1917 returns due after Oct. 16, 1917; i. e., fiscal years ended Aug. 31, Sept. 30, Oct. 31, Nov. 30, and Dec. 31, 1917.)	T. D. 2650, dated Feb. 9, 1919 (amending T. Ds. 2561, 2615, and 2633).

General extensions of date for filing returns—Continued.

Year.	Extended to—	Authority.
Enemies or allies of enemies: Returns for 1917 and subsequent years under sections 6(c), 8(b)(c), and 13(b)(c) of the Revenue Act of 1916, as amended, and under the Revenue Act of 1917.	Not exceeding 90 days after proclamation by President of end of war with Germany. President's proclamation was issued Nov. 14, 1921; 90-day period expired Feb. 12, 1922.	T. D. 2673, dated Mar. 18, 1918. IT: Mim. 3069.
Corporations: Fiscal year ended in 1918.	Mar. 15, 1919. To corporations which have secured extensions which have not expired. Two forms to be filed; one under Act of Sept. 8, 1916, and Act of Oct. 3, 1917, and one under Revenue Act of 1918.	T. D. 2796, dated Feb. 27, 1919. (See IT: Mim. 2101.)
Corporations: Fiscal year ended in 1918.	Mar. 15, 1919. To corporations which have, before Feb. 25, 1919, filed returns for a fiscal year ended in 1918 and paid or become liable for a tax under the Revenue Act of 1917 and are subject to additional tax for the same period under Revenue Act of 1918, the return covering such additional tax shall be filed at the same time as returns of persons making returns for the calendar year 1918 are due under existing rulings.	T. D. 2797, dated Mar. 11, 1919.
Corporations: 1918 calendar year. Notice was given through press and otherwise that 1031-T would be accepted, with one-fourth estimated tax due, and 45 days given to file complete returns.	June 15, 1919. To corporations which have filed 1031-T on or before Mar. 15, 1919.	IT: Mim. 2101, dated Apr. 14, 1919.
1918 Returns of Information (1096 and 1099: Fiduciary (1041). Withholding (1042). (1098 and 1013.)	June 15, 1919	IT: Mim. 2101, dated Apr. 14, 1919 (extending T. D. 2796).
Foreign corporations for 1918 and subsequent years.	90 days after proclamation by President of end of war with Germany.	T. D. 2796, dated Feb. 27, 1919.
Individuals: 1918 calendar year. Notice was given through press and otherwise that 1040-T would be accepted, with one-fourth estimated tax due, and 45 days given to file complete returns.	Not deemed necessary to grant extension beyond the 45 days for personal returns, except on special request and sufficient reasons.	IT: Mim. 2101, dated Apr. 14, 1919.
Individuals: 1918 and subsequent years. To alien individuals living beyond boundaries of the United States and American citizens traveling or residing abroad, and persons in military or naval service on duty outside the United States.	Not exceeding 90 days after proclamation by President of end of war with Germany. Affidavit to be attached stating cause of delay in filing. President's proclamation was issued Nov. 14, 1921; 90-day period expired Feb. 12, 1922.	T. D. 2796, dated Feb. 27, 1919. Article 445 of Regulations, 45. IT: Mim. Coll. No. 3069.
Partnerships and personal service corporations: 1918 calendar year.	June 15, 1919	IT: Mim. 2101, dated Apr. 14, 1919 (extending T. D. 2796).
Partnerships and personal service corporations: Fiscal year ended in 1918.	May 15, 1919. To partnerships and corporations which have secured extensions which have not expired.	T. D. 2804, dated Mar. 13, 1919 (extending T. D. 2796).
All taxpayers filing returns in Hawaii for 1918.	May 15, 1919	T. D. 2792, dated Feb. 19, 1919.
All taxpayers living or temporarily residing in Alaska—1918 returns.	June 15, 1919	T. D. 2810, dated Mar. 31, 1919.
Corporations: 1919 calendar year	May 15, 1920. If tentative (Form 1120 indicated as "Tentative") filed and one-fourth estimated tax paid on or before Mar. 15, 1920, with request for extension.	IT: Mim. 2420, dated Mar. 4, 1920 (C. B. 2, p. 202) (modifying IT: Mim. 2383).
Corporations: Fiscal year ended Jan. 31, 1919; Feb. 28, 1919; Mar. 31, 1919; Apr. 30, 1919.	July 15, 1919. If on or before June 15, 1919, 1031-T filed and one-fourth of tax paid.	T. D. 2856, dated June 7, 1919. (See also IT: Mim. 2101—extending T. D. 2796.)
Corporations: Filing 1031-T extends time for filing completed returns, but not beyond due date of second installment of tax (five and one-half months after close of fiscal year ended in 1919).		T. D. 2856, dated June 7, 1919. (See also IT: Mim. 2129.)
Partnerships and personal service corporations: Jan. 31, 1919; Feb. 28, 1919; Mar. 31, 1919; Apr. 30, 1919.	Aug. 15, 1919	T. D. 2883, dated July 9, 1919 (extending T. D. 2856).
Corporations: 1921 calendar year	June 15, 1922. Upon filing tentative (Form 1120, indicated as "Tentative") on or before Mar. 15, 1922, and payment of one-fourth of tax accompanied by statement of reason for delay and request for extension.	T. D. 3291, dated Feb. 21, 1922 (C. B. I-1, p. 245).

General extensions of date for filing returns—Continued.

Year.	Extended to—	Authority.
1921 and subsequent years for: *a* Foreign corporations and partnerships; *b* domestic corporations which transact their business and keep account books abroad; *c* domestic corporations whose principal income within United States possessions; *d* American citizens residing or traveling abroad, including persons in the military or naval service on duty outside of United States.	15th day of sixth month following close of taxable year. Affidavit must be attached stating cause of delay in filing, and installments of tax actually due must be paid at time of filing return.	T. D. 3284, dated Feb. 11, 1922 (C. B. I-1, p. 249).
1922 and years subsequent		(See T. D. 3284, above.)
1921 calendar year. Forms 1013 and 1042 (annual returns of normal income tax to be paid at the source).	Apr. 1, 1922	T. D. 3292, dated Feb. 28, 1922 (C. B. I-1, p. 246).
1921 calendar year. Individuals residing or located in Hawaii and Alaska.	May 15, 1922	T. D. 3306, dated Mar. 17, 1922 (C. B. I-1, p. 247).
1921 calendar year. 1921 fiscal year: Fiduciary (Form 1041); partnership and personal service corporation (Forms 1065, 1096, and 1099).	May 15, 1922	T. D. 3272, dated Jan. 19, 1922 (C. B. I-1, p. 245).
1921 fiscal year: All taxable returns.	May 15, 1922. (If any taxpayer has before Nov. 23, 1921, filed a return for a fiscal year ending in 1921, and paid or become liable for a tax computed under the Revenue Act of 1918, and is subject to additional tax for the same period under the Revenue Act of 1921, the return covering such additional tax shall be filed at the same time as the returns of persons making returns for the fiscal year ending Feb. 28, 1922, are due under the law and regulations.	T. D. 3305, dated Mar. 16, 1922 (C. B. I-1, p. 247). See T. D. 3291 for further extension to June 15, 1922, if tentative return filed May 15, 1922, and payment one-fourth of tax, accompanied by statement of reasons for delay and request for extension.
1921 calendar year: Corporations filing in the district of Hawaii.	Apr. 15, 1922. (Time to file tentative returns required by T. D. 3291 extended to Apr. 15, 1922.)	IT:1257 (C. B. I-1, p. 246).
Corporations (domestic): 1922 calendar year.	June 15, 1923. If tentative (Form 1120 indicated as "Tentative") filed and one-fourth of tax paid on or before Mar. 15, 1923.	T. D. 3434, dated Feb. 6, 1923 (C. B. II-1, p. 153).
Corporations: Fiscal year ended Jan. 31, 1922; Feb. 28, 1922.	June 15, 1922. Upon filing tentative (Form 1120, indicated as "Tentative") on or before Apr. 15, 1922, and May 15, 1922, respectively, and payment of one-fourth of tax, accompanied by statement of reasons for delay and request for extension.	T. D. 3291, dated Feb. 21, 1922 (C. B. I-1, p. 245).
Corporations (domestic): Fiscal year ended Jan. 31, 1923; Feb. 28, 1923.	June 15, 1923. If tentative (Form 1120 indicated as "Tentative") filed and one-fourth of tax paid on or before Apr. 15 and May 15, 1923, respectively.	T. D. 3434, dated Feb. 6, 1923 (C. B. II-1, p. 153).
Corporations located in Alaska: 1922 calendar year and fiscal years ended Jan. 31, 1923; Feb. 28, 1923.	June 15, 1923. (If tentative return filed and one-fourth tax paid on or before May 15, 1923.)	T. D. 3453, dated Mar. 15, 1923 (C. B. II-1, p. 154).
1922 calendar year: Persons located or residing in Alaska. (*a*) Individual (Forms 1040 and 1040A); (*b*) Fiduciary (Form 1041); (*c*) Partnership (Form 1065); (*d*) Information (Forms 1099 and 1096).	May 15, 1923	T. D. 3453, dated Mar. 15, 1923 (C. B. II-1, p. 154).

SECTION 229.—INCORPORATION OF INDIVIDUAL OR PARTNERSHIP BUSINESS.

II-35-1223
I. T. 1857

REVENUE ACT OF 1918.

Section 330 is interpreted as meaning that members of partnerships existing January 1, 1918, and members of partnerships formed subsequent to that date were equally entitled to its benefits, provided they came within its other provisions.

The O partnership was formed April 1, 1918. On October 31, 1918, the partnership was reorganized as a corporation, and the business passed into the ownership and control of the M Company, which was formed for the purpose of succeeding to the title and interest of the individual partners. A corporation return was filed for the period from April 1, 1918, to December 31, 1918. It is now argued, in substance, by the taxpayer that the provisions of section 330, to the effect that the net income of a trade or business previously owned by an individual or partnership, and otherwise within the scope of that section—

* * * from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided*, That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: * * *

confines the benefit of that section to such partnerships as were in existence at January 1, 1918, and that a partnership coming into existence during 1918 at a date subsequent to January 1 must make a return as a partnership during the time the business was conducted as a partnership venture, and that a separate corporation income and profits tax return must be made for the period in 1918 subsequent to the organization of the business as a corporation. It is desired to file amended returns on this basis.

This office does not agree with this contention. The Revenue Act of 1918 was passed February 24, 1919, and was retroactive and was effective as of January 1, 1918. Under its provisions the rates of the surtax imposed upon individuals were greatly increased, and as individual partners were taxed upon their shares in the undistributed net income of partnerships accumulated during 1918, a situation was created which might have caused hardship and even financial embarrassment to the individual members of a partnership who had been unable to anticipate this radical increase over the 1917 surtax rates and whose business methods had been pursued in accordance with their best interests as dictated by the provisions of the 1917 law. As an act of justice to persons so situated, section 330 was introduced into the 1918 Act. This section enabled such persons to protect themselves against increased individual taxation through the exercise of an option to have the income of their business for the entire taxable period in 1918 taxed as the income of a corporation in the manner indicated by the provisions of that section, and provision was made so that this right to protection might be exercised to and including June 30, 1919.

No good reason is found for restricting the provision of section 330 to members of partnerships which were in existence at January 1, 1918, nor does the language employed in section 330 require such a construction. The date January 1 is used in this section to designate the date beyond which the benefits of an election could not be enjoyed, as beyond that date the provisions of the Revenue Act of

1917 still remained effective. There is no reason why the members of a partnership formed at January 2, 1918, were not as much entitled to protection and relief as the members of a partnership existing at January 1 of that year, and the same reason that applies to January 2 applies to all subsequent dates within the scope of section 330. The hardship to be relieved and the danger to be averted were as much present in the one case as in the other. As a greater period of time includes a less, this office construes the language of section 330 to mean that members of partnerships existing at January 1, 1918, and members of partnerships formed subsequent to that date, were equally entitled to the benefits of section 330, provided they came within its other requirements.

PART III.—CORPORATIONS.

SECTION 230.—TAX ON CORPORATIONS.

ARTICLE 501: Income tax on corporations. II–29–1148
(Also Section 250, Article 1008.) T. D. 3525

INCOME TAXES—REVENUE ACTS OF 1916 AND 1917—DECISION OF COURT.

1. APPEAL AND ERROR—FINDING BASED ON CONFLICTING TESTIMONY SHOULD NOT BE DISTURBED.

Where a finding of fact is based on conflicting testimony taken in open court, it should not be disturbed on appeal.

2. INCOME TAX—DISSOLVED CORPORATIONS—LIABILITY OF STOCKHOLDERS.

Stockholders of a dissolved corporation are liable for Federal taxes due from the corporation to the extent of assets distributed on dissolution.

3. CONSTITUTIONALITY OF ACT OF OCTOBER 3, 1917—RETROACTIVE APPLICATION.

The Act of October 3, 1917, which is retroactive as of January 1, 1917, is constitutional and its provisions are applicable to a corporation which was in existence during part of the year 1917 but was dissolved prior to the passage of the Act.

4. Decision of the District Court (285 Fed., 410; T. D. 3442) affirmed. (290 Fed., 167.)

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

To collectors of internal revenue and others concerned:

The following decision of the United States Circuit Court of Appeals, Seventh Circuit, affirming the judgment of the United States District Court for the District of Oregon in the case of *United States* v. *Boss & Peake Automobile Company, a corporation, C. L. Boss and E. W. A. Peake* (T. D. 3442 [C. B. II–1, p. 43]) is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 11, 1923.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Boss & Peake Automobile Company, a corporation, C. L. Boss and E. W. A. Peake, plaintiffs in error, v. *United States of America, defendant in error.*

[June 18, 1923.]

RUDKIN, Circuit Judge: The Boss & Peake Automobile Company was organized as a corporation under the laws of Oregon on November 8, 1916, with a capital stock of $30,000, divided into 300 shares, of the par value of $100 each. While two qualifying shares were held by others, half of the capital stock was in fact owned by Boss, and the remaining half by Peake. The corporation continued in business from the time of its formation until dissolved, on or about June 22, 1917. On June 1, 1917, Peake transferred his stock to Boss in consideration of the sum of $26,137.15, which was paid by check. This amount was made up of the following items: Capital $15,000, earnings $10,000, back salary $1,079.17, chair and desk $57.98. The entire net income of the corporation from January to June 1, 1917, was $22,549.94. On May 1, 1920, the Government imposed a tax on this net income under the Revenue Acts of September 8, 1916 (39 Stat., 756), and October 3, 1917 (40 Stat., 300), amounting to the sum of $12,405.30. Boss paid half of this tax, and the present suit was instituted by the Government against the automobile company and against Boss and Peake individually, to recover the residue, with penalty and interest added. The validity or amount of the tax was not questioned; but Boss interposed a cross-complaint, claiming that upon the dissolution of the corporation, its assets were distributed to the stockholders and that Peake, having received half of the assets, should pay half the tax. The court below entered a decree in favor of the Government and against the defendant Boss, but dismissed the complaint as to the defendant Peake and likewise the cross-complaint. From this decree Boss alone has appealed.

The court below, after a painstaking review of the testimony, found that the transaction of June 1 was a transfer or sale of stock in fact as well as in name, and not a division or distribution of the property and assets of the corporation among stockholders. (*United States* v. *Boss & Peake Automobile Co.* (D. C.), 285 Fed., 410.)

We might content ourselves with the mere statement that this finding, based as it is on conflicting testimony taken in open court, should not be disturbed on appeal. But an independent review of the testimony leads to the same conclusion. The withdrawal of Peake from the business had been under consideration for some time before the final agreement was consummated. As early as March 26, 1917, a contract was prepared to that end. Whether this contract was suggested by Boss or by Peake is not very material, because it was entirely satisfactory to the former. By the terms of this contract Peake agreed to sell and deliver his 150 shares of stock to Boss on July 1, 1917, and Boss agreed to pay therefor 50 per cent of the inventory value of the goods, wares, merchandise, and open accounts of the corporation, to be taken as of the latter date, within three days after the completion of the inventory. This contract apparently failed of execution because Peake refused to consent to the inventory method of fixing the selling price of his stock. There is nothing in the record to indicate any change of plan or purpose after that date. Probably the intention to dissolve the corporation was formed later. No doubt a dissolution was contemplated at least as early as June 1, and probably Peake had notice of that intention. But why should that concern him? As soon as he had disposed of his stock, the fate of the corporation rested in other hands, and he was thereafter powerless to insist upon a dissolution, even if he so desired.

The fact that the selling price of the stock was fixed at approximately half the value of the assets of the corporation is of little significance, in view of the fact that each party owned half of the stock. Furthermore, the price fixed was not exactly half the value of the assets, for certain contingent liabilities were assumed by Boss, and he was left more than half the value of the assets for that reason. Boss admitted that he assumed all known liabilities of the corporation and that Peake assumed none. This assumption would doubtless include the tax imposed under the Act of 1916, but that was only a small fraction of the whole. On the entire record we are satisfied that the present claim that there was a dissolution of the corporation and a division and distribution of its assets among stockholders on June 1 is a mere afterthought,

to escape liability for the tax. So far as the record discloses, there was then no reason why there should be a dissolution of the corporation, or a division and distribution of its assets, rather than a transfer and sale of the Peake stock, or why the transaction should assume one form rather than the other. There was a transfer of stock in form at least, and we are satisfied there was a transfer in fact and in law. It is unfortunate that the entire burden of the tax should fall upon one stockholder, but apparent injustice will often result from the imposition of a tax under a retroactive law. With such questions the courts have no concern, where a liability is lawfully imposed under a valid law.

There is no error in the record, and the decree is therefore affirmed.

ARTICLE 503: Corporations liable to tax. II-13-965
T. D. 3494

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME TAX—INCOME FROM EXPORTS—CONSTITUTIONALITY.

An income tax levied upon net income from the business of exporting goods from the United States and selling such goods in foreign countries is not a tax laid on articles exported from any State in violation of Article I, section 9, clause 5, of the Constitution of the United States.

2. INCOME TAX—REVENUE ACT OF 1918—CONSTITUTIONALITY.

An income tax levied under the Revenue Act of 1918 upon net income from the business of exporting goods from the United States and selling them in foreign countries does not deprive the taxpayer of his property without due process of law in violation of the fifth amendment to the Constitution of the United States, even though the Act be construed as exempting from such tax the income of foreign corporations from like sources; nor does such a tax violate the rule of uniformity.

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

To collectors of internal revenue and others concerned:

The attached decision of the District Court of the United States, Southern District of New York, in the case of *National Paper and Type Co.* v. *William H. Edwards, Collector of Internal Revenue for the Second District of New York*, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved June 22, 1923.
A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF NEW YORK.

National Paper and Type Company, plaintiff, v. *William H. Edwards, Collector of Internal Revenue for the Second District of New York, defendant.*

[May 26, 1923.]

MACK, Circuit Judge:

This is a suit to recover the sum of $183,844.14, income and excess profits taxes assessed against the plaintiff for the fiscal year ending March 31, 1919,

under sections 230, 233, and 301 of the Revenue Act of 1918,[1] and alleged to have been paid by the plaintiff under protest.

It appears from the complaint that during the year in question the plaintiff was engaged in the business of exporting goods from the United States and of selling such goods in foreign countries. The total gross business of the plaintiff for the period was $6,435,512.69, of which amount $6,295,165.87 were sales of goods by the plaintiff in foreign countries after the goods had been exported there, and $158,346.82 were sales to export commission merchants in this country with the intent and purpose that the goods should be exported and with the result that the goods were actually exported. The validity of the taxes assessed is assailed in the complaint on two grounds: (*a*) That the taxes are upon exports in violation of Article I, section 9, clause 5, of the Constitution; and (*b*) that the taxes are unequal, discriminating, and unfair, and in consequence null and void, because the income of foreign corporations engaged in exporting goods from the United States is not subject to tax under similar circumstances. The defendant has moved for judgment on the pleadings on the ground that the facts alleged are not sufficient to constitute a cause of action.

In the light of the decision in *Peck & Co.* v. *Lowe, Collector* (247 U. S., 165), in which the Supreme Court held, under the income tax law of 1913, that income of domestic corporations derived from the business of export was within the taxing power of Congress and was not in violation of Article I, section 9, clause 5, of the Constitution, plaintiff in its brief has abandoned its attack on these taxes as in violation of this provision of the Constitution. It now concentrates its attack upon the law on the ground that, as interpreted by the Attorney General (32 Opinions of Atty. Genl., 336) and as enforced by the Treasury, it deprives the plaintiff of property without due process of law in violation of the fifth amendment, because it imposes upon the plaintiff's business discriminatory and unequal burdens which are not imposed upon foreign corporations similarly situated.

It is admitted by the Government that the Acts of 1909 and 1913, the wording of which differs slightly from that of the Act of 1918, were in practice applied, at least to some extent, to foreign corporations in respect of income derived from the sale in foreign countries of goods manufactured or acquired in the United States.[2] It is unnecessary, however, here to consider the proper interpretation to be given to the Acts of 1909 and 1913 or the Act of 1918 as applied to foreign corporations, since I am satisfied of the constitutionality of the law as applied to the plaintiff, even though the income of foreign corporations from like sources is construed to be exempt.

There is, as is now conceded, no question as to the power of Congress to tax the net income of domestic corporations derived from their export business. The question as to how far it is wise and proper to extend our taxing laws to foreign corporations that manufacture or acquire goods in this country and sell them abroad involves many economic and political considerations. These are peculiarly within the province of Congress, not the courts. It is perhaps in-

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[1] The pertinent parts of the Revenue Act of 1918 here involved are:

SEC. 230. (a) That, in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by section 4 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 236; and

(2) For each calendar year thereafter, 10 per centum of such excess amount.

* * * * * * *

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, except that:

* * * * * * *

(b) In the case of a foreign corporation gross income includes only the gross income from sources within the United States, including the interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

SEC. 301. (a) That in lieu of the tax imposed by Title II of the Revenue Act of 1917, but in addition to the other taxes imposed by this Act, there shall be levied, collected and paid for the taxable year 1918 upon the net income of every corporation a tax equal to the sum of the following: * * *.

[2] It may be noted in passing that under section 217(e) of the Revenue Act of 1921, income from the sale of goods produced in whole or in part within and sold without the United States is to be treated as derived partly from sources without the United States, but that income derived from the purchase of goods within and their sale without the United States is to be treated as derived entirely from the country in which sold.

evitable not only that the rate of taxation should vary in different countries, but that there should be some laps and some gaps in the adjustment of the revenue laws of the various countries to foreign trade. It may happen for a time that income from some transactions may escape all taxation, while other income may have to bear its tax in more than one country. But a nation that attempts to reach out too far in the direct or indirect taxation of foreign trade may invite retaliation and reprisal. So long as the tax on American corporations is measured by *net* income actually realized, it is difficult to see that the American corporations are seriously handicapped in competing for any particular contracts even if it could be assumed that foreign competitors were subject to no equivalent taxation by their own Governments. Clearly, however, such a handicap or discrimination does not make the classification such a grave abuse or oppression as to condemn the law as a denial of due process within the fifth amendment. For to bring it within this condemnation it must be, as the Supreme Court says in *Brushaber* v. *Union Pacific R. R. Co.* (240 U. S., 1, 24, 25):

"a case where although there was a seeming exercise of the taxing power, the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the fifth amendment, or what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion."

In *La Belle Iron Works* v. *United States* (256 U. S., 337, 392, 393) the court again points out:

"The fifth amendment has no equal protection clause, and the only rule of uniformity prescribed with respect to duties, imposts, and excises laid by Congress is the territorial uniformity required by Article I, section 8, * * *. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the States under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. * * * The Act treats all corporations and partnerships alike, so far as they are similarly circumstanced. * * * If in its application the tax in particular instances may seem to bear upon one corporation more than upon another, this is due to differences in their circumstances, not to any uncertainty or want of generality in the tests applied."

Defendant's motion for judgment on the pleadings is granted.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 513: Mutual savings banks. II-18-1033
I. T. 1745

REVENUE ACT OF 1921.

It appears that, in addition to the earnings, there accrues to the depositors a certain bonus paid by A-B & Company to its employees. It also appears that only employees of said company may become members, and that no withdrawals may be made during the time the employee remains with the company. This is not a "bank" within the meaning of section 231(2) of the Revenue Act of 1921, inasmuch as deposits by the general public are not permitted, withdrawals may not be made therefrom at the will of the depositor, and there accrues to the depositor his portion of a "bonus."

ARTICLE 516: Cemetery companies. II-38-1264
I. T. 1881

REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

The M Company, which was organized to take charge of the money set aside by the N Cemetery Company, to be used to maintain and improve the cemetery after the cemetery corporation had ceased to sell lots, is held to be a trust, and as such is not entitled to the exemption allowed cemetery companies under the Revenue Acts of 1916, 1917, 1918, and 1921.

The N Cemetery Company, a corporation composed of —— stockholders, voluntarily set aside for the benefit of its lot owners a certain per cent of the proceeds of the sales of its lots, it being intended that the funds so accumulated should be used to maintain and improve the cemetery after the company had ceased to sell lots. An unincorporated organization known as the M Company was created to take charge of the money thus set aside by the company. This organization is composed of y lot owners. There are no stock or membership certificates. The board of trustees is elected triennially. At the election each lot owner has 1 vote. In the board of trustees is vested absolute control and management of the fund. The fund is to be expended solely under the direction of the trustees for the benefit of all the members. It is at all times to be kept invested in first mortgages and United States or municipal bonds. The members have no power other than to elect the trustees. The organization itself may only administer the fund. It owns no other property and at present takes no part in the management of the cemetery and will take none until such time as it is called upon to apply the funds in its hands to the maintenance and improvement of the cemetery. The organization has none of the common characteristics of an association or corporation. There is present, however, the characteristic which commonly distinguishes a trust from an association, namely, that the trustees have the absolute control of the assets.

Section 11(a) of the Revenue Act of 1916 provides that there shall not be taxed under that title income received by a "cemetery company owned and operated exclusively for the benefit of its members." Section 231 of the Revenue Act of 1918 provides for the exemption of "cemetery companies owned and operated exclusively for the benefit of their members." Section 231 of the Revenue Act of 1921 provides a similar exemption.

It should be noted that the exemption granted applies only to companies. The word "companies" includes both corporations and associations, but does not include trusts. In the instant case the M Company is clearly a trust, and, therefore, is not entitled to an exemption.

It is, therefore, held that the M Company is a trust and that as such it is not entitled to the exemption allowed cemetery companies under the Revenue Acts of 1916, 1917, 1918, and 1921.

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests.

(See I. T. 1827; sec. 214(a)11, art. 251.) Classification of charitable organizations other than those specified in section 231(6) for the purpose of determining deductibility of contributions.

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests. II-38-1265 I. T. 1882

REVENUE ACTS OF 1918 AND 1921.

An association organized for the purposes of cultivating the science of jurisprudence; promoting reforms in the law; elevating the standards of courtesy, integrity, and honor in the profession; and cherishing the spirit of brotherhood among its members; which also maintains a legal library for the use of its members, arranges with prominent lawyers to lecture at its meetings, and provides a fund to be used in alleviating the condition of indigent and impoverished lawyers, is exempt from taxation under the provisions of section 231(6) of the Revenue Acts of 1918 and 1921. Its income is derived from dues paid by members and no part of the earnings inures to the benefit of any individual. Contributions made thereto are deductible to the extent provided in section 214(a)11.

ARTICLE 519: Civic leagues.

(See I. T. 1800; sec. 214(a)11, art. 251.) Classification of civic leagues as charitable organizations for the purpose of deduction of contributions.

ARTICLE 522: Cooperative associations. II-23-1092 T. D. 3511

INCOME TAX.

Cooperative associations—Article 522 of Regulations 62 amended.

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

To collectors of internal revenue and others concerned:

Article 522 of Regulations No. 62 is hereby amended to read as follows:

ART. 522. *Cooperative associations.*—(a) Cooperative associations, acting as sales agents for farmers, fruit growers, live-stock growers, dairymen, etc., or engaged in the marketing of farm products, and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the produce furnished by them, are exempt from income tax and shall not be required to file returns. Thus cooperative dairy companies, which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the statute and is not exempt. The accumulation and maintenance of a reasonable reserve for depreciation or possible losses or a reserve required by State statute or a reasonable sinking fund or surplus to provide for the erection of buildings and facilities required in business, or for the purchase and installation of machinery and equipment, or to retire indebtedness incurred for such purposes will not destroy the exemption. A corporation organized to act as a sales agent for farmers, or to market cooperatively the products of the

farm, and having a capital stock on which it pays a dividend not exceeding the legal rate of interest in the State in which it is incorporated and in which substantially all of the outstanding capital stock is owned by actual producers, will not for such reasons be denied exemption, but any ownership of stock by others than actual producers who market their products through the association must be satisfactorily explained in the application for exemption. In every such case the association will be required to show that the ownership of its capital stock has been restricted as far as possible to actual producers, and that the association has not voluntarily sold or issued any stock to nonproducers. Thus, if by statutory requirement all officers of an association must be stockholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a stockholder for any reason ceases to be a producer and the association is unable, because of a constitutional inhibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that, under such circumstances, a small amount of the outstanding capital stock is owned by stockholders who are no longer producers will not destroy the exemption.

(b) Cooperative associations organized and operated as purchasing agents for farmers, fruit growers, live-stock growers, dairymen, etc., for the purpose of buying supplies and equipment for their use and turning over such supplies and equipment to them at actual cost, plus necessary operating expenses, are also exempt. The provisions of paragraph (a) relating to a reserve, sinking fund, or surplus and to capital stock shall apply to associations coming under this paragraph.

In order to be exempt under either (a) or (b) an association must establish that it has no net income for its own account, other than that reflected in a reserve, sinking fund, or surplus specifically authorized in paragraph (a). An association acting both as a sales and a purchasing agent is exempt if as to each of its functions it meets the requirements of the statute.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 6, 1923.

A. W. MELLON,
Secretary of the Treasury.

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 546: Sale of capital assets. (Also Section 202, Article 1561: Section 213(a), Article 41.)

T.I–24–1100
A. R. R. 2954

REVENUE ACT OF 1918.

Where a corporation sells its assets and the consideration is paid to its stockholders there is a sale by the corporation and the corporation is taxable upon any profit realized on the transaction.

In determining the earnings of a corporation chargeable to good will in accordance with A. R. M. 34 (C. B. 2, p. 31), Federal income taxes may be deducted. In arriving at the investment return of shares of stock the income and profits taxes should be treated the same as other expenses.

The taxpayer appeals from the action of the Income Tax Unit in holding that the appellant realized a taxable profit of $14.27x$ dollars upon the sale of its assets to the N Company on July —, 1919.

The M Company was incorporated ———, 1889. From the date of organization down to July —, 1919, the business was operated and controlled by A and B. On July —, 1919, these two men owned all or substantially all of the capital stock ($9.2x$ dollars) of the company. All of the tangible assets of the corporation were located in the city of S.

In 1919, A and B desired to convert a large part of their holdings and accordingly entered into negotiations with C, investment banker, of the city of T. As a result of these negotiations the N Company was formed, with an authorized capitalization of $60y$ shares of preferred stock of a par value of $20z$ dollars and $600y$ shares of common stock of no par value.

On August —, 1919, A, B, C, D, and E subscribed for the entire issue of the stock of the N Company as per the following:

	Number of shares.	
	Preferred.	Common.
A	$36.03y$	$360.33y$
D	$.13y$	$1.305y$
B	$23.71y$	$237.055y$
E	$.13y$	$1.305y$
C	.....	$.605y$
	$60y$	$600y$

This subscription was irrevocable for 15 days from its date and was conditioned upon the acceptance by the N Company of all of the assets of the M Company in full payment for such stock.

Under a memorandum of agreement made between the stockholders of the M Company and C (trading as P Company) on the —— day of July, 1919, all of the preferred stock and $375y$ shares of the common stock of the N Company were to be deposited in the city of T Bank of O with a letter of instructions in words and figures as follows:

Unless second party (the P Company) pays into the bank under the terms of said letter (a) the sum of $8.8x$ dollars within three months from this date, (b) and such amount as may be required to release to him all of said stock deposited with said letter within six months from this date, then and in either of said events, this contract will be at an end; second party shall thereafter have no right to buy any stock for which he had not heretofore made deposits, and thereafter no rights or liabilities shall be claimed or asserted under this contract by any party thereto.

The following resolution was passed at a stockholders' meeting of the M Company held on August —, 1919:

Resolved, hereby, by the stockholders of the M Company, that this corporation forthwith sell all of its property real and personal, of every nature, including all its trade-marks, trade names, and the good will of its business as a going concern, to the N Company, in consideration of $60y$ shares full paid seven per cent (7%) cumulative preferred stock and $600y$ shares of the common stock of no par value of said N Company being issued by said last referred to corporation to the stockholders of this corporation.

Resolved, further, that the transfer hereby authorized be upon a condition that the N Company corporation shall assume and agree to pay all the liabilities of the corporation including liabilities for taxes on account of being in business heretofore.

Resolved that this corporation be and is hereby dissolved.

Thereafter, on August —, 1919, at a joint meeting of the incorporators and board of directors of the N Company, the subscription was accepted and the corporation accepted in full payment of the stock so subscribed the property of the M Company.

In its brief the appellant states that all moot questions have been resolved by the Income Tax Unit against it, namely:

(*a*) That the consideration paid by the N Company passed to the M Company and not to the individual stockholders as provided in the resolution authorizing the sale.

(*b*) That in determining the relative values of good will in 1913 and 1919 the net income should be taken before the deduction of Federal income and profits taxes and not after such deductions as claimed by the company.

(*c*) That the consideration received had a market value of $42x$ dollars instead of $30x$ dollars as claimed by the company (assuming the transaction is taxable and the stock had a market value when issued).

It then states that its appeal is based upon the following propositions:

(1) As a matter of law, the sale by the M Company of its assets and property to the N Company, July —, 1919, did not constitute a taxable transaction.

(2) No taxable profit was realized by M Company in the sale of its assets, business, and property to the N Company, either in law or in fact.

(*a*) The stock of the N Company had neither market nor market value at the time of its issue and delivery.

(*b*) That if the Commissioner is of the opinion and so decides that the stock of the N Company had both a market and a market value at the date of its issue, the aggregate market value of such stock, properly determined, did not then exceed the fair market value of the assets and property of the M Company, as at March 1st, 1913, adjusted by changes in the value of tangible assets to July —, 1919.

(*c*) That the relative values of the good will of the M Company as at March 1, 1913, and the date of sale, July —, 1919, must be determined after the payment of all taxes.

1. The Committee is of the opinion that the sale of the M Company of its assets and property to the N Company on July —, 1919, constituted a taxable transaction. The decision of the United States District Court, Eastern District of Wisconsin, in *United States* v. *Cedarburg Milk Company*, decided November 1, 1922 (288 Fed. Rep., 996), appears to be conclusive upon this point. In that case the court held that where a corporation sold its assets, and the consideration was paid to its stockholders, there was a sale by the corporation and that the corporation was taxable upon any profit realized on the transaction and that the fact that the consideration was paid directly to the stockholders was immaterial.

2. In computing the amount of the profit made by the appellant upon the sale of its assets in 1919, the Income Tax Unit has held that the price for which the broker, C, sold the common and preferred stock to the public represents the fair market value of that stock to the stockholders of the M Company. In other words, the Unit held that the fair value of the stock received was $42x$ dollars. Under the agreement which the stockholders made with C, the stockholders were to and did receive $17z$ dollars per share for the $60y$ shares of preferred stock and $.8z$ dollars for 375 shares of the $600y$ shares of common stock. The amount of cash actually received by them from C was $26.4x$ dollars. C agreed to and did sell the preferred and common stock to the public at the rate of $20z$ dollars per share for the preferred stock and $1.5z$ dollars per share for the common stock. In order to do this he had to create a market for the stock by extensive advertising. The Committee does not think, in view of this fact, that the fair market value of the preferred and common stock to the stockholders of the M Company was in excess of $17z$ dollars

per share for the preferred stock and $8z$ dollars per share for the common stock. Upon this basis the M Company sold its assets for the cash equivalent of $30x$ dollars.

In arriving at the value of the appellant's assets on March 1, 1913, the Income Tax Unit has invoked the method which was employed in A. R. R. 252 (C. B. 3, p. 46); it has found the absolute amount paid by the purchaser for the intangibles by deducting from the selling price the book value of the tangibles plus $49x$ dollars representing appreciation thereof to March 1, 1913, and then has divided the portion of the average earnings for the preceding five-year period properly allocable to the intangibles after first deducting from those earnings an 8 per cent return upon the average amount of tangibles (plus $.49x$ dollars). In making this computation the Unit has invoked A. R. M. 145 (C. B. I-1, p. 24), which holds in effect that an individual "in determining the earnings chargeable to good will in accordance with A. R. M. 34" (C. B. 2, p. 31) may not deduct Federal income taxes. It has, therefore, used as the earnings for the five-year period substantially the net income shown upon the corporate returns.

The Committee is of the opinion that A. R. M. 145 is not applicable to a corporation. Corporation income and profits taxes were heavy during the war period and corporation income taxes were also in existence during the pre-war period. In arriving at the investment return of shares of stock the income and profits taxes should be treated the same as other expenses.

The Committee is of the opinion that the fair value of the appellant's assets as of March 1, 1913, should be computed upon the basis of a 7 per cent return upon tangibles and a 10 per cent return upon intangibles. This basis is arrived at after a careful study of the earnings of the corporation from the date of its organization in 1889. The average earnings after taxes of the appellant for the five-year period 1908 to 1912, inclusive, were $1.98x$ dollars. After allowing a 7 per cent return upon the average tangibles of the period, $9.38x$ dollars, the amount of the earnings allocable to the intangibles is $1.33x$ dollars, and the capitalization of these earnings upon a 10 per cent basis shows that the value of the intangibles as of March 1, 1913, was $13.27x$ dollars. The book value of the tangibles on July —, 1919, was $8.24x$ dollars and the appreciation to March 1, 1913, carried down to July —, 1919, per A-2 letter dated September —, 1922, was $.49x$ dollars. The depreciated cost of the tangibles as of July —, 1919, was, therefore, $8.72x$ dollars, and the total cost or fair market value of tangibles and intangibles as of March 1, 1913, on the date of sale, was $21.99x$ dollars. The profit, therefore, realized by the appellant on the sale of its assets in 1919 is shown by the following:

	Dollars.	Dollars.
Sold for		$30x$
Book value of tangibles on July —, 1919	$8.24x$	
Appreciation to Mar. 1, 1913	$.49x$	
Good will Mar. 1, 1913	$13.27x$	
		$22x$
Net profit		$8x$

The Committee recommends that the action of the Income Tax Unit in this case be modified as above indicated and that it be held that the appellant received a profit of $8x$ dollars upon the sale of its assets to the N Company in 1919.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 234.—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 561: Allowable deductions. II-26-1120
I. T. 1795

REVENUE ACT OF 1918.

The capital stock tax imposed by section 1201 of the general statutes of Connecticut (revision of 1918) is a tax imposed upon the shareholders, and as such is not deductible under section 234(a)3 of the Revenue Act of 1918 in computing the net income of the corporation.

Advice is requested relative to the deductibility by the M Company of the capital stock tax imposed by the State of Connecticut in computing its net income under the Revenue Act of 1918.

Section 1201, general statutes of Connecticut (revision of 1918), reads in part as follows:

The secretary, treasurer, or cashier of every bank or national banking association, and trust, insurance, investment and bridge company whose stock is not exempt from taxation, shall, annually, on or before October 15, file in the office of the tax commissioner a statement, under oath, showing the number of shares of its capital stock and the fair market value thereof on the 1st day of October, the name and residence of each stockholder, and the number of shares owned by each on said last-named date; and on or before the last day of the following February, each of the corporations aforesaid shall pay to the treasurer of this State a tax of 1 per centum on the fair market value of each share of its stock, as such value may be determined under the provisions of section 1204, less the amount of taxes paid by such corporation upon its real estate in the State during the year ended on the 30th day of September next prior thereto, which real estate shall be assessed and taxed in the town or other taxing district within which it is located.

Section 1207 of the statutes above named reads in part as follows:

Stockholders in the corporations mentioned in section 1201 shall be exempt from taxation upon their shares of stock except as in said section provided * * *.

The sections of the law above quoted are substantially the same as sections 2331 and 2335 of the general statutes of Connecticut, 1902, as amended by chapter 54 of the acts of 1905, which were construed by the Supreme Court of Errors of Connecticut, in the case of *Roberts* v. *Automobile Insurance Company of Hartford* (89 Conn., 181), as imposing the tax in question upon the property of the stockholders, namely, the shares of stock owned by them. The court said:

The present statute, like the former one, imposes the tax upon the shares of stock which belong to the stockholder. * * * As a convenient means of accomplishing this result, the corporation is made paymaster for the shareholders. * * * There is nothing to indicate that it was intended to make the tax one upon the property of the corporation, instead of upon the property of the shareholder, as it had previously been. That it was understood by the legis-

lature to be a tax upon the shareholder appears from section 2335, which provides that the stockholders mentioned in section 2331 shall be exempt from taxation on their shares, "except as in the said section provided," clearly indicating that the tax imposed by that section upon the shares, although paid by the corporation, was intended to be a tax upon the shareholder, and not upon the property of the corporation.

After careful consideration of the matter, it is the opinion of this office that the capital stock tax imposed by section 1201 of the general statutes of Connecticut (revision of 1918) is a tax imposed upon the shareholders, and as such is not deductible under section 234(a)3 of the Revenue Act of 1918, in computing the net income of the M Company.

ARTICLE 561: Allowable deductions.

(See I. T. 1836; sec. 215, art. 293.) Fee paid by a corporation to a stock exchange for listing its stock.

ARTICLE 561: Allowable deductions. II–39–1270
I. T. 1886

REVENUE ACT OF 1917.

The president of a Louisiana corporation can not, on behalf of his corporation, make a binding contract of employment unless expressly authorized by the charter, by-laws, or resolution of the board of directors. This is particularly true when the president is not the managing head of the corporation. Compensation paid pursuant to the contract is not deductible, though the value of the services is deductible.

The M Company, a Louisiana corporation, was organized with a paid-up capital stock of $10x$ dollars. The money paid in for the capital stock was furnished by B, who became the president of the company. One-third of the stock was issued to A, who became the vice president and general manager.

The corporation seeks to set up as an expense on its 1917 return an item of $40x$ dollars which it claims is due to its vice president as salary by virtue of a contract made between the president and the vice president, which contract was not approved by the board of directors. The salary item was not included in its original return and has not been paid, nor has it been accrued on the company's books.

The question submitted is in substance as follows:

Has the president of a Louisiana corporation, acting without the approval of his board of directors, the power to bind his corporation by a contract of employment?

The Louisiana courts adhere to the strict rule. The case of *Taylor* v. *Vossburg Mineral Springs Company* (La.) (54 So., 907) states the general rule in that State as follows:

The general rule upon the subject of the authority of the president of a corporation is stated as follows:

"According to the decided weight of authority whether he (the president of a corporation) has authority to do a particular act depends upon the power conferred upon him, either by the charter or by the stockholders or directors. * * * The mere fact that he is president, without more, does not imply that he has any greater power than any other director." Marshall on Cor-

porations, page 953 (quoted as authority in *Jackson Brewing Company* v. *Canton* (La.) (43 So., 454)); Cook on Stock and Stockholders and Corporation Law (ed. 1889), 716; Taylor on Private Corporations (3 ed.), page 197.

Bradshaw v. *Knell* (La.) (61 So., 839) affirms the rule in *Jeanerette Rice Milling Company* v. *Durocher* (La.) (48 So., 780).

"The president of a corporation has not by virtue of his office the power to bind the corporation or control its property. His power as agent must be delegated directly in the organic law of the corporation or through the board of directors."

It is therefore clear that the president of a Louisiana corporation can not, on behalf of his corporation, make a binding contract of employment with the vice president of the corporation unless expressly authorized by the charter, by-laws, or resolution of the board of directors. This is particularly true when, as in this case, the president was not the managing head of the corporation.

In the instant case the vice president and general manager of the corporation, having rendered continuous services in that capacity, is entitled to compensation, but this is by virtue of the services rendered and not by virtue of the contract. If suit were brought on the contract it would fail, and the only basis of recovery would be a *quantum meruit*. Such a claim may not be included as an item of expense until actually paid.

ARTICLE 566: Tax on bank or other stock. II–17–1022
I. T. 1741

REVENUE ACT OF 1918.

Under the laws of the State of Michigan, the tax on shares of bank stock is assessed against the stockholder. Therefore, the tax is not an allowable deduction by the bank.

Inquiry is made whether taxes paid by the M bank, which was organized under the laws of the State of Michigan, during the years 1918, 1919, and 1920 to the State and county on shares of stock of the bank, represent allowable deductions from its gross income.

Section 8 of public act 206 of 1893, State of Michigan, being compilers' section 4002 of the Compiled Laws of 1915, as amended by public act 8, 1917, provides in part as follows:

SEC. 8. For the purposes of taxation, personal property shall include:

* * * * * * *

8. All shares in banks organized within this State under the laws of this State or of the United States, at their cash value, after deducting the assessed value of real property owned by and assessed to such banks, and the value of any buildings erected upon leased lands by any bank, when the value of such real property is also assessed to said bank * * *.

Section 13 of the general tax law, which is section 4007 of the Compiled Laws, 1915, and not amended, provides that:

All personal property, except as hereinafter provided, shall be assessed to the owner in the township in which he is an inhabitant, on the second Monday of April, of the year for which the assessment is made.

Section 14 of the general tax law, which is section 4008 of the Compiled Laws, 1915, and not amended, provides that:

The excepted cases referred to in the preceding section are as follows, viz:

* * * * * * *

Third. All shares in banks shall be assessed to their owners in the township, village, or city where the bank is located: *Provided*, That the shares owned by

a person residing in the county where the bank is located shall be assessed in the township or city where he resides * * *.

It is clear from the above-quoted sections of the statute that the taxes in question are assessed against the stockholders. It is held, therefore, that such taxes are not allowable deductions from the gross income of the bank under the provisions of the Revenue Act of 1918.

SECTION 236.—CREDITS ALLOWED CORPORATIONS.

ARTICLE 591: Credits allowed. II–15–988
I. T. 1725

REVENUE ACT OF 1921.

> A corporation's right to take the $2,000 specific credit provided for in section 236(b) of the Revenue Act of 1921, in any year which involves a credit under section 204 of that Act, will depend upon the amount of the net income of the corporation prior to any credit on account of a loss for a prior year. The amount of the net income which determines the taxpayer's right to take the $2,000 specific credit is shown on line 25 of Form 1120 for 1922.

Article 1602 of Regulations 62 provides, with respect to a deductible loss under section 204 of the Revenue Act of 1921, that such loss shall be treated as a credit and deducted after the net income of the taxpayer has been determined, and that this method shall be followed in making such deduction for both the first and second years succeeding the year in which the loss was sustained.

The result is that a corporation's right to take the $2,000 specific credit provided for in section 236(b) of the Revenue Act of 1921, in any year which involves a credit under section 204 of that Act, will depend upon the amount of the net income of the corporation prior to any credit on account of a loss for a prior year. The amount of the net income which determines the taxpayer's right to take the $2,000 specific credit is shown on line 25 of Form 1120 for 1922.

SECTION 238.—CREDIT FOR TAXES IN CASE OF CORPORATIONS.

ARTICLE 612: Domestic corporation owning a majority of the stock of foreign corporation. II–20–1052
I. T. 1755

REVENUE ACT OF 1921.

Only the taxes paid by a foreign subsidiary of a domestic corporation to foreign countries or to possessions of the United States may be claimed as a credit against the tax due the United States under the provisions of section 238(e). Taxes paid by the foreign subsidiary of the foreign subsidiary may not be claimed as a credit by a domestic corporation under this section.

SECTION 239.—CORPORATION RETURNS.

ARTICLE 621: Corporation returns. II-30-1160
I. T. 1814

REVENUE ACT OF 1921.

Application for the renewal of the charter of a corporation which had expired by limitation not having been made within the time prescribed by law, its assets were conveyed to trustees "in trust for the present stockholders * * * for such time as need be required to lawfully adjust any and all questions of doubt existing and to renew the articles of incorporation at the earliest possible time." A law was subsequently passed validating the existence of all corporations which had not applied for a renewal of their charter within the time prescribed by law. No steps were taken to close the corporate affairs, the business and accounts of the corporation were continued as previously, and no steps were taken toward organization under the trust instrument.

Held, that no separate taxable entity was created by the trust instrument and that the M Company should file the returns as a corporation for all taxable years, including the periods after the expiration of the corporate charter.

The charter of the M Company expired by limitation in 1921 and under the law of the State in which it was incorporated it was necessary to apply for a renewal within 90 days. This was not done. The corporate assets were located in the State of S, by the law of which corporations were limited in the amount of their capital stock to a maximum of $4x$ dollars. The assets of the corporation had appreciated in value to an amount in excess of $4x$ dollars and it was feared that complications would arise if the corporation applied for a new charter. It was accordingly decided to convey all the corporate property to trustees "in trust for the present stockholders of the M Company for such time as need be required to lawfully adjust any and all questions of doubt existing and to renew the articles of incorporation at the earliest possible time." An act was subsequently passed by the State in which the company was incorporated validating the existence of all corporations which had not applied for a renewal of their charter within the prescribed 90 days. No steps were taken to close the corporate affairs. The business and accounts of the corporation were continued as previously and no steps were taken toward organization under the trust instrument.

Held, that no separate taxable entity was created by the trust instrument and that the M Company should file the returns as a corporation for all taxable years, including the periods after the expiration of the corporate charter.

ARTICLE 621: Corporation returns. II-34-1207
I. T. 1846

REVENUE ACT OF 1921.

Under an agreement, a corporation lessee pledged the rents received from subtenants to A for the purpose of paying amounts due A and certain other creditors, taxes, etc. The rents are collected by the president of the company, who, after paying certain expenses, remits the balance to the pledgee. The subtenants are not parties to the agreement.

The rents are income to the company and must be accounted for in its income tax return.

The pledgee is not required to file a return nor is he liable for the payment of any tax.

The M Company is the lessee of certain business property in the city of S. It occupies a portion of this property for its own purposes and subleases the balance to several tenants, the monthly payments of which total a substantial amount.

The M Company is indebted to a number of creditors, including A. In order to discharge this indebtedness it has pledged its right to the rents from the subleases to A. The president of the M Company collects the rent each month from the subtenants and after deducting certain expenses remits the balance to the pledgee, who pays the rent and other charges due to the owner of the building, including taxes, which the M Company is obligated to pay under the terms of its lease, and the balance remaining after the payment of these amounts by the pledgee is applied in the discharge of the indebtedness due A and the other creditors named in a schedule attached to the agreement.

The subtenants are not parties to the agreement.

The agreement provides that it does not constitute an absolute assignment of the subleases but that it shall operate only as a pledge for the purpose of making the payment to the creditors.

Held, that the effect of this agreement, considered from the standpoint of the income tax laws, is to constitute A the agent of the M Company for the purpose of paying its creditors. The rents when received from the subleases are income to the M Company, which must be accounted for in its income tax returns. The money derived from these rents when it reaches the hands of the pledgee represents nothing more than money paid by a debtor to its agent for the purpose of distributing among its creditors, and the pledgee is not required to file any income tax return accounting for the money received and paid out in accordance with the agreement, nor is he liable for the current income tax of the corporation, nor is he required to pay any additional taxes that may be assessed against the company for past years.

ARTICLE 622: Returns by receivers. II–20–1053
I. T. 1756

REVENUE ACT OF 1921.

A certificate to the effect that a national bank has not sufficient assets to settle and satisfy the claims of depositors and, therefore, is entitled to benefits of section 3417 of the Revised Statutes, known as the Act of March 1, 1879, should be procured from the receiver of the insolvent national bank rather than from the chief bank examiner for the district in which the bank is located.

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns. II–23–1086
I. T. 1777

REVENUE ACT OF 1921.

The filing of a consolidated return for 1922 by two affiliated corporations constituted an exercise of the election permitted by section 240(a) and separate amended returns for 1922 can not be filed.

Two affiliated corporations filed a consolidated return for 1922 upon the advice of an accountant and in this way lost the right to take the specific credit of $2,000 for each corporation in computing their income tax. The taxpayers stated that they were unfamiliar with the provisions of the Revenue Act of 1921 at the time the consolidated return was filed and asked leave to file separate amended returns for 1922 in lieu of the consolidated return previously filed.

Held: In the instant case a consolidated return for 1922 by the taxpayers was authorized by law. As a return in that form was made, this constituted an exercise of the election permitted by section 240(a) of the Revenue Act of 1921, and separate amended returns for 1922 can not be filed, although the consolidated return may have been made in ignorance of the election conferred by that section of the law. The taxpayers, however, have a right to apply for permission to make a change in the basis of their returns for future years.

ARTICLE 632: Consolidated returns. II–39–1271
(Also Section 252, Article 1036.) I. T. 1887

REVENUE ACT OF 1918.

A subsidiary corporation was not assessed a tax, and the entire tax was paid by the parent company. Reimbursement of a parent corporation which pays a tax on behalf of the group is dependent upon private agreement, and the arrangement between the corporations is not subject to review by the Commissioner. Therefore, the payments of taxes by the parent company must be regarded as payments by the parent company only, and any adjustments of the tax liability and claims for credit or refund must be made upon that basis.

During 1918 and 1919 two corporations located in different States were affiliated, but the parent company subsequently disposed of the subsidiary's stock. In the consolidated return for 1918 a notation was made as to the amounts of tax which were to be allocated between the parent and the subsidiary corporations, and this basis for division of the tax was repeated in the information return filed by the subsidiary with the collector for its district. The apportionment designated by the corporations was disregarded by the Bureau and the entire tax due was assessed against the parent company, which paid the same and sought reimbursement from its subsidiary.

In 1919 the consolidated return of the taxpayers made no allocation of the tax and the information return of the subsidiary stated that the entire tax was to be paid by the parent company. The parent company paid the tax for 1919 and sought reimbursement from its subsidiary.

Subsequent to a change of the ownership of the subsidiary company's stock, the subsidiary asked that a readjustment with reference to the tax paid by it for 1918 and 1919 be made on the basis of its net income for those years, and asked that the Bureau recognize that it paid taxes for 1918 on the basis of the original allocation and for 1919 in an amount specified by it.

Section 240 of the Revenue Act of 1918 provides in part as follows:

In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall

then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each.

It appears from the foregoing statement that the companies made an apportionment for 1918 at the time of filing their original returns, but in assessing the tax consideration was not given to such an agreement. The assessment for 1919 appears to have been made in accordance with the agreement of the two companies. The allocation of tax for 1918 as agreed upon by the companies was not upon the basis of net income, but appears to have been an arbitrary apportionment. The amount of tax burden borne by each company in 1919 was not based on net income. No abatement claim was filed, seeking to reduce the assessment made against the parent to the agreed portion, and to have the proper amount assessed against the subsidiary by the collector, but payment was made by the parent of all the amount assessed. No refund claim appears to have been filed, seeking a refund on behalf of the parent company for the amount paid by it in excess of its apportioned share, and no application was made to secure a reallocation in accordance with its original request until after the parent had parted with its ownership of the subsidiary stock.

In a brief filed by the parent company's attorneys and verified by the treasurer of the parent company, it seems that the latter is willing for the Department to adjust several claims concurrently filed, and the tax liability of each company, upon the basis of the apportionment now requested by the former subsidiary.

It becomes necessary to consider whether an agreement made by the affiliated companies as to the apportionment of tax under section 240 may be disregarded and the basis of apportionment changed thereafter upon application by the companies, and whether the Department may legally consider the former subsidiary as a taxpayer by reason of the fact that it reimbursed the parent company both years for taxes paid the Government on behalf of the subsidiary. This office is of opinion that where taxpayers have made an agreement as to the apportionment of tax under section 240, such apportionment must be adhered to by the Department in adjusting the tax liability thereafter of any of the affiliated companies, and recognition may not be given any attempts to change their original agreement.

Section 252 of the Revenue Act of 1918, in referring to the refunding and crediting of income, war-profits or excess-profits taxes, states that any excess payment shall be credited against taxes due " from the taxpayer " and any balance of the excess shall be immediately refunded " to the taxpayer." Mention is also made therein of the filing of claim for credit or refund " by the taxpayer," etc.

In this case the subsidiary was not assessed a tax and paid no tax to the United States. The Department can not legally recognize payments of tax made by said company to the United States as being paid by the former subsidiary. The matter of reimbursing the member (of a group) actually paying the tax is a private agreement, not compulsory as in the case of withholding agents, nor subject to review by the Commissioner of Internal Revenue.

It is, therefore, held that the income and profits taxes paid to the United States by the parent company for the years 1918 and 1919

must be regarded as payments only by the parent, and any adjustments of the tax liability and claims for credit or refund must be made upon that basis.

ARTICLE 633: When corporations are affiliated. II–22–1073
A. R. R. 2958

REVENUE ACT OF 1918.

In the absence of ownership or control of substantially all the stock of two or more corporations by the same interests there is no authority in the Revenue Act of 1918, or regulations thereunder, to consider the shifting of income or profits from one corporation to another, or any other relationship existing between the corporations, as decisive in determining whether or not the returns of such corporations should be consolidated.

The Committee has considered the appeal of the M Company from the action of the Income Tax Unit in refusing to accept consolidated returns from the M Company and the N Company for the taxable years 1919 and 1920.

The opinion of the Solicitor was requested upon this appeal and his opinion dated April —, 1923, reads as follows:

Reference is made to your request of December —, 1922, for an opinion as to the propriety of consolidating the returns of two corporations under the following circumstances:

"The M Company is engaged in a mercantile business and occupies a building which was formerly owned by A. A had five children, two sons and three daughters. In the taxable years 1919 and 1920, the two sons, B and C, owned 38.47 per cent and 35.13 per cent, respectively, of the stock of the M Company. Each of the daughters owned 8.74 per cent of the stock of that company; three relatives each owned a single share, or 0.06 per cent of the total.

"A desired to make provision for each of his five children in his will. One of them had a crippled child and this daughter was given property in lieu of any stock in the N Company. Each of the other four children was given 25 per cent of the stock of the N Company. The N Company owned a single building and rented it to the M Company for a very nominal rental; at first this was $2x$ dollars, but later it was increased to $5x$ dollars. There are affidavits in the file from reputable real estate men to the effect that the fair rental of the property is not less than $12x$ dollars per annum."

In the brief filed on behalf of the taxpayer, great stress is laid upon the "shifting of income" to the M Company, because of the nominal rental paid to the N Company by the M Company. There does not seem to be any serious contention that the stock ownership is sufficiently identical to warrant consolidation were it not for this shifting of income. It may be admitted that there was a shifting of income, although it is questionable that this sufficiently appears, even conceding it to be an important feature.

The Revenue Act of 1918 (section 240(a)) provides:

"That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital * * *"

And subdivision (b) provides:

"For the purpose of this section two or more domestic corporations shall be deemed to be affiliated * * * (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests."

It will be noted that nothing in the Act itself provides a test for this class of cases other than substantial *ownership* or *control* of all of the stock in two or more corporations by the same interests.

Regulations 45, article 631, explaining the underlying necessity for consolidated returns, reads as follows:

"The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services, and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. * * *"

Article 633, Regulations 45, so far as the same may be construed to be pertinent to the facts of the instant case, is as follows:

"The words 'substantially all the stock' can not be interpreted as meaning any particular percentage, but must be construed according to the facts of the particular case. * * * The words 'the same interests' shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned or controlled by two or more individuals or by two or more partnerships a consolidated return is not required unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations."

Attention is particularly directed to the latter part of article 633 as above quoted: "A consolidated return is *not* required unless the *percentage* of stock held by each individual, etc., is *substantially the same* in each of the affiliated corporations."

Article 631, above quoted, is explanatory of the 1918 law and while it recites as one reason for the law as quoted, the prevention of tax evasion by the "shifting of income," etc., it by no means pretends to lay down the rule that a "shifting of income" or "artificial distribution of profits" are determining elements. Indeed, any attempt so to construe the statute by regulation would appear to be unfounded. There is no ambiguity in the language of the Act and, therefore, no occasion to go outside its wording to seek its intent. To say that consolidations may be allowed or required in the absence of stock ownership or control upon the presumption that the particular case seems to be within the purpose of the statute would be "so far outside the language that to include it within the statute would be to legislate and not construe legislation." *France* v. *United States* (164 U. S., 676–683).

This office is of the opinion that there was no ownership or control of substantially all the stock of the two corporations by the same interests so as to warrant consolidation under the provisions of section 240, Revenue Act of 1918, and, further, that in the absence of such ownership or control, there is no authority in the law or regulations thereunder to consider the shifting of income or profits from one corporation to another, or any other relationship existing between the corporations as decisive in determining whether or not the returns of such corporations should be consolidated.

In view of this opinion, it is believed that the action of the Income Tax Unit should be sustained.

The Committee concurs in the above opinion and therefore recommends that the action of the Income Tax Unit in denying the consolidation be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 634: Change in ownership during taxable year. II-24-1101 I. T. 1783

REVENUE ACT OF 1921.

When a corporation secured the ownership and control of another corporation for a negligible period of the year 1922, and separate returns were filed for such period, the filing of the separate returns will not operate as the exercise of the option of filing separate or consolidated returns within the meaning of section 240 of the Revenue Act of 1921 and thereby deny the corporation the right to file a consolidated return for the year 1923.

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 250.—PAYMENT OF TAXES.

ARTICLE 1003: Nonpayment of tax—Interest and penalty. II-15-989 I. T. 1726

REVENUE ACT OF 1921.

Under subdivision (c) of section 250 of the Revenue Act of 1921, which subdivision is by subdivision (h) of the same section made applicable to the collection of taxes under the Revenue Act of 1917, interest should not be collected on that portion not abated of an abatement claim filed by a representative of an estate of a deceased person. If, however, a demand was made upon the individual prior to his decease, the interest on the unabated portion should be collected.

ARTICLE 1003: Nonpayment of tax—Interest and penalty. II-16-1002 I. T. 1735

REVENUE ACT OF 1921.

The collection from a former bankrupt of a penalty for delinquency in making payment of tax is not erroneous where the Government's claim for a tax was not scheduled in the bankruptcy proceedings and no claim therein was filed by the collector.

The taxpayer was adjudicated a bankrupt in February, 1921. He was discharged from bankruptcy in April, 1921. On the 1921 list, additional taxes for 1917 were assessed against the taxpayer in the amount of $6x$ dollars. First notice and demand for this tax was sent the taxpayer in March, 1921, and second notice and demand in April, 1921. The taxpayer paid the additional tax in two installments, $2x$ dollars in May, 1922, and $4x$ dollars in August, 1922, together with penalty and interest in the amount of x dollars.

A claim for refund of penalty and interest has been filed by the taxpayer, who alleges that he was adjudicated a bankrupt prior to the laying of this additional assessment, and, therefore, did not schedule this liability, and that his failure to pay the additional assessment at the time of the filing of his return was inadvertent and not intended to evade the income tax laws in any respect.

Section 59(j) of the Bankruptcy Act provides for the collection of interest on debts due the United States. Accordingly, interest would have been collectible if the claim had been filed in the bankruptcy proceeding. However, since the Government's claim was not scheduled in the bankruptcy proceeding and no claim was filed by the collector therein, this tax obligation was never before the referee in bankruptcy for consideration. Therefore, the provisions of the Bankruptcy Act prohibiting the collection of penalty has no application to this case.

In view of the above, it is clear that the penalty and interest as well as the tax were legally due and collectible. There is, therefore, no authority of law under which the same may be refunded.

ARTICLE 1004: Penalty for failure to file return. II–15–990
(Also Section 225, Article 421.) I. T. 1727

REVENUE ACTS OF 1918 AND 1921.

Where an executor or administrator is delinquent, without a reasonable cause, in making a required return for his decedent's estate, the 25 per cent penalty must be asserted.

Section 250(e) of the Revenue Acts of 1918 and 1921 specifically excludes the estates of insane, deceased, or insolvent persons from the penalty and interest therein prescribed. No such provision is made, however, with respect to the 25 per cent penalty for failure to file a return on time, imposed by section 3176 of the Revised Statutes of the United States, as amended by the Revenue Act of 1918 and reenacted by section 1311 of the Revenue Act of 1921, and consequently where an executor or administrator is delinquent, without a reasonable cause, in making a required return for his decedent's estate, the delinquency penalty must be asserted. Such assertion is entirely within the law, for the last sentence of section 225 of the Revenue Act of 1918, as well as the same section of the Revenue Act of 1921, provides that any fiduciary required to make a return under the Act shall be subject to all provisions of such Act which apply to individuals.

ARTICLE 1004: Penalty for failure to file return. II–26–1121
(Also Section 223, Article 401.) T. D. 3519

INCOME AND PROFITS TAX—REVENUE ACT OF 1917—DECISION OF COURT.

1. EXCESS PROFITS TAX—SEPARATE RETURN.

Under the excess profits tax provisions of the Act of October 3, 1917, and the regulations thereunder, an individual who receives income from a trade or business having an invested capital is required to file a separate excess profits tax return in addition to his income tax return.

2. EXCESS PROFITS TAX RETURN—PENALTY FOR FAILURE TO FILE.

Failure to file such a return under the conditions stated subjects the taxpayer to the penalty prescribed by section 3176, R. S., as amended, even though he makes an income tax return which impliedly shows that he was not engaged in a business having an invested capital and that he did not owe any excess profits tax upon income derived from a business having invested capital.

3. RETURN—FAILURE TO FILE—REASONABLE CAUSE FOR FAILURE.

The fact that the taxpayer turned over to an expert accountant what he thought was all the data necessary to make out complete and accurate income and excess profits tax returns, and that through inadvertence he failed to give the accountant all the necessary facts, as a result of which his income was understated in his income tax return and no excess profits tax return was filed does not constitute reasonable cause for failure to file an excess profits tax return, the facts also showing that the taxpayer executed the income tax return without looking at it or noting the amount thereof.

4. APPEAL AND ERROR—MATTERS CONCLUDED BY JUDGMENT IN TRIAL BY COURT.

In an action by a taxpayer to recover a refund of a penalty of 50 per cent imposed by the Commissioner of Internal Revenue under section 3176, R. S., as amended by section 16 of the Revenue Act of 1916, and paid under protest, where a jury is waived, a judgment dismissing the action involves a finding of fact that the plaintiff failed to make and file a return within the time prescribed by the statute.

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

To collectors of internal revenue and others concerned:

The attached decision of the United States Circuit Court of Appeals for the Sixth Circuit in the case of *James B. Beam* v. *Elwood Hamilton, collector*, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 20, 1923.
A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT. No. 3787.

James B. Beam, plaintiff in error, v. *Elwood Hamilton, collector of internal revenue, defendant in error.*

Error to the District Court of the United States for the Western District of Kentucky.

(Submitted April 9, 1923. Decided May 15, 1923.)

[289 Fed., 9.]

Before KNAPPEN, DENISON, and DONAHUE, Circuit Judges.

KNAPPEN, Circuit Judge: This writ brings up for review a judgment rendered in favor of the collector in a suit by plaintiff in error to recover a penalty of 50 per cent assessed (and paid under protest) for alleged failure to make a return under the Revenue Act of October 3, 1917 (40 Stat., 300). During that calendar year (and for many years before) plaintiff in error was the vice president and general manager of a distillery, for which service he received an annual salary of $4,200. On his shares of stock therein he drew dividends of $18,000. He was also on his own account (and for several years preceding had been) engaged in the business of registered distiller and wholesale and retail liquor dealer, and as such distiller owned and operated that individual business. He made an income tax return showing the salary and dividends referred to and several thousand dollars of other income (not connected with his personal distillery and liquor business), showing a net taxable income of $27,472.78,

on which a tax of $1,360.74 was computed and paid. No return whatever was made of his income from his personal business as distiller, etc., from which he received during 1917 an income of $51,994.70. A return thereof would have made plaintiff liable to an additional income tax of $4,333.18 (a total of $5,693.92 instead of $1,360.74), and to an excess profits tax of $21,155.47. On discovering this situation the Commissioner made a new assessment of taxes on the correct basis, adding to the taxes assessed a penalty of 100 per cent ($5,693.92) for making a false and fraudulent return and a penalty of 50 per cent upon the excess profits taxes for failure to make and file an excess profits return. The entire of the additional taxes and penalties so assessed was paid under protest. In this suit to recover both items of penalties paid, the District Court (which tried the case on statutory waiver of jury, under Rev. St., 649, U. S. Comp. Stat., sec. 1587) concluded that the return actually made was not false and fraudulent, it appearing to have been prepared by an expert accountant, plaintiff in error claiming he had given the accountant full data for the return and that he had executed the same without "looking at it or noting the amount thereof."

The court held, however, that plaintiff was not entitled to recover the 50 per cent penalty assessed and paid for failure to make an excess profits return. The Government has not asked review of the judgment regarding the 100 per cent penalty. Plaintiff in error does not complain of the reassessed taxes paid. The only question here relates to the 50 per cent penalty.

Rev. St., 649 (U. S. Comp. Stat., sec. 1587), provides that "the finding of the court upon the facts, which may be either general or special, shall have the same effect as the verdict of a jury." Rev. St., section 700 (U. S. Comp. Stat., sec. 1668), provides for a review of the rulings of a court in the progress of a trial if excepted to at the time and presented by bill of exceptions, and that "when the finding is special the review may extend to the determination of the sufficiency of the facts found to support the judgment." The record does not show that any request for special findings was made, nor that any finding was made except that in the judgment entry the court "found the fact to be that the said return, upon which said penalty was based, imposed and collected as stated in the pleadings, was not wilfully 'false' nor 'fraudulent,' nor was it wilfully made with intent to defeat or evade assessment of a tax." The return referred to is obviously the income tax return actually made, on which the tax of $1,360.74 was computed and paid. The statute under which the penalty in question was assessed (Rev. St., sec. 3176, as amended Sept. 8, 1916 (39 Stat., p. 775); U. S. Comp. Stat., sec. 5899), provides that "in case of *any*[1] failure to make and file a return or list within the time prescribed by law, or by the collector, the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount," subject to an exception hereinafter referred to. A fraudulent failure to file return is not necessary to the imposition of that penalty; concededly, mere failure is enough. With reference to that item the judgment entry is merely "in respect to the remainder of the amount sought to be recovered by the plaintiff, viz, the further sum of $11,015.21, and interest thereon, the court is of opinion and now adjudges that plaintiff's action should be and it is dismissed." This adjudication has the force of a general verdict of a jury, and (in the absence of exception to the admission of evidence) is conclusive upon all matters of fact involved therein. See *Lehnen* v. *Dickson* (148 U. S., 71); *Vicksburg, etc., Ry. Co.* v. *Anderson, etc., Co.* (256 U. S., 408, 415); *National Security Co.* v. *C., N. O. & T. P. Ry. Co.* (C. C. A., 6; 145 Fed., 34); *Mason* v. *Smith* (C. C. A., 6; 191 Fed., 502, 503). Our statement of facts, *supra*, is supported by admissions in pleadings or otherwise.

The exception in the 50 per cent penalty provision before referred to is that "when a return is voluntarily and without notice from the collector filed after such time, and it is shown that the failure to file was due to a reasonable cause, and not to wilful neglect, no such addition shall be made to the tax." On this record plaintiff is not entitled to the benefit of this exception. The fact of voluntary return without notice from the collector is not found, the allegation thereof in plaintiff's petition is denied by the answer, and there is direct evidence to the contrary. Two witnesses testified, without dispute, that plaintiff refused, under advice of his accountant, to sign the excess profits tax return prepared by the revenue officers. Presumably the extent of plaintiff's actual claim in respect to voluntary return of the excess profits tax is that his act in furnishing the revenue officers with the details of his income from

[1] All italics in this opinion are ours.

his personal business, which was incorporated into the proposed return and upon which the excess profits tax was assessed, amounted to a making of such return by him.

The sole substantial question presented is whether the penalty provision involved extends to a failure to make a return of excess profits, or whether it is limited to failure to make *any* income tax return.

In our opinion the 50 per cent penalty applied to the failure to make an excess profits tax return. The excess profits feature had its genesis in the United States in the Act of March 3, 1917, which applied only to corporations and partnerships. The Act of October 3, 1917, with which we are concerned, applied to individuals as well, and superseded the Act of March 3, so covering the entire of the year 1917. (Holmes Federal Taxes, 1923 Ed., p. 1213.) In the Act of October 3 a distinction between ordinary income taxes and excess profits taxes was clearly recognized, separate and distinct provisions being made for return of the two classes of taxes. The Act was divided into 13 titles, Title I relating to war income taxes, Title II to war excess profits taxes, Titles III to IX, inclusive, and Title XI relating, respectively, to taxes on beverages, tobacco and manufactures thereof, public utilities and insurance, excise, admissions and dues, stamp taxes, estate tax, and postal rates. Title X contained administrative provisions, Title XII income tax amendments, and Title XIII general provisions. Section 201, which is part of Title II, imposed the excess profits taxes in question. Section 212, also part of Title II, expressly made applicable thereto all provisions of Title I of the Act of September 8, 1916, as amended by the Revenue Act here in question, relating to returns and payment of the tax therein imposed, "*including penalties*," thus incorporating into Title II of the Act of October 3, 1917, the requirement of section 8 of Title I of the 1916 Act, which requires a "true and accurate return under oath" to be made "in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe"; while section 213 (also part of Title II) authorized the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to make regulations for carrying out the provisions of that title, and to require corporations, partnerships, or individuals subject to the provisions thereof "to furnish him with such facts, data, and information as in his judgment are necessary to collect the taxes imposed by *this title*," viz, the excess profits taxes. In 1917 the Commissioner provided two separate forms for individual tax returns, No. 1040, entitled "Individual income tax return for calendar year 1917," and No. 1101, entitled "Individual excess profits tax *return* for calendar year 1917." Heading A on Form 1040 contained blanks for details regarding "income from salaries, wages," etc. The first paragraph of instruction No. 7 (Form 1040), entitled "Excess profits taxes," directed that "if your net income reported under A * * * exceeded $6,000 you are subject to an excess profits tax at the rate of 8 per cent on the amount by which the net total under A exceeds $6,000." Heading B on Form 1040 relates to "income from business (including farming)." The second paragraph of instruction No. 7 on that form reads: "If your total income from all sources exceeded $6,000 *and you received any income from a trade or business with invested capital*, you should get a copy of the excess profits tax return (Form 1101) and calculate the amount of your tax, if any, as directed therein." On Form 1101 instruction 2 reads: "Every individual *employing invested capital* in his trade or business and having a net income for 1917 of $6,000 or more *must make a return on this form*"; and instruction No. 4 on Form 1101 gives the information that net income subject to excess profits taxes falls into two classes; that the first comprises all net income derived from trade or business (including occupations and professions) having no invested capital or not more than a nominal capital, and includes incomes reported in Schedule A, Form 1040; that the tax on *such income* should be computed and entered on Form 1040 according to the instructions thereon; but that all other income subject to tax (with reference to instruction No. 3 above, which in terms relates to excess profits taxes) should be entered on Form 1101, and the tax computed as directed in the instructions on that form. This Form 1101 contained four schedules, designated, respectively, as "net income subject to tax," "adjusted capital," "deduction," and "computation of tax," each heading containing express reference to excess profits tax regulations. This Form 1101 was required to be sworn to as "a true and *complete return*" * * * "pursuant to the Excess Profits Tax Regulations."

We think the two returns, thus so clearly distinguished, in connection with the requirement of separate return on Form 1101, do not lose their separability

or distinct identities from the fact that the amount of the excess profits tax is to be carried onto Form 1040, under headings 34 and 35, designated, respectively, as "excess profits tax at rate of 8 per cent (see instruction No. 7, p. 1)" and "excess profits tax on income from business with invested capital, as computed on *excess profits tax return Form 1101*," nor from the fact that the excess profits tax is to be deducted, in line L of Form 1040, from the taxable income otherwise shown thereby.

As plaintiff's income from salaries, wages, etc., under subdivision A, Form 1040, did not amount to $6,000, he was not subject to excess profits taxes thereon. The blanks under B, however, relating to income from business having invested capital, were left unfilled (as was the blank in line "L" relating to deduction of excess profits taxes), and so Form 1040 failed to show any income subject to excess profits tax. In view of the considerations we have pointed out, we are unable to agree with plaintiff's contention that because Schedule B was so left blank, and plaintiff thereby (impliedly only) made a return that he was not engaged in a business with invested capital and that he did not owe any excess profits tax, he thereby made a return within the meaning of the excess profits title, although the return so impliedly made on Form 1040 was untrue; nor with the further contention that unless the return actually made was wilfully false or fraudulent, as the court below found it was not, plaintiff can not be subject to the penalty for failure to make another return as to which the liability is not conditioned upon fraudulent action. Not only was the excess profits tax a separate, distinct and then novel source of revenue, but the statute and regulations, as we have above shown, in express and formal terms required separate and distinct returns thereof; and we think it clear that failure to make a separate return of excess profits tax is none the less a failure to make the return contemplated by the statute because of the mere fact that the computations on the excess profits return are to be carried onto Form 1040; the use of that form also is necessary to a complete report. By section 213 the Commissioner was undoubtedly given authority, with the approval of the Secretary of the Treasury, to require both returns. The document, failure to make which the statute penalizes, is not styled a "report"; the statute denominates it as a "return or list"; and Form 1101 is plainly such "return or list." The statute penalizes "*any* failure to file a return or list," etc. Nor is there any inconsistency between the court's finding of lack of "wilfully false or fraudulent" action as applied to the return made on Form 1040, and the conclusion of liability for failure to make an excess profits return. While we must assume, in view of the judgment, that plaintiff thought he had acquainted the expert with his ownership of a separate distillery business, and so did not act fraudulently, the accountant testified on the trial that plaintiff "never informed" him that he (plaintiff) "was in business as a distiller on his own account." In so far as the conclusion of fact so testified to was essential to the judgment rendered, the trial court is presumed to have believed the testimony. We think the Commissioner justified in holding that while the accountant was responsible for the correctness of the figures, plaintiff was responsible for the source of the same and sufficient details to insure a complete understanding of the business, and that failure to take such precaution to "discover the omission of the principal item of income" does not "constitute reasonable cause for failure to file an excess profits tax return, which was also due to the omission of the income in question from [plaintiff's] income tax return." The penalty, while drastic, was intended to insure payment of public revenue. No question of its reasonableness is involved.

The judgment of the District Court is affirmed.

ARTICLE 1005: Deficiency in payment—Interest and penalty. (Also Section 252, Article 1034.)

II–14–974
L. O. 1115

INCOME TAX: SECTION 204, SECTION 250 (b) AND (e), SECTION 252, REVENUE ACT OF 1918.

CREDITS AND REFUNDS OF AD VALOREM PENALTIES AND INTEREST.

(1) Where a return contains a fraudulent understatement of tax and there is therefore a deficiency in the tax, but the deficiency is wiped out by applying a deduction allowable under section 204, the ad valorem fraud penalty provided in section 250(b) is not ap-

plicable, since upon the redetermination under section 204 there is no deficiency within the meaning of section 250(b).

(2) Where a tax is assessed and collected, together with the 5 per cent penalty and interest at the rate of 1 per centum per month, provided in section 250(e) for failure to pay within 10 days after notice and demand by the collector, and by reason of a redetermination as provided in section 204 the tax is reduced and a portion refunded, so much of said penalty and interest, made a part of the tax by section 250(e), as is applicable to the amount of tax refunded, may be credited or refunded as excessive, as provided in section 252.

(3) Solicitor's Opinion 96 (not published) is modified accordingly.

In connection with the tax liability of the M Company, the question arises whether the fraud penalty provided in section 250(b) of the Revenue Act of 1918 should be assessed and collected, the understatement of the tax in the return for 1918 being fraudulent, but because of the deduction for losses in 1919 allowable under section 204 the tax for 1918 is less than that originally paid and in consequence there is no "deficiency," although considering the status as it was when the return was made there was a large deficiency.

Section 250(b) of the 1918 law provides:

As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits then due to the taxpayer under section 252, be paid upon notice and demand by the collector. * * *

If the understatement is false or fraudulent with intent to evade the tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns willfully made, but in addition to other penalties provided by law for false or fraudulent returns, *there shall be added as part of the tax 50 per centum* of the amount of the deficiency.

Section 252 of the same law provides:

That if, upon examination of any return of income made pursuant to this Act (Revenue Act of 1918), * * * it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: * * *

Section 204(b) provides:

If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such a redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. * * *

These provisions must be read together so that the whole may harmonize.

Section 250(b) requires that the fraud penalty "shall be added as part of the tax" and shall be "50 per centum of the amount of the deficiency" and that where the amount "paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252."

Section 252 requires that if it appears that the amount of tax "paid is in excess of that properly due, then * * * the amount of the excess shall be credited against * * * taxes * * * then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer."

Since the fraud penalty is by the statute required to be added *as part of the tax*, it must necessarily be considered as a part and parcel of the tax under the several sections here under consideration. Such penalty is clearly a penalty and not a tax except for assessment and collection purposes. The sections of the law here under consideration make it necessary to consider such penalties as part of the tax for such purposes, namely, assessment and collection. Clearly credits and refunds under section 252 are for such purposes, namely, assessment and collection. Being a part of the tax there is authority under section 252 to credit or refund any part thereof found to be excessive. Clearly a penalty which under the statute must be measured by the amount of the tax is excessive in amount if for any reason the tax is, under legal authority, reduced; in other words, where, after the penalty has been calculated on the greater amount of tax, the basis on which a percentage penalty rests is reduced, the penalty is excessive unless it be proportionately reduced, and since the amount of such reduction of penalty measures the excessive amount assessed or collected, and since the fraud penalty is for the purposes of the sections under consideration made a part of the tax, there is no escape from the conclusion that the excess may be lawfully credited or refunded under the provisions of section 252.

The provisions of section 204 require the net loss coming within the provisions of the section to be deducted from the net income of the taxpayer for the preceding taxable year and that the taxes "for such preceding taxable year shall be redetermined accordingly," and that "any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252." The redetermination of the taxes is mandatory and not optional. The crediting or refunding of any amount found to be due to the taxpayer is mandatory and not optional. "Any amount found to be due to the taxpayer" clearly has reference to any amount of the taxes as thus redetermined. Since the ad valorem fraud penalty is by section 250(b) made a part of the tax, the amount to be credited or refunded includes the excessive amount of the penalty.

In Solicitor's Opinion 96 it was held:

> Where upon default in payment of an installment due under section 250 notice is given and demand made, in accordance with section 250(c), and thereafter the tax, 5 per cent penalty and interest of 1 per cent per month have been legally assessed and collected, the Commissioner of Internal Revenue has no authority to refund the penalty and interest, notwithstanding the fact that by virtue of section 204 the amount of the tax is refunded.

Section 250(c), which was under consideration in Solicitor's Opinion 96, makes the penalty and interest thereby imposed a "part of the tax." If, therefore, the ruling laid down in Solicitor's Opinion 96 is to stand there would be no escape from the conclusion that the fraud penalty imposed by section 250(b), which penalty by the statute is also made a part of the tax, must be assessed and collected, where the understatement of the tax in the return was fraudulent, even though the tax by virtue of section 204 is so reduced as to wipe out the deficiency. For the same reasons as above outlined in the case of fraud penalties the conclusion is reached that the 5 per cent penalty and interest of 1 per cent per month imposed by section 250(e) for failure to pay within 10 days after notice and demand by the collector may be credited or refunded under section 252 in proportion to the amount of the refunding of the tax on which such penalty and interest is reduced by applying the provisions of section 204.

It is held: (1) Where a return contains a fraudulent understatement of tax and there is therefore a deficiency in the tax, but the deficiency is wiped out by applying the deduction allowable under section 204 of the Revenue Act of 1918, the ad valorem fraud penalty provided in section 250(b) of said Act is not applicable since upon the redetermination under section 204 of the Act there is no deficiency within the meaning of section 250(b); (2) where a tax is assessed and collected, together with the 5 per cent penalty and interest at the rate of 1 per centum per month, provided in section 250(e) for failure to pay within 10 days after notice and demand by the collector, and by reason of a redetermination as provided in section 204 the tax is reduced and a portion refunded, so much of the penalty and interest made a part of the tax by section 250(c) as is applicable to the amount of the tax refunded may be credited or refunded as excessive, as provided in section 252; (3) Solicitor's Opinion 96 is modified to accord with the above.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

ARTICLE 1005: Deficiency in payment—Interest and penalty. II-23-1087 Sol. Op. 151

INCOME TAX: SECTION 250 (a), (b), REVENUE ACT OF 1918; SECTION 3176, REVISED STATUTES, AS AMENDED BY THE REVENUE ACT OF 1918.

NEGLIGENCE; DELINQUENT ERRONEOUS RETURNS.

Where a delinquent erroneous income tax return under the Revenue Act of 1918 was filed by a taxpayer and there was no reasonable cause for the delinquency, the penalty provided for in section 3176, Revised Statutes, as amended by the Revenue Act of 1918 for failure to file within the time prescribed by law is applicable and the penalty and interest provisions of section 250(b) relating to negligence are not applicable.

In your reference of September —, 1921, with which you transmitted a proposed letter to A, you requested advice whether the penalty of 25 per cent for delinquency and the 5 per cent penalty for negligence in understatement of tax can both attach for the same year.

Section 250(a) of the Revenue Act of 1921 provides in part:

That except as otherwise provided in this section and sections 221 and 237 the tax shall be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment shall be paid at the time fixed by law for filing the return, and the second installment shall be paid on the 15th day of the third month, the third installment on the 15th day of the sixth month, and the fourth installment on the 15th day of the ninth month after the time fixed by law for filing the return. * * *

The tax may at the option of the taxpayer be paid in a single payment instead of installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return. * * *

Section 250(b) provides in part:

As soon as practicable after the return is filed, the Commissioner shall examine it. * * *

If the amount already paid is less than that which should have been paid, the difference, to the extent not covered by any credits due to the taxpayer under section 252 (hereinafter called "deficiency"), together with interest thereon at the rate of one-half of 1 per centum per month from the time the tax was due (or, if paid on the installment basis, on the deficiency of each installment from the time the installment was due), shall be paid upon notice and demand by the collector. If any part of the deficiency is due to negligence or intentional disregard of authorized rules and regulations with knowledge thereof, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency in the tax, and interest in such a case shall be collected at the rate of 1 per centum per month on the amount of such deficiency in the tax from the time it was due (or, if paid on the installment basis, on the amount of the deficiency in each installment from the time the installment was due), which penalty and interest shall become due and payable upon notice and demand by the collector. * * *

Section 3176, Revised Statutes, as amended by the Revenue Act of 1918, provides in part:

If any person, corporation, company or association fails to make and file a return * * * at the time prescribed by law or by regulation made under authority of law, * * *, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise, make a return or amend any return made by a collector or deputy collector. Any return * * * so made and subscribed by the Commissioner or by a collector or deputy collector and approved by the Commissioner shall be prima facie good and sufficient for all legal purposes. * * *

The Commissioner of Internal Revenue shall determine and assess all taxes other than stamp taxes, as to which returns * * * are so made under the provisions of this section. In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner of Internal Revenue shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. * * *

The amount so added to any tax shall be collected at the same time and in the same manner as part of the tax unless the tax has been paid before the discovery of the neglect, * * *, in which case the amount so added shall be collected in the same manner as the tax.

If an income tax return under the Revenue Act of 1918 was not filed within the time prescribed by law, section 3176, Revised Statutes, as amended by the Revenue Act of 1918, makes it necessary to handle the case under the provisions of said section. So far as this feature is concerned there is no difference between the Revenue Act of 1918 and the Revenue Act of 1921. In Solicitor's Opinion 150 (C. B. II–1, p. 164) it was held that where an income tax return is not filed within the time prescribed by law, section 3176 of the

Revised Statutes as amended makes it necessary for the Commissioner formally to assess the whole amount of tax and add thereto the 25 per cent ad valorem penalty therein provided, the penalty not to be added, however, if a delinquent return is filed and reasonable cause for the delinquency is shown. Therefore, the real question presented here is whether the negligence penalty provided for in subdivision (b) of section 250 may be assessed in a case where the 25 per cent penalty must be assessed because of failure to file on time, a delinquent return having been filed and there being no reasonable cause for the delinquency. That part of section 250(b) relating to the negligence penalty and interest does not provide for the imposition of such negligence penalty and interest except upon the "deficiency," which term "deficiency" is defined to be the difference between the amount "already paid" and the amount "which should have been paid." As pointed out in Solicitor's Opinion 150, such a "deficiency" can not exist if no amount was paid when it should have been paid. The expression "already paid" has meaning only from what preceded in the section, and, as stated in Solicitor's Opinion 150, clearly means only such amounts as were paid in accordance with the provisions of subsection (a) of the section, which makes no provision for delinquent payment.

The payment of an amount at a later date than that fixed by law for its payment is manifestly not a payment at a time fixed by law for its payment; therefore, if nothing was paid at the time fixed by law for its payment, there can be no "deficiency" as defined in subdivision (b) of section 250, and if no deficiency exists the negligence penalty and interest can not attach, since by the section it is made to attach only to a deficiency.

It is therefore held that where a delinquent erroneous income tax return under the Revenue Act of 1918 was filed by a taxpayer and there was no reasonable cause for the delinquency, the penalty provided for in section 3176, Revised Statutes, as amended by the Revenue Act of 1918, for failure to file within the time prescribed by law is applicable, and that the penalty and interest provisions of section 250(b) relating to negligence are not applicable.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

ARTICLE 1005: Deficiency in payment—Interest and penalty. II–32–1183 I. T. 1830

REVENUE ACTS OF 1918 AND 1921.

Where a taxpayer files his return after the time fixed by law, with or without an affidavit of reasonable cause, the installment plan of paying the tax is not applicable, and the 5 per cent penalty and 1 per cent per month interest for failure to pay the tax when due can not attach to any part of the tax unless the same remains unpaid for 10 days after notice and demand by the collector.

In reference to Office Decision 1111 (C. B. 5, p. 238), Solicitor's Opinion 150 (C. B. II–1, p. 164), and Solicitor's Opinion 151 (see p. 224), advice on two points is requested:

(1) An income tax return is filed after the time fixed by law, without reasonable cause, and the taxpayer pays therewith the en-

tire amount due. Q. Should the 25 per cent penalty for delinquency (R. S., 3176) and the 5 per cent penalty and 1 per cent per month interest on the first one-quarter of the tax for failure to pay when due (section 250(e), Revenue Acts of 1918 and 1921) be asserted?

(2) An income tax return is filed after the time fixed by law, the taxpayer making affidavit that the failure to file when due is for a "reasonable cause," and pays therewith the entire amount due. Q. Should the penalty of 5 per cent and interest at the rate of 1 per cent per month on the first one-quarter of the tax for failure to pay when due (section 250(e), Revenue Acts of 1918 and 1921) be asserted?

These two propositions are considered in the order above named.

(1) The first inquiry is answered in the negative. Office Decision 1111 was specifically modified by Solicitor's Opinion 150 so as to harmonize therewith. In Solicitor's Opinion 150 it is clearly pointed out that in such a case as is outlined in (1) "the installment plan of payment is not applicable" and "that the whole amount of the tax" with the penalty for delinquency must be assessed by the Commissioner as provided in section 3176, Revised Statutes, as amended. It is further pointed out in the body of the opinion that the amount thus assessed becomes due for payment only upon notice and demand by the collector, following receipt by him of the assessment list from the Commissioner. Since such amount, or any part thereof, does not become due for payment until notice and demand by the collector after he has received the assessment list from the Commissioner, clearly the 5 per cent penalty and 1 per cent per month interest for failure to pay when due, as provided in section 250(e), can not attach to any part of the tax unless same remains unpaid after 10 days after notice and demand by the collector. The installment plan of payment not being applicable, there is nothing due as a first installment, and clearly no penalty and interest can attach to a supposed first installment.

(2) The second inquiry is also answered in the negative and for practically the same reasons as outlined in (1) above. The only difference in the two propositions is this: In (1) the delinquency penalty attaches. In (2) the delinquency penalty does not attach. In either case, however, there is no "first installment" to which the penalty and interest provided for in section 250(e) can attach, the installment plan of payment not being applicable to such a case.

ARTICLE 1005: Deficiency in payment—Interest and penalty. II-34-1208 I. T. 1847

REVENUE ACT OF 1921.

The provisions of section 250(b) of the Revenue Act of 1921, relative to the addition of interest at the rate of one-half of 1 per cent a month in case of underpayments of tax, apply only to returns rendered under the Revenue Act of 1921. The earliest returns under this Act are returns for the calendar year 1921 or for any fiscal year ending during such calendar year.

No provision is made for the addition of interest at the rate of one-half of 1 per cent a month in the case of underpayments of tax on returns rendered under the Revenue Act of 1918.

ARTICLE 1008: Collection of tax by suit.

(See T. D. 3525; sec. 230, art. 501.) Suit against stockholder of a dissolved corporation for the collection of tax assessed against the corporation.

ARTICLE 1008: Collection of tax by suit. II–35–1225
I. T. 1859

ALL REVENUE ACTS.

Where a taxpayer's obligation to the Government has been satisfied by the surety on his bond, the Government has no claim or interest in any claim against the taxpayer which might be made the subject of assignment. Moreover, even if the Government had such claim or interest, there is no provision of law authorizing the Commissioner to assign it. However, the surety in satisfying the taxpayer's obligation to the Government is subrogated to the Government's right to recovery from the taxpayer without such assignment. The right of subrogation carries with it only the substantive right of recovery and in no way involves matters of procedure for the collection of taxes, such as distraint proceedings, which procedure, under the statute prescribing it, is available only to the Government.

Tax in the amount of x dollars was assessed against the taxpayer. A claim for abatement was filed, bond being furnished by the claimant with the M Company as surety thereon. This claim was rejected and, because of the collector's inability to collect the tax from the taxpayer, demand was made upon the surety, and the assessment with accrued charges was paid in pursuance of such demand. The M Company requests the assignment to it of the Government's interest in the claim against the taxpayer.

Since the taxpayer's obligation to the Government was satisfied by the surety on his bond, the Government has no claim nor any interest in any claim against the taxpayer which might be made the subject of assignment. Moreover, even if the Government had such claim or interest, there is no provision of law authorizing the Commissioner to assign it. However, the surety, in satisfying the taxpayer's obligation to the Government, is subrogated to the Government's right to recover from the taxpayer without such assignment.

The right of subrogation carries with it only the substantive right of recovery and in no way involves matters of procedure for the collection of taxes, such as distraint proceedings, which procedure, under the statute prescribing it, is available only to the Government.

In the event of the institution of judicial proceedings for the recovery thereof, the surety will be furnished with copies of such of the records of the Bureau, showing the assessment and discharge of the tax liability, as may be required in the prosecution of such proceedings.

ARTICLE 1010: Liens and enforcement of tax liens by bill in equity. II–37–1254
I. T. 1874

ACT OF MARCH 4, 1913.

A list of the States which have enacted suitable "appropriate legislation" referred to in the second proviso of section 3186, Revised Statutes, as amended by the Act of March 4, 1913 (37 Stat., 1016).

The second proviso to section 3186, Revised Statutes, United States, as amended by the Act of March 4, 1913 (37 Stat., 1016), provides that whenever any State by appropriate legislation authorizes the filing of a notice of Federal tax lien in the office of the registrar or recorder of deeds of the county of that State (or parishes in the State of Louisiana), the Government's lien shall not be valid in that State as against any mortgagee, purchaser or judgment creditor until such notice shall be filed in the office of the proper county or parish official of the county within which the property subject to the lien is situated.

A list of the States which have enacted "appropriate legislation," together with the date of the act and the effective date thereof, is as follows:

State.	Act of—	Effective date.	State.	Act of—	Effective date.
Alabama	Feb. 10, 1923	Feb. 10, 1923	Minnesota	Apr. 18, 1923	Apr. 18, 1923
Arkansas	Mar. 25, 1923	Mar. 25, 1923	Missouri	Apr. 2, 1923	Apr. 2, 1923
California	June 22, 1923	Aug. 17, 1923	Nebraska	Mar. 9, 1923	Mar. 9, 1923
Colorado	Apr. 19, 1919	Apr. 19, 1919	North Dakota	Feb. 19, 1923	July 1, 1923
Illinois	June 27, 1923	July 1, 1923	Ohio	Apr. 6, 1923	July 18, 1923
Iowa	Apr. 19, 1923	Apr. 19, 1923	Oregon	Jan. 26, 1923	May 24, 1923
Kansas	Mar. 20, 1923	Mar. 24, 1923	Rhode Island	May 28, 1923	May 28, 1923
Maryland	Ch. 502, 1914	1914	South Dakota	Mar. 8, 1923	July 1, 1923
Michigan	Senate bill 50	Aug. 30, 1923	Texas	Jan. 30, 1923	Jan. 30, 1923

ARTICLE 1012: Assessment of tax. II–14–975
I. T. 1714

REVENUE ACT OF 1921.

The voluntary filing of an amended return has uniformly been accepted as a waiver on the part of the taxpayer permitting an assessment of the tax disclosed to be due on the amended return. Taxes due under an amended return for the year 1916 may be assessed at any time within five years from the date such amended return was filed.

ARTICLE 1012: Assessment of tax. II–17–1023
(Also Section 252, Article 1034.) I. T. 1742

REVENUE ACT OF 1921.

Taxpayers filing returns for a fiscal-year period beginning in 1917 and ending in 1918 were required to file two returns—one under the Revenue Act of 1916 as amended by the Revenue Act of 1917 and one under the Revenue Act of 1918. For the purposes of section 250(d) of the Revenue Act of 1921, the actual date of filing the returns under the Revenue Act of 1916 as amended by the Revenue Act of 1917 is the date from which to compute the five-year limitation with reference to the assessment of additional tax applicable to the period within the calendar year 1917. Similarly, the actual date of filing the return under the Revenue Act of 1918 is the date from which to reckon the five-year limitation with respect to the assessment of additional tax applicable to the period within the calendar year 1918.

For the purposes of section 252 of the Revenue Act of 1921, as amended, the five-year limitation is to be computed from the due date of the return on which the tax was assessed. An overpayment of tax may be credited or refunded only within a period of five years from the due date of the return on which the tax was assessed, or within two years from the date of payment, unless a claim is filed by the taxpayer within such period.

An opinion has been requested concerning the application of the five-year period of limitation provided in sections 250(d) and 252 of the Revenue Act of 1921, in cases where taxpayers who keep their accounts on a fiscal-year basis file returns for a fiscal year ending in 1918, under the provisions and at the rates prescribed by the Act of September 8, 1916, and the Act of October 3, 1917, and subsequently file a return for the same period under the provisions of the Revenue Act of 1918. An opinion is also requested as to whether taxpayers who filed returns for a fiscal year ending in 1918, under prior revenue statutes, and did not file a return for that year under the Revenue Act of 1918, have a status different from taxpayers who filed returns for such fiscal year under both statutes. Section 250(d) of the Revenue Act of 1921 provides in part that:

> The amount of income, excess-profits, or war-profits taxes due under any return made * * * under prior income, excess-profits, or war-profits tax Acts, * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; * * *

Section 252, as amended, provides in part:

> That if, upon examination of any return of income made pursuant to * * * the Revenue Act of 1916, as amended, the Revenue Act of 1917, or the Revenue Act of 1918, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer, or unless before the expiration of two years from the time the tax was paid a claim therefor is filed by the taxpayer: * * *

The question presented is whether returns filed under prior revenue Acts in effect for the year 1918, up to the passage of the Revenue Act of 1918, covering fiscal years ending in 1918, are to be considered in determining the limitations periods specified in the above sections of the Revenue Act of 1921, or whether the returns required to be filed for the same period, under the provisions of the Revenue Act of 1918, should be used as a basis for such purpose.

Section 223 of the Revenue Act of 1918 provides:

> That every individual having a net income for the taxable year of $1,000 or over if single or if married and not living with husband or wife, or of $2,000 or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this title. * * *

Section 239 of the same statute provides:

> That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. * * *

Section 200 provides that—

> The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918; * * *

Section 205(a) provides:

That if a taxpayer makes return for a fiscal year beginning in 1917 and ending in 1918, his tax under this title for the first taxable year shall be the sum of (1) the same proportion of a tax for the entire period computed under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, and under Title I of the Revenue Act of 1917, which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period: * * *

T. D. 2796 (not published in Bulletin service), approved February 27, 1919, contains the following language:

Partnerships and corporations having a fiscal year ending in 1918 which have secured extensions of time which have not expired are hereby granted an extension of time to March 15, 1919, for the filing of such returns. When the returns are filed, two forms should be used and two computations made, one showing on the return form used for 1917 the tax calculated on the whole income for the entire period under the provisions and at the rates prescribed by the Act of September 8, 1916, and the Act of October 3, 1917, the other showing on the form for 1918 the tax on the whole income for the entire period calculated under the provisions and at the rates prescribed by the Revenue Act of 1918. The tax due will be the sum of so many twelfths of the first amount as there are months in 1917 covered by the return and of the second amount as there are months in 1918.

T. D. 2797 (not published in Bulletin service), approved March 11, 1919, is as follows:

If a corporation has before February 25, 1919, filed a return for a fiscal year ending in 1918 and paid or become liable for a tax computed under the Revenue Act of 1917, and is subject to additional tax for the same period under the Revenue Act of 1918, the returns covering such additional tax shall be filed at the same time as returns of persons making returns for the calendar year 1918 are due under existing ruling, and payment of such additional tax is due in the same installments and at the same times as in the case of payments based on returns for the calendar year 1918. If no part of the tax for such fiscal year was due until after February 24, 1919, the whole amount of tax due, including tax due under the "original" return and additional tax due under the "amended" return, will be payable in the same installments and at the same times as in the case of payments based on returns for the calendar year 1918.

(Attention is directed to T. D. 3305 (C. B. I–1, p. 247), concerning fiscal years ended in 1921, in which the new returns required under the Revenue Act of 1921 are not referred to as "amended" returns.)

Thus it will be seen that taxpayers having a fiscal year ending in 1918 were required to file two returns covering such period, the one showing on the form used for 1917 the tax calculated on the whole income for the entire period under the provisions and at the rates prescribed by the Act of September 8, 1916, and the Act of October 3, 1917, the other showing on the form for 1918 the tax on the whole income for the entire period calculated under the provisions and at the rates prescribed by the Revenue Act of 1918. Although the second return required to be filed on the 1918 form has sometimes been referred to as an "amended" return, there are, indeed, two separate and distinct returns under two separate and widely differing statutes, albeit both returns cover the same taxable period. Bearing in mind this fundamental principle, it is to be noted that under the provisions of section 250(d) of the Revenue Act of 1921 the amount of tax due under either of the returns must be determined and assessed by the Commissioner within five years from

the time such return was filed. Although the return filed on the 1918 form was required to be made and the tax computed for the entire fiscal year at the 1918 rates, the only amount of "taxes due" under such return was so many twelfths of the total amount as there were months of the fiscal year falling within the calendar year 1918. Hence, if in the audit of the returns it is discovered that the taxpayer has failed to report certain items of income, the net income subject to tax in each return must be increased accordingly, and the additional tax due must then be determined in the same manner as the original tax was computed by the taxpayer. (See section 239 of the statute and T. D. 2796, supra.) It follows necessarily that such portion of the additional tax as results from a redetermination in connection with the 1918 form is an amount of tax due under that return, and the period of limitation with respect to the assessment and collection of such amount runs from the date of filing of that form. On the other hand, so much of the additional tax as results from a redetermination with respect to the 1917 form is an amount of tax due under that return, and the statutory period with respect to the assessment and collection of such amount runs from the date of filing of the 1917 form.

Considering now the provisions of section 252, as amended, with respect to the refunding or crediting of overpayments of taxes, it is to be noted that this section provides that if, upon the examination of "any return" made pursuant to certain specified revenue statutes, an overassessment is discovered, such amount shall be immediately credited or refunded to the taxpayer, subject to the restriction, however, that no such credit or refund shall be allowed or made after five years from the date when "the return" was due, unless a claim is filed by the taxpayer within such period. Beyond peradventure the return to be used as the basis for determining the statutory period in the application of the above section is the return pursuant to which the tax was assessed, although the overpayment may have been revealed in a subsequent return. Any other construction would clearly defeat the obvious intent of the Congress, which was that a certain definite period should be provided within which tax adjustments should be made by the Commissioner, and after the expiration of which the Government might be sure that moneys collected under the several revenue statutes would remain in the Treasury. It can not be seriously contended that if by any chance a statement made in the 1921 return of a taxpayer indicated an overpayment of tax for the year 1916, that in such case the Commissioner would be bound to make a credit or refund of the overpayment within five years from the date the return for the year 1921 was due. As above stated, such a construction would defeat the very purpose of the enactment. Accordingly, if upon the examination of either of the returns filed by the taxpayer for the fiscal year ending in 1918 it is discovered that an overpayment has been made, such overpayment may be credited or refunded by the Commissioner sua sponte only within a period of five years from the due date of the return under which the tax was assessed or within two years from the date of payment.

There remains for consideration the question of whether taxpayers having a fiscal year ending in 1918, who filed a return under the Revenue Act of 1916, as amended, and the Revenue Act of 1917, but did not file a return under the Revenue Act of 1918, have a status

different from those taxpayers who, under like circumstances, filed a return under both statutes. In view of the authorities cited earlier in this opinion, it is clear that in the class of cases under consideration a return was required to be filed under the provisions of the Revenue Act of 1918. If for any reason such return was not filed, this office is of the opinion that the taxpayer has become delinquent, and may be called upon at the present time to file such return, and additional taxes shown thereby to be due may be assessed and collected within five years from the date of filing. The period within which a refund or credit may be made runs, of course, from the date when such return was due.

ARTICLE 1012: Assessment of tax. II-18-1034
(Also Section 213(a), Article 33, and Section 213(b), Article 73.) A. R. R. 2895

REVENUE ACTS OF 1913 AND 1921.

The running of the three-year period of limitation for assessment provided by paragraph E of the Act of October 3, 1913, did not confer a vested right against the collection of the tax which can not be disturbed by subsequent repeal of the limitation without violating the due process clause of the fifth amendment of the Constitution of the United States.

A, who has rendered services of substantial value to the M corporation, received from the stockholders of the corporation shares of stock in recognition of the past services. The property received was income to him.

The Committee has had under consideration the appeal of A from the action of the Income Tax Unit in proposing assessment of tax for the year 1915 upon income received in that year which the taxpayer neglected and refused to report. The appellant contends (1) that because of the limitation imposed by paragraph E of the Revenue Act of October 3, 1913, the amount received in the year 1915 is not now taxable, and (2) that even if the provisions of section 250(d) of the Revenue Act of 1921 apply to the facts in the case, the amount received in 1915 was a gift and, therefore, was not taxable income.

Both questions presented, being purely of a legal nature, were referred to the Solicitor for his consideration and opinion.

The Committee is now in receipt of the Solicitor's opinion, which reads as follows:

In 1902 A was employed by those who were later corporators of the M Company to take charge of its properties in a foreign country. The M Company was a corporation organized under the laws of the State of S, with a capital stock of 2,000x dollars divided into 50y shares of the par value of $\$$—— each. In addition to his salary, he acquired the right to purchase ratably at par from the stockholders of the company 10 per cent of the capital stock, less one-tenth of the stock which they held, subject to similar option agreements with others. This option, by its terms, expired February —, 1905, three years from its date, without having been exercised by A. On October —, 1905, another option was granted him to purchase at par ratably from those then stockholders of the company 9.8 per cent of the capital stock. This option, by its terms, would have expired February —, 1913, but by an agreement dated August —, 1912, between A and those then stockholders in the company, its term was extended to February —, 1915. By an agreement dated December —, 1914, between A and those then stockholders, the option previously given was canceled and annulled, and in place thereof there was substituted an option to A to pur-

chase 9.8 per cent of the capital stock at 66.85z dollars per share. The exercise of this option was conditioned upon A's satisfying an indebtedness of his in the sum of 5.74x dollars to the M Company.

In 1915 the N Company was incorporated under the laws of the State of S, with a capitalization of 500y shares of no par value, and this new corporation made a contract with the M Company for the purchase of all of the latter's assets in consideration of the issuance of the stock of the new corporation to the stockholders of record of the old corporation. At some time during the year 1915, independently of any right which A had under his option agreement of December —, 1914, he was given by the stockholders of the M Company 4.9y shares of its capital stock without his having paid or agreed to pay anything therefor. Upon the transfer of the assets of the M Company to the N Company, A received from the latter corporation, in exchange for his 4.9y shares of stock of the former corporation, 24.5y shares of the stock of the N Company and 60.86x dollars in cash. The stock of the N Company, at the time of its receipt, was valued at —— dollars a share, so that the value of 24.5y shares amounted to 264.6x dollars. This sum, added to the cash payment of 60.86x dollars, brought the total of A's receipts to 325.46x dollars. The receipt by A of 74.9y shares of stock of the M Company, and the exchange of this stock for stock of the N Company and cash, both took place in the year 1915.

The Income Tax Unit has found that A's option, under his agreement of August —, 1912, had a March 1, 1913, value of 68.6x dollars. This figure is arrived at as representing the difference between the value of 4.9y shares of the M Company stock, then worth 67.5z dollars a share, and the price which A would have had to pay in order to acquire 4.9y shares of stock under the option. In other words, since A had an option to buy for 50z dollars a share stock which was worth 67.5z dollars a share, his option was worth 17.5z dollars a share on March 1, 1913. The Unit has taxed the difference between 325.46x dollars, the value of the N Company stock plus the cash payment, and 68.6x dollars, the March 1, 1913, value of the option, or 256.86x dollars, as income received during the year 1915. It is the opinion of this office that the income received during this period amounted to 325.46x dollars, and that the March 1, 1913, value of A's option under his agreement of August —, 1912, is immaterial. The value of this option is immaterial for two reasons: First, at the time of A's receipt of 4.9y shares of the M Company stock, this option was not in existence, having been annulled and canceled by the new option agreement of December —, 1914; and, secondly, the stock received does not appear to have been received by virtue of the option, for A neither paid nor agreed to pay anything for the stock which he got from the stockholders of the M Company.

A filed no return of income for the year 1915, for the reason, as he contends, that the amounts received by him in that year were gifts.

The assessment of income taxes for the year 1915 is proposed to be made by virtue of section 250(d) of the Revenue Act of 1921, which provides that in case of a failure to file a required return under prior income tax laws, the amount of tax due may be determined, assessed, and collected at any time after it becomes due. The taxpayer contends that the time for assessment is governed by paragraph E of the Income Tax Act of October 3, 1913, and that, the period of three years therein provided having expired, he has a vested right against the collection of the tax which can not be affected by later legislation without violating the due process clause of the fifth amendment of the Constitution of the United States. This contention is clearly unsound, in view of *Campbell* v. *Holt* (115 U. S., 620), wherein it is held that the repeal of a statute of limitation of actions on personal debts does not, as applied to a debtor, the right of action against whom is already barred, deprive him of his property without due process of law. So, in the present case, the running of the three-year period of limitation for assessment provided by paragraph E of the income tax law of October 3, 1913, did not confer upon A any right of property which could not be disturbed by a subsequent repeal of the limitation. If the amount received by A in 1915 was income, the tax may, under section 250(d) of the Revenue Act of 1921, be assessed at any time for the reason that A filed no return of income for the year 1915.

The taxpayer's contention that, since A neither paid nor agreed to pay anything for the stock he received in 1915, the amount received was a gift, and as such not to be included in gross income for the year 1915, does not seem to be well founded. The stock was obviously given by the stockholders in consideration of past services rendered to the M Company, and, therefore, indirectly, but none the less substantially, rendered to the stockholders themselves. It is true

that the consideration was a past consideration. This office is of the opinion that the existence of this past consideration is sufficient to negative the idea that the transaction was a gift, which is a transfer of property from donor to donee for *no* consideration. The Bureau has ruled that pensions, given to one who has rendered services by the person to whom the services were rendered, and given in consideration of those past services, are not to be excluded from gross income as gifts, but represent compensation for services performed. (See art. 32 of Regulations 62, L. O. 1040 (C. B. 3, p. 120), and I. T. 1262 (C. B. I-1, p. 71).) In the present case, A, who had rendered services of substantial value indirectly to the stockholders of the M Company, for what benefited the corporation benefited also its stockholders, received from the stockholders shares of stock in recognition of the past services rendered by him to them. The property so received was income to A.

The Income Tax Unit should be instructed that the entire amount of $325.46x$ dollars ($264.6x$ dollars in stock of the N Company and $60.86x$ dollars in cash) received by A in 1915 was income, and that the tax should be computed upon this amount and assessed and collected.

In view of the foregoing opinion of the Solicitor, in which the Committee concurs, it is recommended, in the appeal of A, that the total amount received by him in 1915 be treated as taxable income, and that the tax due thereon, computed at the rates applicable for that year, be assessed and collected.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1012: Assessment of tax. II-18-1035
I. T. 1746

ALL REVENUE ACTS.

The Government is not bound by section 57(n) of the Bankruptcy Act, limiting the time within which creditors may file claims to 12 months. Where a field investigation disclosing additional tax has been made by a revenue agent, and the taxpayer has become a bankrupt, a copy of the agent's report should be furnished direct to the collector, and the latter should be requested to immediately file proof of claim with the referee based upon such report, and to give the trustee notice of his personal liability to protect the Government's priority respecting such additional taxes under section 3467 of the Revised Statutes. Assessment is not necessary as a prerequisite to filing claim.

ARTICLE 1012: Assessment of tax. II-24-1102
I. T. 1784

REVENUE ACT OF 1921.

A waiver by a taxpayer as to the time within which assessments may be made against him is not invalidated by reason of the fact that it is executed subsequent to the five-year period of limitation imposed by section 250(d).

ARTICLE 1012: Assessment of tax. II-30-1161
I. T. 1815

REVENUE ACT OF 1921.

Procedure in connection with reports of revenue agents as the result of their examination of the books and records of taxpayers for the purpose of verifying income tax returns.

In order to be of further assistance to taxpayers in expediting the final determination of their tax liability, the Income Tax Unit of the Bureau of Internal Revenue has adopted a new procedure in connection with reports of revenue agents as the result of their examination of the books and records of taxpayers for the purpose of verifying income tax returns. Instead of transmitting the original report to the Bureau in Washington at the same time a copy is furnished the taxpayer, revenue agents in charge of the 34 divisions into which the United States is divided, upon completion of a field examination, will forward a copy of the report to the taxpayer, with the statement that the original report will be held for a period not to exceed 20 days, so that the taxpayer if he desires may present to the revenue agent in charge any protests, briefs, or letters containing additional information. Taxpayers may also arrange oral conferences with revenue agents in charge.

If the taxpayer files an answer in the form of a protest, brief, letter, or other evidence, the revenue agent in charge will examine the same and prepare any additional comments he may deem proper to submit, forwarding all papers to Washington for final audit, unless, in his judgment, there is material variance as to the statement of facts, in which case he may order a reinvestigation.

The taxpayer will be notified of amendments to the original report. Should he not avail himself of the opportunity to submit a protest or brief within 20 days, the revenue agent in charge will upon the twenty-first day forward the report to Washington, with the statement that the taxpayer has made no protest within the time specified. In the event taxpayer does not intend to file protest and so advises the agent in charge, the report will be transmitted to the Bureau without awaiting expiration of the 20 days.

ARTICLE 1012: Assessment of tax. II–36–1240
A. R. R. 4519

REVENUE ACTS OF 1916 AND 1921.

Section 1322 of the Revenue Act of 1921 is not a statute of limitation against the assessment of additional munitions tax. It refers to taxes that become due prior to assessment, while the munitions tax is not due until after determination by the Commissioner of the amount of the tax and assessment and notice thereof. An assessment of additional munitions tax for the year 1916 found due, assessed, and notice and demand for which was made in December, 1922, is, therefore, valid.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in assessing additional munitions tax for the year 1916 in the amount of 2.3x dollars. Claim in abatement of said assessment was filed January —, 1923. Under date of July —, 1923, the taxpayer was informed that said claim would be rejected. Under date of July —, 1923, the taxpayer was advised that upon receipt of formal appeal the case would be sent to the Committee on Appeals and Review. Said appeal, dated July —, 1923, was filed with the Income Tax Unit on August —, 1923.

The Committee finds that on March —, 1917, the M Company, the appellant herein, filed with the local collector of internal revenue a return of munition manufacturer's tax for the year 1916, pursuant to Title III of the Act of September 8, 1916; that a notice and demand, dated May —, 1917, for the payment of the tax of 21.6x dollars shown by said return was received, fixing the due date thereof at June —, 1917, on which date the tax was paid to the collector; that subsequently, as the result of a field investigation, an additional tax was found to be due for the year in question in the amount of 17.02x dollars, which was paid on June —, 1917; that thereafter an additional tax of 2.3x dollars for 1916 was found due and assessed, and notice and demand on Form 7658, dated December —, 1922, was received from the collector.

It is contended by the appellant that its munition manufacturer's tax for the year 1916 "became due on or before June —, 1917," which was the date when the tax shown on the face of its original return became due and payable, and that the assessment herein considered is illegal and barred under the provisions of section 1322 of the Revenue Act of 1921. It is admitted in the taxpayer's brief, dated September —, 1923, that under section 306 of the Act of September 8, 1916, additional munitions taxes may be collected, but it is claimed that this "does not negative the fact that the due date had already been established by section 305." The Committee does not concur. Section 305, above mentioned, merely provides the method for the assessment and collection of the munitions tax; it does not provide that the due date of whatever amount is first found to be due shall be the due date of the entire munitions tax liability.

By a reference to section 305 it will be seen that five successive steps are necessary in the assessment and collection of the munitions tax: (1) The filing of the return; (2) ascertainment of the amount of the tax by the Commissioner; (3) assessment of the tax found due; (4) notification of the person liable for the tax; (5) payment of the tax on or before 30 days from the date of notice. It thus appears that ascertainment of the amount of the tax by the Commissioner, *assessment*, and notice are necessary before the tax is due.

The Commissioner of Internal Revenue has authority to make an assessment of taxes legally due at any time in the absence of a statutory time limitation. The statute of limitations sought to be invoked by the appellant against the assessment in question is section 1322 of the Revenue Act of 1921, which reads as follows:

> That all internal revenue taxes, except as provided in section 250 of this Act, shall, notwithstanding the provisions of section 3182 of the Revised Statutes or any other provision of law, be assessed *within four years after such taxes become due*, but in the case of fraud with intent to evade tax or willful attempt in any manner to defeat or evade tax, such tax may be assessed at any time.

The Committee is of the opinion that section 1322, supra, is not applicable to the instant case. Said section refers to taxes that become due prior to assessment, while, as has been shown above, the munitions tax is not due until after determination by the Commissioner of the amount of the tax, and assessment and notice thereof. The Committee is, therefore, of the opinion that the assessment herein appealed from is valid and that the claim in abatement involved in this appeal should be rejected in full.

It is therefore recommended in the appeal of the M Company that the action of the Income Tax Unit be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 1012: Assessment of tax. II–37–1255
(Also Section 252, Article 1034.) I. T. 1875

REVENUE ACTS OF 1918 AND 1921.

In income and profits tax cases where the taxable year is a fiscal year ended during the year 1918, the time from which the five-year period for making assessments begins to run is as follows:

(1) In cases where prior to the enactment of the Revenue Act of 1918 a return was filed under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was filed under that Act, the time from which the five-year period begins to run is the time of filing the return filed subsequent to the passage of the Revenue Act of 1918.

(2) In cases where prior to the enactment of the Revenue Act of 1918 a return was filed under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 no return was filed under that Act, the five-year period of limitation for the making of assessments is not applicable, and assessments for such period may be made at any time.

(3) In cases where prior to the enactment of the Revenue Act of 1918 no return was filed under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was filed under that Act, the time from which the five-year period for making assessments begins to run is the time of the filing of the return filed subsequent to the passage of the Revenue Act of 1918.

(4) In cases where no return was filed either under the Revenue Acts of 1916 and 1917 or under the Revenue Act of 1918, the five-year period of limitation is not applicable, and assessments may be made at any time.

In income and profits tax cases where the taxable year is a fiscal year ended during the year 1918, the time from which the five-year period for making refunds and credits begins to run is as follows:

(1) In cases where prior to the enactment of the Revenue Act of 1918 a return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was made under that Act, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, if the taxpayer made no return, the five-year period begins to run from the due date of the return made subsequent to the passage of the Revenue Act of 1918, which is the due date provided under that Act.

(2) In cases where prior to the enactment of the Revenue Act of 1918 a return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 no return was made under that Act, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, the time from which the five-year period begins to run is the due date of the return filed under the Revenue Acts of 1916 and 1917, as fixed by those Acts.

(3) In cases where prior to the enactment of the Revenue Act of 1918 no return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was made under that Act, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, if the taxpayer did not make a return, the five-year period begins to run from the due date of the return made after the passage of the Revenue Act of 1918, which is the due date provided under that Act.

(4) In cases where no return was made under either the Revenue Acts of 1916 and 1917 or under the Revenue Act of 1918, either

by the taxpayer or by the Commissioner, a collector, or a deputy collector, the five-year period is not applicable. (I. T. 1742 (see pp. 229–233) revoked.)

An opinion is requested concerning the application of the limitation upon assessments as provided in section 250(d) of the Revenue Act of 1918 and of the limitation upon refunds and credits as provided in section 252 of the same Act, in income and profits tax cases where the taxable year is a fiscal year ended during the year 1918. In I. T. 1742 (see pp. 229–233) the position was taken that in such cases two separate and distinct returns were required under two separate and different statutes, although both returns covered the same taxable period, that two separate and distinct taxes were imposed for the same period by different statutes, and that the limitations should be applied upon that basis. Further careful consideration has been given to the questions involved and it is believed that the theory adopted as the basis for I. T. 1742 is erroneous.

The situation is complicated by the fact that the Revenue Act of 1918 was not enacted until February 24, 1919, and is retroactive in its application. Prior to the enactment of the Revenue Act of 1918 many taxpayers whose taxable year was a fiscal year made returns under the Revenue Acts of 1916 and 1917, then in force, for fiscal years ended during the calendar year 1918. Nevertheless such taxpayers were required to file returns under the Revenue Act of 1918.

The inquiry is concerned only with taxpayers whose liability is determinable upon the basis of a fiscal year ended during the calendar year 1918. Two general questions are involved, namely, (1) the time from which the five-year period for making assessments begins to run, and (2) the time from which the five-year period for making refunds and credits begins to run. In each instance the cases may be segregated into four classes, namely, (1) cases where prior to the enactment of the Revenue Act of 1918 a return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was made under that Act; (2) cases where prior to the enactment of the Revenue Act of 1918 a return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 no return was made under that Act; (3) cases where prior to the enactment of the Revenue Act of 1918 no return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was made under that Act; and (4) cases where no return was made either under the Revenue Acts of 1916 and 1917 or under the Revenue Act of 1918.

The limitation now in force against the making of assessments is found in section 250(d) of the Revenue Act of 1921, which provides in part as follows:

> The amount of income, excess-profits, or war-profits taxes due * * * under prior income, excess-profits, or war-profits tax Acts, * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax: * * * *Provided further*, That in the case of a false or fraudulent return with intent to evade tax, or of a failure to file a required return, the amount of tax due may be determined, assessed and collected, * * * at any time after it becomes due.

The limitation now in force against the making of refunds and credits is found in section 252 of the Revenue Act of 1921, as

amended by the Act of March 4, 1923, which provides in part as follows:

> That if, upon examination of any return of income made pursuant to * * * the Revenue Act of 1916, as amended, the Revenue Act of 1917, or the Revenue Act of 1918, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer.

As a fundamental proposition, it appears to be clear that the Revenue Act of 1918 imposes a tax upon the net income received by taxpayers during the entire period of any fiscal year ended during the calendar year 1918. Sections 210 and 230 provide that the tax shall be levied at certain rates for each taxable year, and section 200 defines the term "taxable year" as being the calendar year or the fiscal year ending during such calendar year, and provides further that the term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December, and that the first taxable year to be called the taxable year 1918 shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918. The Revenue Act of 1918 is thus retroactive and imposes a tax upon the net income received by any taxpayer during the entire period of any fiscal year ended during the calendar year 1918. It is also clear from sections 223 and 239 that returns are required to be filed under the Revenue Act of 1918 for the entire period of any fiscal year ended during the year 1918. Accordingly, upon the passage of the Revenue Act of 1918 every individual or corporation keeping books of account upon a fiscal-year basis and liable under the law to make a return was required under the law to file a return for such period and to pay the tax imposed by the Revenue Act of 1918 upon the income of that period. There can be no doubt that the Revenue Act of 1918 imposes a tax upon the entire net income of a fiscal year beginning in 1917 and ending in 1918. Section 205 specifically so states and moreover provides that any amount theretofore or thereafter paid on account of the tax imposed for such fiscal year by Title I of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by Title I of the Revenue Act of 1917, shall be credited toward the payment of the tax imposed for the same period by the Revenue Act of 1918 and any excess refunded or credited to the taxpayer. In addition, section 1400(a) of the Revenue Act of 1918 repeals Title I of the Revenue Act of 1916 and Title I of the Revenue Act of 1917, subject to the limitations provided in subdivision (b) of the same section. An examination of those limitations does not disclose, in the opinion of this office, any limitation which is inconsistent with the position that the tax finally imposed for a fiscal year beginning in 1917 and ending in 1918 is imposed solely by the Revenue Act of 1918. Although it is true that section 205 of the Revenue Act of 1918 provides that the tax shall be in part a certain proportion of a tax for the entire period computed under Title I of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and under Title I of the Revenue Act of 1917,

the reference to the provisions of the Revenue Acts of 1916 and 1917 is only for the purpose of affording by reference a basis for the computation in part of the tax imposed by the Revenue Act of 1918. It necessarily follows that the tax previously imposed under the Revenue Acts of 1916 and 1917 for any fiscal year beginning in 1917 and ending in 1918, or for any part of such year, is superseded by the tax imposed under the Revenue Act of 1918, and that any return for a fiscal year beginning in 1917 and ending in 1918 filed after the passage of the Revenue Act of 1918 must be considered as an original return made under that Act, whether it was upon a form used under the 1916 and 1917 Acts or upon a form used under the 1918 Act or whether both forms were used in making the return.

Treasury Decision 2797, approved March 11, 1919, refers to the tax imposed by the 1918 Act as an "additional" tax and to the return required by the 1918 Act as an "amended" return, and Office Decision 71 (published in Cumulative Bulletin No. 1, p. 234) refers to the return required by the 1918 Act as a "supplemental" return. Although in a very broad and general sense the tax imposed by the 1918 Act is an additional tax in that it is a greater tax than that imposed by the 1916 and 1917 Acts, and although the return required by the 1918 Act is in the same general sense an amended or supplemental return, it is not, in the opinion of this office, proper from a legal viewpoint to refer to the tax imposed by the Revenue Act of 1918 as an additional tax or to the return required by the same Act as an amended or supplemental return. For any fiscal year beginning in 1917 and ending in 1918 the Revenue Act of 1918 imposes for the whole taxable period an entire tax which superseded the tax previously imposed by the Revenue Acts of 1916 and 1917 and the return for such period required to be filed by the Revenue Act of 1918 is an original return under that Act.

Therefore, in any case where subsequent to the passage of the Revenue Act of 1918 a taxpayer filed a return for a fiscal year beginning in 1917 and ending in 1918, the amount of net income, excess-profits, or war-profits taxes due for such period, or any part thereof, may be assessed at any time within five years after such return was filed, and can not lawfully be assessed thereafter unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax, in which event the determination, assessment, and collection must be made within the period limited by the consent, or unless the return so filed was false or fraudulent with intent to evade the tax, in which event the tax may be determined, assessed and collected at any time. In other words, the time from which the five-year period for making assessments begins to run is the time of filing the return under the Revenue Act of 1918. In any case where for a fiscal year beginning in 1917 and ending in 1918 no return was filed after the passage of the Revenue Act of 1918 and a tax is found to be due for such period, the tax may be assessed and collected at any time whether or not a return was made prior to the passage of the Revenue Act of 1918 under Acts then in force.

An examination of the provisions of section 252 of the Revenue Act of 1921, as amended, discloses that the five-year period therein provided for the making of refunds and credits without the neces-

sity of the taxpayer's filing a claim commences from the due date of the return, the examination of which discloses the excessive payment, and that the five-year period is applicable only to those cases where the excessive payment becomes apparent upon the examination of a return made pursuant to any of the several Acts of Congress referred to in the section. It should be noted that under the provisions of section 3176, Revised Statutes, as amended, and as reenacted by section 1311 of the Revenue Act of 1921, if any person or corporation fails to file a return, the collector or deputy collector may make the return, or the Commissioner may make the return or amend any return made by a collector or deputy collector. The provisions of section 252 appear to be as applicable to cases where returns are made by the Commissioner, a collector, or a deputy collector, as to those cases where returns are made and filed by taxpayers. In any case where a return is made by the Commissioner, a collector, or a deputy collector, the due date of such return for the purposes of section 252 is the date upon which a return should have been filed by the taxpayer.

In any case where for a fiscal year beinning in 1917 and ending in 1918 a return for such period was made subsequent to the passage of the Revenue Act of 1918 and an excessive amount of tax was paid, in view of the fundamental propositions set forth above in regard to the nature and extent of the tax imposed by the Revenue Act of 1918 and in regard to the requirements of that Act in respect to the making of returns, there can be no proper determination of the correct amount of tax without an examination of the return made under the Revenue Act of 1918, which is the return required by law for such period. Accordingly, in any such case the excessive amount of tax may be refunded or credited at any time within five years from the due date of the return made under the Revenue Act of 1918 without the filing of a claim by the taxpayer. In other words, the time from which the five-year period begins to run in any case where a return was made subsequent to the passage of the Revenue Act of 1918 is the due date of the return required to be made by that Act. In those cases, if any, where a return for a fiscal period beginning in 1917 and ending in 1918 was made prior to the passage of the Revenue Act of 1918 under the Acts then in force and no return was made subsequent to the passage of the Revenue Act of 1918 and at the same time it appears that a tax in excess of that imposed by the Revenue Act of 1918 has been paid, the return, the examination of which discloses the excessive payment, having been made pursuant to the Acts then in force, any excessive payment thereby disclosed may be refunded or credited at any time within five years from the due date of that return without the filing of a claim by the taxpayer. In other words, in any such case the time from which the five-year period begins to run is the due date for returns as prescribed by the Revenue Acts of 1916 and 1917. In the improbable case of an excessive amount of tax having been paid in the absence of any return having been made, either prior to or subsequent to the passage of the Revenue Act of 1918, the five-year period has no application.

It is, therefore, held that in income and profits tax cases where the taxable year is a fiscal year ended during the year 1918, the time from which the five-year period for making assessments begins to run is as follows:

(1) In cases where prior to the enactment of the Revenue Act of 1918 a return was filed under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was filed under that Act, the time from which the five-year period begins to run is the time of filing the return filed subsequent to the passage of the Revenue Act of 1918.

(2) In cases where prior to the enactment of the Revenue Act of 1918 a return was filed under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 no return was filed under that Act, the five-year period of limitation for the making of assessments is not applicable, and assessments for such period may be made at any time.

(3) In cases where prior to the enactment of the Revenue Act of 1918 no return was filed under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was filed under that Act, the time from which the five-year period for making assessments begins to run is the time of the filing of the return filed subsequent to the passage of the Revenue Act of 1918.

(4) In cases where no return was filed either under the Revenue Acts of 1916 and 1917 or under the Revenue Act of 1918, the five-year period of limitation is not applicable, and assessments may be made at any time.

In income and profits tax cases where the taxable year is a fiscal year ended during the year 1918, the time from which the five-year period for making refunds and credits begins to run is as follows:

(1) In cases where prior to the enactment of the Revenue Act of 1918 a return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was made under that Act, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, if the taxpayer made no return, the five-year period begins to run from the due date of the return made subsequent to the passage of the Revenue Act of 1918, which is the due date provided under that Act.

(2) In cases where prior to the enactment of the Revenue Act of 1918 a return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 no return was made under that Act, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, the time from which the five-year period begins to run is the due date of the return filed under the Revenue Acts of 1916 and 1917, as fixed by those Acts.

(3) In cases where prior to the enactment of the Revenue Act of 1918 no return was made under the Revenue Acts of 1916 and 1917, and after the passage of the Revenue Act of 1918 a return was made under that Act, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, if the taxpayer did not make a return, the five-year period begins to run from the due date of the return made after the passage of the Revenue Act of 1918, which is the due date provided under that Act.

(4) In cases where no return was made under either the Revenue Acts of 1916 and 1917 or under the Revenue Act of 1918, either by the taxpayer or by the Commissioner, a collector, or a deputy collector, the five-year period is not applicable. (I. T. 1742 (pp. 229–333) revoked.)

SECTION 252.—REFUNDS.

ARTICLE 1032: Claims for abatement of taxes erroneously assessed. II-36-1241 I. T. 1869

REVENUE ACT OF 1921.

Where the taxpayer fails to furnish the bond requested upon the filing of an abatement claim and the collector proceeds to collect the tax as if no claim for abatement had been filed, he should return the abatement claim to the taxpayer and advise him of his remedy by a claim for a refund.

In nearly all instances where abatement claims are filed with collectors the taxpayer is required to furnish a bond to secure payment of the tax in the event the claim is rejected.

Where the required bond is not furnished, the collector proceeds to collect the tax as if no claim had been filed. Inquiry is made as to what disposition should be made of these claims; that is, whether they should be forwarded to the Bureau or returned to the taxpayer.

Article 1032 provides in part as follows:

The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund.

Accordingly, where the collector proceeds to collect the tax as if no claim for abatement had been filed, he should return the abatement claim to the taxpayer and advise him of his remedy by a claim for refund.

ARTICLE 1034: Claims for credit of taxes erroneously collected.

(See L. O. 1115; sec. 250, art. 1005.) Fraudulent understatement of tax and the failure to pay the tax within 10 days after notice and demand by collector in a case where a redetermination under section 204 shows no deficiency of tax to be due.

ARTICLE 1034: Claims for credit of taxes erroneously collected.

(See I. T. 1742; sec. 250, art. 1012.) Computation of five years' limitation in case of fiscal year ending in 1918 for which two returns were required.

ARTICLE 1034: Claims for credit of taxes erroneously collected. II-18-1036 I. T. 1747

REVENUE ACT OF 1921.

Where section 250(d) of the Revenue Act of 1921, with respect to appeals and hearings, has been fully complied with, and the additional tax placed on the assessment list, a taxpayer is not precluded from filing a claim for credit against such assessment, but merely from filing a claim for abatement.

ARTICLE 1034: Claims for credit of taxes erroneously collected.

(See I. T. 1875; sec. 250, art. 1012.) Computation of five-years' limitation in case of fiscal year ending in 1918.

ARTICLE 1036: Claims for refund of taxes erroneously collected. II–15–991 I. T. 1728

REVENUE ACT OF 1921.

A claim for credit or refund of taxes paid by an affiliated corporation may be made only by the corporation entitled to receive the credit or refund. The amount of such credit or refund may not be taken advantage of in reducing the amount of the total tax due under a consolidated return submitted for a later year and which includes for such year the income of the claimant corporation. With respect to refunds and credits each affiliated corporation occupies a status similar to that of an independent and unaffiliated corporation.

The M Company filed a consolidated return of income and excess profits tax for the years 1917, 1918, and 1919. In the year 1920 the Department ruled that the M Company was not affiliated with the N Company and compelled it to file separate amended returns for the years mentioned, which disclosed an overpayment by the M Company of x dollars.

The O Company is now the holder of all the stock of the M Company and filed income and excess profits tax returns for the M Company for the past two years and paid the tax in the name of the O Company.

Request is made that the O Company be permitted to credit against taxes due from it the overpayment of x dollars made by the M Company.

Held, that under the provisions of section 252 of the Revenue Act of 1921 a refund or credit of taxes may be made only to the taxpayer by whom the overpayment was made. Even though a consolidated return is submitted, for the purpose of the tax each affiliated corporation is considered a separate and distinct entity. A claim for refund or a claim for credit of excess taxes paid by an affiliated corporation may be made only by the corporation entitled to receive the credit or refund. The amount of such credit or refund may not be taken advantage of in reducing the amount of the total tax due under a consolidated return submitted for a later year and which includes for such year the income of the claimant corporation. With respect to refunds, credits, and additional assessments, each affiliated corporation occupies a status similar to that of an independent and unaffiliated corporation.

Accordingly, no credit may be allowed the O Company against taxes due from it on its 1921 consolidated return on account of an overpayment made by the M Company on its consolidated returns with the N Company for the years 1917, 1918, and 1919. If, however, the M Company itself has an outstanding tax assessed against it, the amount overpaid by it for 1917, 1918, and 1919 may be credited against such outstanding assessment.

ARTICLE 1036: Claims for refund of taxes erroneously collected. II-30-1162 I. T. 1816

REVENUE ACT OF 1921.

The "return" referred to in section 252, from the due date of which the statute of limitation begins to run, is the original return and not an amended return.

A taxpayer filed a 1916 return showing a tax liability of $2x$ dollars. During 1923 he filed an amended 1916 return showing a tax liability of $3x$ dollars, or an additional tax of x dollars. After filing the amended return the taxpayer claimed that such amended return was in error and that the tax should have been x dollars. He, therefore, contends that he is entitled to file a claim for the refund of the x dollars paid in connection with the amended return and a claim for refund for the x dollars overpaid on the original return.

Under the provisions of section 252 of the Revenue Act of 1921, as amended by the Act of March 4, 1923, claims for credit or refund for 1916 must be filed within five years from the time the return was due or within two years from the time the tax was paid.

It has been held that "return" as used in section 252 means the original return and not an amended return filed as a supplement thereto. Accordingly, the filing of the amended return would not extend the time for filing claims for credit or refund for the year 1916. If, however, the taxpayer paid an additional tax of x dollars in 1923, he may file a claim for credit or refund covering such amount within two years from the time such tax was paid.

ARTICLE 1036: Claims for refund of taxes erroneously collected. II-32-1184 I. T. 1831

REVENUE ACT OF 1921.

Where a trust has been terminated, the trust assets distributed, and the trustee discharged, a claim for the refund of an excess payment made by the trustee should be executed by all the beneficiaries entitled to the refund. Attached to the claim should be an affidavit from the trustee stating that he has been discharged and the assets distributed.

ARTICLE 1036: Claims for refund of taxes erroneously collected.

(See I. T. 1887; sec. 240, art. 632.) Credit or refund where parent corporation was assessed and the tax paid by it.

ARTICLE 1037: Special relief where invested capital reduced by Commissioner. II-14-976 I. T. 1715

REVENUE ACT OF 1921.

Pursuant to the second proviso of section 252, excess-profits tax imposed by the Revenue Act of 1917 and the Revenue Act of 1918 as well as income tax shall be credited or refunded as provided in that section.

ARTICLE 1037: Special relief where invested capital reduced by Commissioner. II-14-978 I. T. 1717

REVENUE ACT OF 1921.

The second proviso of section 252 of the Revenue Act of 1921 as originally enacted is not restricted in its operation to liability for taxes under the various income tax Acts enacted since March 1, 1913, but also contemplates the refund or credit of taxes paid under the Excise Tax Act of 1909.

Advice is requested as to whether the second proviso of section 252 of the Revenue Act of 1921, as originally enacted, contemplates the redetermination of tax liability under the Corporation Excise Tax Act of 1909 or is restricted in its operation to liability for taxes under the various income tax Acts enacted since March 1, 1913.

Section 252 of the Revenue Act of 1921, as originally enacted, so far as material here, reads as follows:

SEC. 252. That if, upon examination of any return of income made pursuant to this Act, the Act of August 5, 1909, entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," the Act of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the Revenue Act of 1916, as amended, the Revenue Act of 1917, or the Revenue Act of 1918, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer: *Provided*, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer: *Provided further*, That if upon examination of any return of income made pursuant to the Revenue Act of 1917, the Revenue Act of 1918, or this Act, the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, then, notwithstanding any other provision of law and regardless of the expiration of such five-year period, the amount of such excess shall, without the filing of any claim therefor, be credited or refunded as provided in this section: * * *.

It is contended that the tax imposed in the Act of August 5, 1909, was not, properly speaking, an income tax and that the relief intended to be extended by the second proviso of section 252 as above quoted could not be deemed to include taxes paid under such Act of 1909, since in terms such relief was limited to overpayments of income taxes only.

Upon careful consideration it is believed this position is erroneous. The first portion of section 252 of the Revenue Act of 1921, dealing generally with the refunding or crediting of overpayments of taxes in prior years discovered upon the examination of returns, refers to the Act of August 5, 1909, as one of the Acts to which the relief contemplated is to be extended. The reference to the Act of 1909 clearly shows an intention on the part of Congress to include within the meaning of the words "income tax" as used therein taxes paid under such Act. The plain intention sought to be expressed by the language used appears to be that refunds or credits should be made of overpayments of taxes under *any return of*

income filed since 1909 under the Acts specified, provided, of course, the conditions of section 252 are complied with. The second proviso of such section, as originally enacted, refers to overpayments of income tax shown as a result of adjustments made for 1917, 1918, and subsequent taxable years. Section 252 contains but one sentence and since the proviso in question is made a part of such sentence the words "income tax" as used therein should be given the same meaning as given to them in other parts of the same sentence. Furthermore, the tax under the Act of 1909 was measured by the corporation's net income. The failure to take adequate deductions in any of the years falling thereunder would affect the tax paid in the same way as in the case of the subsequent taxes upon income. There is, on this account, every practical reason for extending the relief to the Act of 1909.

ARTICLE 1037: Special relief where invested capital reduced by Commissioner. II–36–1242 I. T. 1870

REVENUE ACT OF 1921.

In determining whether an amount of tax in excess of that properly due has been paid in any previous year or years under the third proviso of section 252, as amended, consideration must be given to all items affecting gross income and allowable deductions. It can not be said that the failure to deduct in the return for any year the full amount of one or more items of allowable deductions results in the overpayment of tax when, by reason of the deduction of other items which are unallowable or excessive in amount, and the omission from the return of items of taxable income, the tax paid for such year is in fact less than the true tax liability.

In the audit of the returns of the M Company for 1916 and 1917, based upon a revenue agent's report, the invested capital of the taxpayer for 1917 was decreased by $19x$ dollars, representing $14x$ dollars additional depreciation for 1916 and $5x$ dollars error in inventory for that year. Upon the audit of the 1916 return it was ascertained that after allowing the deduction for additional depreciation, correcting the error in inventory, and increasing the income by the amount of the profits from the sale of a by-product, and investment stock previously omitted from gross income, and reducing the deduction for taxes paid in the amount of $12x$ dollars, a further tax of $\frac{1}{8}x$ dollars was disclosed for 1916, which, in the absence of a waiver by the taxpayer, could not be assessed.

The question presented is whether, in view of the fact that the audit disclosed a further tax due for 1916, any refund or credit can properly be allowed the taxpayer for that year under the third proviso of section 252 of the Revenue Act of 1921, as amended. This proviso reads as follows:

That if upon examination of any return of income made pursuant to the Revenue Act of 1917, the Revenue Act of 1918, or this Act, the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, then, notwithstanding any other provision of law and regardless of the expiration of such five-year period, the amount of such excess shall, without the filing of any claim therefor, be credited or refunded as provided in this section.

It is to be noted that under the third proviso of section 252 of the Revenue Act of 1921, as amended, the following conditions precedent must be complied with before a refund or credit for any previous year may be allowed after the expiration of the statutory period of limitation:

(1) An examination must be made of the taxpayer's return.

(2) The invested capital of the taxpayer must be decreased by the Commissioner.

(3) The decrease in the invested capital must be due to the fact that the taxpayer failed to take adequate deductions for the previous year.

(4) The result of the failure to take such deductions must be that the tax paid for the previous year is in excess of that properly due.

The answer to the question presented involves the proper construction of the following clause contained in the proviso:

With the result that an amount of income tax in excess of that properly due was paid in any previous year or years.

The question, therefore, resolves itself into when is a tax paid in excess of the tax properly due for any previous year. Under all the income and profits tax Acts enacted since March 1, 1913, the tax is levied and collected upon the sum of the items of the taxable income from all sources, less the amount of certain deductions and credits. These include several items. The conclusion can not, therefore, be avoided that what is meant by the clause in question is that a tax paid in excess of that properly due for the previous year is a tax in excess of the true tax liability for such year computed upon the basis of the total amount of taxable income derived by the taxpayer from all sources, less the exact amount of all the allowable deductions and credits to which the taxpayer is entitled. It can not be said that the failure to deduct in the return for any year the full amount of one or more items of allowable deductions results in the overpayment of the tax when by reason of the deduction of other items which are unallowable or excessive in amount, and the omission from the return of items of taxable income, the tax paid for such year is in fact less than the true tax liability.

In view of the foregoing, it is held that inasmuch as the audit of the 1916 return of the M Company discloses that the tax paid by the company on such return was in fact less than its true tax liability for 1916, no refund or credit can be properly allowed the company for that year under the third proviso of section 252 of the Revenue Act of 1921, as amended.

ARTICLE 1037: Special relief where invested capital reduced by Commissioner. II–36–1243 I. T. 1871

REVENUE ACT OF 1921.

Under the third proviso of section 252 of the Revenue Act of 1921, as amended, the refund or credit directed to be made for prior years may be allowed after the statutory period of limitation on refunds and credits in all cases where an amount is disallowed as invested capital due to the fact that the taxpayer

> failed to take adequate deductions in prior years, with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, even though through some other adjustment for a prior year the net result is an increase rather than a decrease in invested capital.

Advice is requested as to the proper interpretation of the third proviso of section 252 of the Revenue Act of 1921, as amended, which reads as follows:

> That if upon examination of any return of income made pursuant to the Revenue Act of 1917, the Revenue Act of 1918, or this Act, the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, then, notwithstanding any other provision of law and regardless of the expiration of such five-year period, the amount of such excess shall, without the filing of any claim therefor, be credited or refunded as provided in this section.

The question presented is whether under the proviso referred to there must be a net reduction in invested capital for the taxable year in order that the refund or credit for the prior years may be allowed after the expiration of the statutory period of limitation on refunds and credits, or whether such refund or credit may be allowed after such time if deductions for the prior years greater than those claimed by the taxpayer are taken into consideration in determining the invested capital for the taxable year, even though by reason of other adjustments the invested capital is increased.

It becomes necessary, therefore, to determine the meaning of the clause "* * * the invested capital of a taxpayer is decreased by the Commissioner," and in this connection the following statement of Dr. Adams, made in the course of a hearing before the Senate Committee on Finance on September 14, 1921, is of value:

> You well know that under the excess-profits tax everything turns on invested capital. You get your principle of 8 per cent exemption on invested capital. Now, invested capital, in turn, included accumulated earnings, and to get at the earnings you have got to go back and trace the history of the corporation to see whether the accumulated earnings have been properly computed. That means, under the excess profits tax, that we should go back to the origin of the company, even if it was back as far as 1888. We would go back as far as we could. We may find in our examination somewhere some manifestly incorrect calculation of the earnings. One of the most common defects and one of the most common errors is the failure of the corporation to take sufficient depreciation into consideration. That is one of the most common mistakes for corporations, and that was particularly true before the income tax became heavy. The corporations failed to take sufficient depreciation. Under such circumstances the accurate auditor would say "Gentlemen, in your 1914 return you did not take enough depreciation. The thing that you claim is accumulated earnings is not accumulated earnings. You have not established your depreciation yet." The result is to reduce the amount of their invested capital and increase their expenditures for the period under consideration. If you force them to do that and take them over the past, it seems to me that it is only fair to give them a rebate for taxes overpaid.
>
> In 1914 the rate was 1 per cent. Assume that a man ought to have taken, say, $20,000 depreciation. He should have taken that much. If we make him do that, then it seems harsh to cut that down and not say "You can shake up your taxes for that year, it will be taken as a credit against the excess profits tax."

The amendment was approved by the committee without further discussion, and the only further comment made with respect to its

provisions in the course of its legislative history is contained in the report of the Committee on Finance, and is as follows:

> Section 252 is extended to authorize a refund in any case (regardless of time limitations) in which the invested capital of the taxpayer is decreased by the Commissioner of Internal Revenue and such decrease is due to the fact that the taxpayer failed to take adequate depreciation or other deductions in previous years. The refund is for the excess taxes paid in such prior years.

Considering the proviso in the light of the statements of Dr. Adams, it seems clear that the purpose of the enactment was to confer upon the taxpayer a special benefit to offset the advantages which the Government enjoyed in the matter of determining invested capital. In other words, in determining invested capital as stated by Dr. Adams, the Commissioner traces the history of the corporation from the date of its organization in order to determine whether accumulated earnings were properly reported. If in the course of such examination the Department discovers any item which was improperly included in invested capital and which should have been treated as a deduction, such item is disallowed for invested capital purposes, even though it resulted from a transaction which occurred "back as far as 1888." In order to avoid any unfairness to the taxpayer it was provided that the resultant excess income tax paid should be refunded regardless of the expiration of the five-year period of limitation. In other words, the Department was not bound by any limitation period in determining invested capital, and it was deemed proper that the taxpayer should not be bound by any limitation period in adjusting his income tax liability in conformity with the findings of the Department when an item was eliminated from invested capital.

Bearing in mind the purpose of the enactment and the harsh situation which it sought to remedy, it seems clear that effect may be given to its provisions only by construing the clause "* * * the invested capital of a taxpayer is decreased" as having reference to any diminution in invested capital resulting from a failure to take adequate deductions in prior years, albeit the net results of an audit may, as in the instant case, result in an increase rather than a decrease in invested capital for the taxable year in question. Any other construction would, in the opinion of this office, defeat the purpose of the enactment.

In view of the foregoing, it is held that under the third proviso of section 252 of the Revenue Act of 1921, as amended, the refund or credit directed to be made for prior years may be allowed after the statutory period of limitation on refunds and credits in all cases where an amount is disallowed as invested capital due to the fact that the taxpayer failed to take adequate deductions in prior years with the result that an amount of income tax in excess of that properly due was paid in any previous year or years, even though through some other adjustment for a prior year the net result is an increase rather than a decrease in invested capital.

SECTION 256.—INFORMATION AT SOURCE.

ARTICLE 1071: Return of information as to payments of $1,000. II-37-1256 I. T. 1876

REVENUE ACT OF 1921.

Section 256 does not require that returns of information shall be made exclusively by the person who is the original source of income. It requires that they be made by "all individuals, corporations, and partnerships, in whatever capacity acting," making payment to another of interest, etc., of $1,000 or more in any taxable year. Therefore, when a bank pays or accepts for deposit coupons detached from bonds not containing a tax-free covenant clause presented for payment or deposit by a citizen or resident of the United States, the recipient bank is the payor of the income and is the person responsible for the filing of information returns, Forms 1099 and 1096.

The Bureau does not deem it necessary for banks to maintain a record with respect to each item of interest passing through its collection and paying departments in order to comply with the provisions of the statute and the regulations pertaining thereto. It is expected, however, that all banks will use ordinary business care with respect to transactions involving such income and render a substantial compliance with the law. If the bank has reason to believe that the person receiving the income is one to whom payments during the calendar year of interest on bonds not containing a tax-free covenant clause will amount to $1,000 or more, a record of the payments made to that person should be maintained, in order that returns on Forms 1099 and 1096 may be filed not later than March 15 of the succeeding year.

ARTICLE 1072: Return of information as to payments to employees. II-38-1266 I. T. 1883

REVENUE ACT OF 1921.

No provision of article 1072 relieves an employer from making returns of information for the full calendar year. Article 1072 permits an employer to take as a unit the amount estimated for any representative month, which amount is to be multiplied by the number of months during the full calendar year that the workman was employed. The result so obtained is the amount to be reported as the total salary or wages for the full calendar year. A return on Form 1099 showing merely the name and address of the employee and the rate of his compensation per day will not be accepted as a return of information within the meaning of section 256.

Article 1072 of Regulations 62 provides in part as follows:

In case an employer has a large number of employees and the computation of exact amounts paid during the calendar year will result in an undue hardship, careful estimates may be made on the basis of any representative month, and unless the yearly payment based on this estimate in the case of any employee amounts to $1,000 or more, no return of payments to such employee is required.

This provision does not relieve an employer from making returns of information for the full calendar year. It simply permits him to

take as a unit the amount estimated for any representative month, which amount is to be multiplied by the number of months during the full calendar year that the workman was employed. The result so obtained is the amount to be reported as the total salary or wages for the full calendar year. A return on Form 1099 showing merely the name and address of the employee and the rate of his compensation per day will not be accepted as a return of information within the meaning of section 256.

ARTICLE 1074: Return of information as to interest on corporate bonds. II–16–1011 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 1074 * * * of Regulations 62 are hereby amended to read as follows:

ART. 1074. *Return of information as to interest on corporate bonds.*—In the case of payments of interest, regardless of amount, upon bonds and similar obligations of domestic or resident foreign corporations, the original ownership certificates, when duly filed, shall constitute and be treated as returns of information. If a bondholder files no ownership certificate in the case of payments of interest on registered bonds, if such bonds contain a tax-free covenant clause, or if such bonds are owned by a nonresident alien individual, fiduciary, partnership or corporation, the withholding agent shall make out such a certificate in each instance and file it with the monthly return. See sections 221 and 237 of the statute and articles 361–375 and 601.

* * * * * * *

ARTICLE 1076: Foreign items. II–16–1012 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 1076 * * * of Regulations 62 are hereby amended to read as follows:

ART. 1076. *Foreign items.*—The term "foreign item," as here used, means any dividend upon the stock of a nonresident foreign corporation or any item of interest upon the bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank. (*a*) Wherever a foreign country or nonresident foreign corporation issuing bonds has appointed a paying agent in this country, charged with the duty of paying the interest upon such bonds, such paying agent shall be the source of information. If such foreign country or foreign corporation has no such agent, then the last bank or collecting agent in this country shall be the source of information. (*b*) In the case of dividends on the stock of a nonresident foreign corporation, however, the first bank or collecting agent accepting such item for collection shall be the source of information. No return of information is required with respect to foreign items unless the amount thereof is $1,000 or more in any taxable year, nor is any return of information required with respect to such items owned by a nonresident alien individual, a foreign partnership or a foreign corporation, provided the first bank or collecting agent is satisfied as to such ownership. In the latter case the foreign item may be stamped "foreign owner."

* * * * * * *

ARTICLE 1077: Ownership certificates for foreign items. II–16–1013 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 1077 * * * of Regulations 62 are hereby amended to read as follows:

ART. 1077. *Ownership certificates for foreign items.*—When bonds of foreign countries or of nonresident foreign corporations contain a tax-free covenant clause and are owned by citizens or residents of the United States, the foreign country or nonresident foreign corporation having a fiscal or paying agent in the United States, such agent is required to withhold a tax of 2 per cent from the interest on such bonds. Ownership certificate Form 1000, modified to show the name and address of the fiscal agent or the paying agent, should be used unless the owner (if so entitled) desires to claim exemption, in which case Form 1001 should be filed. See article 361.

* * * * * * *

ARTICLE 1078: Foreign items presented for collection unaccompanied by ownership certificates. II–16–1014 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 1078 * * * of Regulations 62 are hereby amended to read as follows:

ART. 1078. *Foreign items presented for collection unaccompanied by ownership certificates.*—If the foreign item is an interest coupon detached from bonds containing a tax-free covenant clause, issued by a foreign country or corporation having a paying agent in the United States, a statement and ownership certificate, Form 1000, shall be furnished as provided in article 369.

* * * * * * *

ARTICLE 1079: Return of information as to foreign items. II–16–1015 T. D. 3497

REVENUE ACT OF 1921.

Articles * * * 1079 of Regulations 62 are hereby amended to read as follows:

ART. 1079. *Return of information as to foreign items.*—In the case of collections of foreign items, the original ownership certificates when required and duly filed shall constitute and be treated as returns of information. (*a*) In the case of dividends on the stock of a nonresident foreign corporation paid to citizens or residents of the United States a return of information on Forms 1096 and 1099 shall be required if the amount thereof is $1,000 or more in any taxable year. (*b*) In the case of interest items on bonds containing a tax-free covenant clause as to which the paying agent in this country is the source of information, the ownership certificate shall accompany the coupon to such agent or source of information, who shall forward the ownership certificate to the Commissioner accompanied by a monthly return on Form 1096A. An annual return on Form 1096B shall be forwarded to the Commissioner not later than March 15 of each year, on which shall be given a summary of the monthly returns. Where ownership certificate Form 1000 is used, a monthly return shall be made on Form 1012 and an annual return on Form 1013, as pro-

vided in articles 361–375. Forms 1012 and 1013, when so used, should be modified to show the name and address of the paying agent. The use of substitute certificates is not permitted in the collection of foreign items.

D. H. Blair,
Commissioner of Internal Revenue.

Approved July 16, 1923.
McKenzie Moss,
Acting Secretary of the Treasury.

Article 1079: Return of information as to foreign items. II–37–1257
I. T. 1877

REVENUE ACT OF 1921.

Definition of the term "foreign items."
Records to be kept by banks and others with respect to foreign items received by them, and also with respect to interest on domestic bonds not containing a tax-free covenant clause and paid to citizens or residents of the United States.

Article 1079 of Regulations 62, as amended by Treasury Decision 3497 (see p. 176), requires returns of information on Forms 1096 and 1099 in all cases where income of $1,000 or more consisting of foreign items is paid in any taxable year. The term "foreign item" means any dividend payment upon the stock of a nonresident foreign corporation or any item of interest upon bonds of foreign countries or nonresident foreign corporations, whether or not such dividend or interest is paid in the United States or by check drawn on a domestic bank.

It has been brought to the attention of the Bureau that banking corporations and others who receive foreign items for collection or payment have interpreted this article of the regulations to mean that an exhaustive record shall be kept with respect to each foreign item passing through their collection and paying departments. The Bureau does not deem it necessary for banks to maintain a record of each foreign item in order to comply with the provisions of the statute and the regulations pertaining thereto. It is expected, however, that all banks will exercise ordinary business care with respect to transactions involving foreign items and render a substantial compliance with the law. If the bank has reason to believe that the person receiving the income is one to whom payments during the calendar year of foreign items will amount to $1,000 or more, a record of the payments made to that person should be maintained in order that returns on Forms 1099 and 1096 may be filed not later than March 15 of the succeeding year.

The same general question has also been raised in connection with interest on domestic bonds not containing a tax-free covenant clause and paid to citizens or residents of the United States. Returns of information are required with respect to payments aggregating $1,000 or more made during the calendar year to such individuals. As in the case of foreign items, it is not the intention of the Bureau to require exhaustive records of these interest payments, and the foregoing general principles in regard to foreign items are also applicable to interest on domestic bonds which do not contain a tax-free covenant clause.

SECTION 257.—RETURNS TO BE PUBLIC RECORDS.

ARTICLE 1091. Furnishing of copies of income returns. II–30–1163 I. T. 1817

REVENUE ACT OF 1921.

A withholding agent is not prohibited under section 3167 of the Revised Statutes and Law Opinion 879 (C. B. 1, p. 262) from furnishing the debtor corporation the ownership certificates received by the withholding agent, or from furnishing the name and addresses of the debtor corporation's bondholders as disclosed thereon upon demand.

Advice is requested in regard to disclosure of the names and addresses of bondholders as represented by ownership certificates.

In Law Opinion 879 (C. B. 1, p. 262), dated July 19, 1919, it was held that ownership certificates are income returns within the meaning of section 3167, Revised Statutes, as amended, and as they are filed as the result of income tax laws for the purpose of being used in connection with income tax returns, they are to be treated as such under the regulations governing the furnishing of copies.

The Bureau has consistently adhered to this view, but is of the opinion that there is no provision of law whereby the fiscal or paying agent of the debtor corporation is barred from disclosing to the debtor corporation the names and addresses of the bondholders shown on the ownership certificates. The debtor corporation is charged with the duty of filing withholding returns on Forms 1012 reporting the amount of tax required to be withheld as shown by the ownership certificates. It is also required to forward the ownership certificates to Washington. In view of this fact, the Bureau can not rule that the debtor corporation is prohibited from receiving such information from its agent. In other words, the principal should be allowed to demand and require of its agent any information necessary in connection with the compliance of section 221 and section 256 of the Revenue Act of 1921.

After careful consideration of the question, this office is of the opinion that disclosure of information shown on ownership certificates by persons through whose hands certificates are passed is prohibited under section 3167 of the Revised Statutes and Law Opinion 879, but that this does not bar a debtor corporation from receiving the ownership certificates from the banks or the names and addresses of its bondholders as disclosed by such ownership certificates in cases where it has appointed a duly authorized agent. To rule otherwise would deny a principal the right of access to information in the hands of an agent, which information comes within the scope of the agency, and would also make it impossible for the debtor corporation to comply with sections 221 and 256 of the Revenue Act of 1921.

ARTICLE 1091: Furnishing of copies of income returns. II–31–1173 I. T. 1822

REVENUE ACT OF 1921.

The commissioner of banking of the State of Texas, who is charged by law with the liquidation and management of insolvent banks, is a "receiver" within the meaning of article 1091.

The department of banking of the State of Texas is charged with the liquidation and management of insolvent banks in that State.

Under the bank deposit guaranty law of the State of Texas it is provided that:

Whenever any State bank or trust company shall become insolvent, and shall voluntarily, or by law, or in any manner as provided in this title, come into the hands of the commissioner of insurance and banking, he may proceed to wind up its affairs, either through a receiver or through some competent person, who shall give bond as may be required by the board, payable to the board for the faithful performance of all duties imposed upon him.

Article 1091 of Regulations 62 provides in part as follows:

A copy of an income return may be furnished by the Commissioner of Internal Revenue to the person who made the return or to his duly constituted attorney, * * * if the entity is in the hands of a receiver, trustee in bankruptcy, guardian, or similar legal custodian, to the receiver, trustee, or other similar custodian upon written application for same, accompanied by satisfactory evidence that the applicant comes within this provision. * * *

Held, that the State commissioner of banking in Texas is a receiver within the meaning of the article above quoted and may, therefore, be furnished with copies of returns upon his written request therefor addressed to the Commissioner of Internal Revenue, wherein it is made to appear that the returns desired are returns filed by an insolvent bank which is in the hands of the commissioner of banking.

ARTICLE 1093: Inspection of returns by stockholder. II-13-963
I. T. 1709

REVENUE ACTS OF 1918 AND 1921.

An officer of a corporation, stockholder of record of another corporation, may inspect the returns of the other corporation on behalf of the corporation of which he is an officer provided the officer, duly authorized, has complied with all the requirements of the law and regulations regarding an application for permission to inspect returns.

Application is made on behalf of the M Company by A, president of the corporation, to inspect certain income tax returns filed by the N Company, in which corporation the M Company owns more than 6 per cent of the outstanding shares of capital stock.

The question is raised whether or not under the regulations governing the inspection of income tax returns by a stockholder of record A would be permitted, as president of the M Company, to inspect the returns of the N Company on behalf of the corporation which is the stockholder of record.

A has furnished an affidavit showing that the M Company owns more than the minimum amount of stock required for such inspection, the date on which such stock was acquired, that it was not acquired for the purpose of making this inspection, that he is making the application under authority received from the board of directors of the corporation, and that he desires to make the inspection on behalf of the corporation.

Section 257 of the Revenue Acts of 1918 and 1921 provides:

* * * That all bona fide stockholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries * * *.

The above provision of the law grants the privilege of inspecting the returns of a corporation to *all bona fide stockholders of record* owning a sufficient amount of the outstanding capital stock of such corporation. It is a well-recognized fact that one corporation may be a stockholder in another corporation. It is also a well-recognized principle of law that a corporation can act only through its officers and that anything it does must be done through its officers. There is nothing in the Act which would indicate that Congress intended to limit the privilege of inspecting corporation returns to individuals who are stockholders. It must, therefore, be presumed that by granting the privilege to all bona fide stockholders meeting the necessary requirements it was intended to include corporations as well as individuals.

It is therefore held that, as A as president of the M Company has complied with all the requirements of the law and regulations regarding an application by a stockholder for permission to inspect the returns of a corporation, he should be permitted to inspect the returns of the N Company on behalf of the corporation which is the stockholder of record. Attention, however, should be directed to that part of section 257 of the Revenue Acts of 1918 and 1921 which makes it a misdemeanor punishable by fine and imprisonment for any stockholder who, pursuant to the provisions of those sections, is allowed to examine the returns of any corporation and who makes known in any manner whatever not provided by law any information obtained by such inspection.

SECTION 262.—INCOME FROM SOURCES WITHIN THE POSSESSIONS OF THE UNITED STATES.

ARTICLE 1136: Domestic corporation deriving income from sources within a possession of the United States. II-24-1103 I. T. 1785

REVENUE ACT OF 1921.

A domestic holding corporation which owns the entire capital stock of a corporation organized in a possession of the United States is not entitled to the benefits of section 262 unless such corporation can satisfy both conditions set forth in section 262(a).

Dividends are not such income as is specified in subdivision (2) of section 262(a).

The business of a domestic holding corporation in a possession of the United States which consists merely of general oversight of the activities of its operating subsidiary, for which no compensation is received, is not the active conduct of a trade or business within the meaning of section 262(a)2.

PART V.—INVESTED CAPITAL.

SECTION 326.—INVESTED CAPITAL.

ARTICLE 831: Meaning of invested capital. II–15–992
A. R. R. 2766

REVENUE ACTS OF 1917 AND 1918.

A bank refused to receive partnership funds for deposit and the partners deposited a part of the surplus each year in the names of the partners, A and B. Upon incorporation all the partnership assets were transferred to the corporation, and these individuals owned over 95 per cent of the stock. The accounts of the corporation contain no record of these deposits or accrued interest.

The deposits do not constitute assets of the corporation even though it received credit on the basis of them and the cost of liquidating the corporation was paid out of them.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in excluding from invested capital the sum of 34.33x dollars, which represented cash in savings banks placed in the individual name of A and B instead of the corporate name of the M Company. In 1920 the Unit requested the advice of the Committee upon the issue involved, which was given in A. R. M. 109 (not published) under date of February —, 1921. Appellant has filed additional evidence and contends that the ruling contained in A. R. M. 109 should be reversed.

The N Company, a copartnership, has engaged in the business of jobbers and commission merchants, and on February —, 1914, was incorporated under the name of the M Company, with an authorized capital of 37.5x dollars. It took over the business of the partnership and all its assets. The appellant corporation in filing its return for the year 1917 set up on its books as an asset as of December 31, 1916, a good-will item of 20.19x dollars. A revenue agent investigated the books of the corporation and reported that this was an arbitrary figure placed on the balance sheet in order to effect a balance of the books. The taxpayer could not explain why this was done, and accordingly this amount was disallowed as a capital item entirely. Amended returns were filed showing 34.33x dollars deposited in savings banks in the individual names of A and B, and a request was made to include this sum in the computation of appellant's invested capital. No claim was made, however, in the amended returns for the good-will item aforementioned. Upon the request of the Unit for advice on the subjects involving the good-will item, 20.19x dollars was disallowed as a capital item. The money in bank, 34.33x dollars, was also excluded from invested capital on the ground that it was not the property of the corporation.

It appears that the savings bank of the city of S as a matter of policy refused to receive partnership funds for deposit, and because of such refusal the partners deposited a part of the surplus each year in the names of the partners, A and B. After incorporation these individuals owned over 95 per cent of the stock of the appellant company, and from February 1, 1914, to the date of liquidation of the appellant company in 1920 the amounts in the savings banks credited to the above-named individuals were continuously increased.

The accounts of the corporation, however, contain no record of these deposits or interest accrued thereon.

There is of record evidence showing that A and B wrote letters to mercantile houses stating that the amounts in the R Bank credited to their accounts were the property of the appellant company; that such statements were given to mercantile agencies; that, on May —, 1918, the appellant company borrowed from the R Bank the sum of $10x$ dollars, and later, on November —, 1918, the sum of $10x$ dollars, on the credit established by the savings deposits credited to A and B; that in 1920, when the business was liquidated, the cost of liquidation was paid out of these deposits, and the balance distributed among the stockholders.

The Committee is unable to agree with the appellant's contention that the deposits in savings banks in the names of A and B constituted assets of the corporation. As a matter of law, the corporation had no title to these deposits, and the fact that it may have received credit upon the basis of such deposits is immaterial. There is no basis in the law or regulations for the inclusion of these deposits in the statutory invested capital of the corporation.

The Committee therefore recommends that the action of the Income Tax Unit be sustained and the appeal denied.

* * * * * * *

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 831: Meaning of invested capital. II–34–1209
(Also Section 214(a)8, Article 164.) I. T. 1848

REVENUE ACTS OF 1917, 1918, AND 1921.

A corporation organized in 1917 used only borrowed money in acquiring its assets. It was not entitled to any statutory invested capital at the date of its organization.

For the purpose of computing depreciation the property should be valued at its cost price, in spite of the fact that it was purchased with borrowed money. In ascertaining the amount upon which depreciation is to be computed the purchase price should be allocated between depreciable and nondepreciable assets.

In 1917 a corporation, organized that year, acquired a mill from another corporation. The purchaser obtained a portion of the money necessary for the purpose by borrowing on the security of a deed of trust; it obtained another portion by borrowing from a third corporation, and gave its notes to the vendor corporation for the balance of the agreed price. The purchaser then issued capital stock to its own incorporators in an amount greatly in excess of the purchase price of the property. This stock was watered stock, as the corporation received no assets in exchange for the same. The property was appraised during 1918 at an amount in excess of the purchase price but below the amount of the capital stock issued. The corporation thereupon balanced the amount of its liabilities, represented by its capital stock and notes payable, by assets representing the plant at its appraised value and an item designated as intangible property representing the excess of its liabilities over the appraised value of its plant.

Held, as the purchaser used only borrowed money in acquiring its assets it was not entitled to any statutory invested capital at the date of its organization. This fact, however, did not bring it within section 209 of the Revenue Act of 1917, as it employed a substantial amount of borrowed capital in conducting its business. The appraisal of its assets in 1918 at a figure in excess of the amount paid for them did not entitle the taxpayer to any paid-in surplus or to any addition to invested capital.

For the purpose of computing depreciation the property should be valued at its cost price, in spite of the fact that it was purchased with borrowed money. In ascertaining the amount upon which depreciation is to be computed the purchase price should be allocated between depreciable and nondepreciable assets.

ARTICLE 831: Meaning of invested capital. II-39-1272
(Also Section 214(a)4, 5, 6, Article 144.) I. T. 1888

REVENUE ACT OF 1918.

There was a completely new corporation formed prior to March 3, 1917, which succeeded to the assets and rights of two corporations organized under the laws of two other States and dissolved after the consolidation. The capital stock of the new corporation was very much larger than that of either of the predecessor corporations and larger than the total of the stock of the predecessor corporations held by individual stockholders. The purpose of the reorganization was to effect a change of character enabling a distribution of dividends. The change of ownership was made. The new corporation would have a right on its application to assert values as of the date of reorganization.

Held, that there was a distinct new taxable entity both for the purpose of invested capital and income and that the stock of a fourth corporation may be included in invested capital only at the value which may be established as of the date of reorganization. Any deductible loss on account of the stock of this fourth corporation must be determined upon the basis of its value as of the date of reorganization.

A consolidation of the M Companies, a corporation organized under the laws of the State of X, and the N Company, a corporation organized under the laws of the State of Y, was effected in 1916 by the organization of a new corporation under the laws of the State of Z, which succeeded to their assets. The merger was accomplished by exchange of the capital stock of the O corporation of Z for the capital stock of both the M Companies and the N Company, and the subsequent dissolution of the latter companies by the O corporation as sole stockholder, the assets of the dissolved companies being received by the new corporation on cancellation or retirement of the stock of the dissolved companies.

The outstanding stock of the M Companies at the time of merger was $50x$ dollars and the outstanding stock of the N Company at the time of merger was $34x$ dollars, whereof $18x$ dollars was held by the M Companies. The O corporation issued in exchange therefor $70x$ dollars par value of its stock. The new corporation, therefore, issued $4x$ dollars par value of stock in excess of the par value of stock of the predecessors outstanding in the hands of stockholders, other than the holdings of parent in subsidiary. This $4x$ dollars represented an ad-

justment as to preferred stock holdings in the predecessor companies partly on account of unpaid accrued dividends and partly on account of an adjustment of values as to holdings of the companies' preferred stock. The total issue of stock of the new corporation was $14x$ dollars less than the total outstanding stock, inclusive of holdings of the parent in the subsidiary, of the predecessors. It appears that the reorganization was effected with the purpose principally of transferring the business to a new corporation under the laws of the State of Z in order that there might be greater freedom in the administration of the affairs of the business, particularly in the distribution of dividends, it appearing that the predecessor corporations were unable to pay dividends under the laws of the States of their organization on account of the impairment of their capital.

One of the predecessor corporations, N Company, had at some time prior to March 1, 1913, acquired stock in the P Company at a cost of $10x$ dollars. The P Company failed in 1914. It appears that the revenue agent was unable to determine that the P Company stock had any value at the date of consolidation and formation of the new corporation.

The corporation now claims that its invested capital should be determined on the basis of the cost to the two predecessor merged companies—that is, on the theory of continuity of the taxable entity or entities, notwithstanding that there was a dissolution of the predecessor corporations and formation of a new corporation in 1916.

In the case of reorganization where a new corporation has been substituted for an old corporation as the owner of the assets, except in the case of reorganization after March 3, 1917, where 50 per cent of the interest or control in the business or property remains the same, it is the general rule that the assets acquired by the new corporation shall be valued for the purposes of invested capital of the new corporation at the cost to the new corporation or the value of the assets acquired for stock at the time so acquired, and the advantage of this rule has been almost universally claimed by such reorganized corporations and has been applied in the computation of invested capital.

In this case, reorganization was not a mere change of domicile, since the stock of the new corporation was nearly double that of either old corporation, and the stockholders had new rights represented by new interests, and the new corporation was not subject to the inability to declare dividends as were the old corporations on account of the impairment of their capital and the inability to declare dividends thereby involved under the laws of the States of their organization.

It appears that the courts have, in the construction of Federal-taxation laws, uniformly observed the distinct entity of a corporation and have not departed from the strict observance of a legal entity and separate taxability of each legal entity whenever there are in fact different legal entities, without reference, however, to the situation where such distinctions under the consolidation requirements are in the years of consolidation for tax to be disregarded.

The courts in *Eisner* v. *Macomber* (252 U. S., 189); *Meischke-Smith et al.* v. *Wardell* (286 Fed., 785); *United States* v. *Phellis* (T. D. 3270; C. B. 5, p. 37); *United States* v. *Rockefeller* (T. D.

3271) consistently applied the separate legal entity doctrine for the purpose of taxation.

In *United States* v. *Phellis* (T. D. 3270), where there was a reorganization and a new and larger corporation was substituted for the old, the court said:

> * * * In the light of all this, we can not regard the new company as virtually identical with the old, but must treat it as a substantial corporate body with its own separate identity, and its stockholders as having property rights and interests materially different from those incident to ownership of stock in the old company.
>
> The findings show that it was intended to be established as such, and that it was so created in fact and in law. There is nothing to warrant us in treating this separateness as imaginary, unless the identity of the body of stockholders and the transfer in solido of the manufacturing business and assets from the old company to the new necessarily have that effect. But the identity of the stockholders was but a temporary condition, subject to change at any moment at the option of any individual. As to the assets, the very fact of their transfer from one company to the other evidenced the actual separateness of the two companies.

The facts in this case are not similar to the facts at issue in A. R. R. 16 (C. B. 2, p. 312), where there was a mere change of domicile. In view of all the facts of this case—that there was a completely new corporation formed in another State; that this new corporation succeeded to the assets and rights of two corporations organized under the laws of two other states; that the capital stock of the new corporation was very much larger than that of either of the predecessor corporations; that the capital stock of the new corporation was larger than the total of the stock of the predecessor corporations held by individual stockholders; that the purpose of reorganization was to effect a change of character enabling distribution of dividends—and in consideration also of the fact that the change of ownership was, therefore, such that the Bureau could not refuse the corporation on its application the right to assert values as of the date of reorganization for invested capital, it is held that there was in this case, at the time of the reorganization, the creation of a distinct new taxable entity both for the purposes of invested capital and income, and that therefore the stock of the P Company may be included in capital only at the value which may be established as of the date of reorganization and that any loss deducted in 1919 or any period after the date of reorganization must be determined upon the basis of the value of the P Company stock as of the date of reorganization. Sol. Op. 4 (C. B. 2, p. 307) indicates that the holding herein is in harmony with the principles heretofore established.

ARTICLE 833: Tangible property paid in: evidences of indebtedness. II-38-1267
I. T. 1884

REVENUE ACTS OF 1918 AND 1921.

A corporation which intended to extend its business increased its capital stock and issued the additional shares to its incorporators, who then executed their respective noninterest-bearing promissory notes for the amount of the stock received by each maker and placed the shares, with the notes attached, in a bank, and entered into negotiations for a credit in case credit became necessary. Later the plan of extension was abandoned and this stock and the

notes were recalled and destroyed, and the additional machinery and materials which had been purchased were paid for from the general funds of the corporation.

Promissory notes given under the conditions described are not bona fide paid in to the corporation as is required by section 326(a)2 of the Revenue Acts of 1918 and 1921.

A corporation which contemplated building an additional plant obtained permission to increase its capital stock by x dollars for that purpose. Shares to that value were issued to the incorporators of the company in equal amounts. They then executed their respective noninterest-bearing promissory notes for the amount of the stock each maker received, and placed the shares of stock with the notes attached with a bank, and entered into negotiations for credit in case credit became necessary. Machinery and materials were ordered, but before their receipt the plan to establish a branch factory was abandoned and the stock and notes were recovered from the bank and destroyed. When the machinery and materials were received they were brought to the company's factory and paid for from the funds of the corporation, so that no money pledged to the new venture was used in any way, and the corporation, its assets and its capital stock, remained identically as they were prior to the proposed increase in the capital stock. Advice is requested whether the x dollars evidenced by the additional shares of stock and the promissory notes can be used as invested capital in computing the excess-profits tax for the year in which they were outstanding.

The item of x dollars increase in capital stock can not be included in computing the statutory invested capital of the corporation for any year or portion of a year. Section 325(a) of the Revenue Acts of 1918 and 1921 defines tangible property as including notes and other evidences of indebtedness. Section 326(a)2 of these Acts states that invested capital means actual cash value of tangible property, other than cash, bona fide paid in for stock or shares. It is perfectly plain that promissory notes given under the conditions stated are not bona fide paid in to the corporation. The Bureau always considers the bona fides of any transaction through which the invested capital of a corporation is sought to be increased, and makes that feature one of the determining factors in deciding whether the invested capital may be increased, even though shares of stock were actually issued by the corporation to the extent of the increase claimed. While the citations given above are taken from the Revenue Acts of 1918 and 1921, the same rule would apply should a case of this character arise under the Revenue Act of 1917.

In the instant case it was not necessary to consider whether the laws of the State in which the taxpayer corporation was organized permitted it to issue stock for notes. Ordinarily, however, this question is of primary importance when it arises in the determination of invested capital, and in such cases the rules announced in article 833 of Regulations 45 and 62 are controlling.

ARTICLE 836: Tangible property paid in: value in excess of par value of stock. II-33-1198 A. R. R. 3572

REVENUE ACT OF 1917.

The purchasers at a receiver's sale in 1914 were the stockholders of the bankrupt corporation. Capital stock in a new corporation in the amount of $10x$ dollars par value was issued to them for the assets purchased. The value of the assets paid in was $23.82x$ dollars. The new corporation is entitled to a paid-in surplus of $13.82x$ dollars.

The M Company has appealed from the action of the Income Tax Unit in making certain adjustments of invested capital and income for 1917 which would result in an additional tax in the amount of $1.41x$ dollars.

The principal question involved in this appeal is the disallowance of $16.49x$ dollars claimed paid-in surplus. The appellant corporation was organized under the laws of the State of S on September —, 1914, to engage in retailing ——— and ——— supplies. A company known as the N Company, owned and operated by the O family, had been engaged in the same business for many years and had gone into the hands of a receiver. On August —, 1914, this receiver sold the stock of merchandise, etc., of the bankrupt concern to one, A, who was acting as agent for the O family, for $6.05x$ dollars. The O family then paid A $6.1x$ dollars for these goods. It is claimed on behalf of the appellant company that this merchandise and other assets were turned into the new corporation at a cash value of $23.82x$ dollars in return for the total capital stock of the new corporation, namely, $10x$ dollars par value. The same assets had been inventoried by the receiver at the time of the sale at $19.61x$ dollars. All of this stock, except qualifying shares, was issued to B, a member of the O family. It is also claimed that her son, C, who held 1 share of stock, turned over to the new corporation goods of the value of $7.34x$ dollars not acquired from the bankrupt concern. It does not appear how C acquired this merchandise nor what it comprised. The articles of association dated September —, 1914, show that the capital stock was issued for assets consisting mostly of merchandise and store and office furniture and fixtures in the total amount of $23.82x$ dollars. The only evidence furnished in support of the claim for that part of the surplus based upon goods turned in by C is the statement that the opening inventory totaled $31.17x$ dollars and comprised assets paid in for stock valued at $23.82x$ dollars and the goods in question, valued at $7.34x$ dollars.

The revenue agent states:

This company bought for cash a bankrupt stock of merchandise and fixtures for $14.68x$ dollars, as shown by the records; no distribution of the $4.68x$ dollars has been made by the corporation over the $10x$ dollars for which the capital stock was issued, this excess has been allowed as paid-in surplus.

In view of the meager data furnished by the appellant company and by the revenue agent, the Committee is of the opinion that the only reliable evidence upon which to base its recommendation is contained in the articles of association, which set forth an itemized de-

scription and valuation of the assets actually paid in to the corporation for capital stock. This valuation is believed to be fair. The revenue agent was in error in holding that the corporation itself bought the assets at a receiver's sale and in allowing paid-in surplus of only $4.68x$ dollars. The company was not incorporated until a month after the sale in question. Under A. R. M. 192 (C. B. II–1, p. 201), the appellant company is entitled to a paid-in surplus in the amount of the difference between $23.82x$ dollars, value of the assets paid in, and $10x$ dollars capital stock, or $13.82x$ dollars. The Committee finds that the claim for a paid-in surplus in excess of this amount has not been established.

The adjustments of income for 1917, including several small changes on account of depreciation, were based upon a field investigation made after the appellant had been notified of the result of an office audit. The appellant objects to a reopening of questions which it had considered closed. Sufficient proof to establish these minor claims of the appellant, however, has not been presented, and, accordingly, the Committee concludes that such adjustments of income as were made by the revenue agent and accepted by the Unit are correct.

The Committee, therefore, recommends that the action of the Income Tax Unit in disallowing paid-in surplus in excess of $4.68x$ dollars be modified to the extent of allowing such surplus in the amount of $13.82x$ dollars, and that the adjustments of income by the Unit on the basis of the field examination be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 837: Surplus and undivided profits: paid-in surplus. II–22–1074 A. R. R. 2971

REVENUE ACT OF 1917.

Property was held in trust for a corporation and at the end of the trust period was to be conveyed to the corporation, provided all the conditions set out in the agreement had been complied with. At any time during the continuance of the trust the property would have reverted for failure to comply with the conditions. It may not be included in invested capital until full compliance with the terms of the agreement.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in excluding from invested capital for 1917 certain cash and tangible property used in the business under the terms of an agreement entered into February —, 1911.

In the year 1911 the appellant entered into a joint agreement with the N Company and the O Company under the terms of which the N Company agreed to contribute $15x$ dollars in cash to be used in building a factory for the appellant in the city of S and the O Company agreed to contribute land of the value of $5x$ dollars on which factory was to be erected. The agreement also provided that the appellant was to invest in the factory buildings, etc., not less than $15x$ dollars and operate the factory for a period of 10 years, during each year of which time not less than $100y$ male employees were to

be employed. The agreement further provided that if before title had been conveyed to the appellant it should abandon or cease to operate said factory or fail to perform any and all of its other obligations under the agreement, then it should forfeit all of its rights and interest in and to the said land and the buildings and permanent improvements that may have been placed thereon and should have no further interest therein and would, upon demand, vacate and surrender the property. During the 10 years the property was to be held in trust by the N Company and at the expiration of the period was to be conveyed to the appellant by a good and sufficient deed, provided all of the conditions set out in the agreement of 1911 had been complied with. The contract was carried out and in the year 1921 the land and buildings were deeded to the taxpayer and a release given by the N Company for any and all contractual rights which it held under the agreement.

The appellant contends that for all practical purposes the cash and land were paid into the corporation for use in its business without any financial consideration or interest charges, and that the $20x$ dollars should be allowed as paid-in surplus under the provisions of article 63 of Regulations 41.

The Committee has carefully considered the arguments that have been advanced and has reached the conclusion that under no construction of the regulations could this cash and tangible property be regarded as having been paid in to the appellant corporation at any time prior to the full compliance with all of the terms of the agreement entered into in 1911. The appellant corporation could, at any time during this period, have failed or refused to comply with one or more of the conditions, and had this been done all of the property would have reverted to the N Company. The provisions of the law and regulations relating to paid-in surplus do not contemplate any such contingent interest with respect to the property paid in.

It is therefore recommended, in the appeal of the M Company, that its claim for paid-in surplus of $20x$ dollars be denied and that the action of the Income Tax Unit be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 837: Surplus and undivided profits: paid-in surplus. II-27-1131 I. T. 1802

REVENUE ACTS OF 1917 AND 1918.

When a corporation purchased its own stock at a price below the paid-in value of the shares it acquired, the amount paid out by the corporation represented a return of paid-in capital, and the difference between the amount paid by the corporation and the paid-in value of the shares represented paid-in surplus, and earned surplus was not affected by the transactions.

When a premium was paid in retiring other shares of the capital stock, the amount thereof should be charged first to earned surplus accumulated prior to March 1, 1913, and secondly to earned surplus accumulated subsequent to February 28, 1913.

A corporation purchased shares of its own stock from one of its stockholders at a price which was less than par which represented

the value of the assets paid in for such stock, and also purchased other shares from the executrix of a deceased stockholder. The agreement with reference to the purchase of the stock from the executrix provided that the estate should be paid x per cent of the amount which the decedent would have been entitled to receive as a shareholder for the three calendar years 1922, 1923, and 1924 had he lived and continued to be a stockholder in the corporation with the same interest he held at the time of his death.

Held, for the purpose of the Federal income tax the purchase by a corporation of its own stock first reduces its paid-in capital, whether such paid-in capital consists of tangible or intangible assets. Accordingly, when the corporation purchased its own stock at a price below the paid-in value of the shares it acquired, the amount paid out by the corporation represented a return of paid-in capital, and the difference between the amount paid by the corporation and the paid-in value of the shares represented paid-in surplus, and earned surplus was not affected by the transactions.

The amount paid to the executrix of the deceased stockholder, together with the payments to be made to the estate out of the profits for the years 1922, 1923, and 1924 should be treated as a return of paid-in capital to the extent of par value of the shares purchased. If, however, it results that a premium is paid in retiring such stock the amount thereof should be charged first to earned surplus accumulated prior to March 1, 1913, and secondly to earned surplus accumulated subsequent to February 28, 1913.

ARTICLE 844: Surplus and undivided profits: reserve for depreciation or depletion. II-25-1113 I. T. 1791

REVENUE ACTS OF 1918 AND 1921.

Mere appreciation in value of property may be considered as an earning only as of the time it is realized. Consequently, it must be excluded from the computation of invested capital for the year in which it is realized as "surplus earned during the year" and may affect invested capital no sooner than the beginning of the year immediately following such realization.

Advice is requested as to the computation of invested capital of the M Company.

It appears that this corporation has property on which it is entitled to compute depletion on its value as of March 1, 1913. The question (as stated in taxpayer's brief) is—

Does the proportion of such depletion that represents a realization of appreciation accrued at March 1, 1913, result in "surplus and undivided profits earned during the year" of realization and should such realized appreciation affect invested capital from the beginning of the succeeding fiscal year or from the time actually paid in?

Simplifying the inquiry, it means, in its essence, When may realized appreciation be considered as affecting invested capital?

The 1918 and 1921 Revenue Acts (section 326(a)3) define the term "invested capital" to include:

* * * paid in or earned surplus; not including surplus and undivided profits earned during the year.

Article 844 of Regulations 45 and Regulations 62 provides:

> Where depreciation or depletion is computed on the value as of March 1, 1913, * * * the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, * * * may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

Counsel for the taxpayer argues upon the authority of the cases of *Gray* v. *Darlington* (15 Wall., 63), *Doyle* v. *Mitchell Bros.* (247 U. S., 179), *Mercer* v. *Buchanan* (132 Fed., 501), and *Southern Pacific R. R. Co.* v. *Lowe* (247 U. S., 330) that appreciation is *earned* when it occurs and not during the year of realization. The cases cited may, with as much, if not more, propriety, however, be employed to support the opposite theory. For instance. in *Gray* v. *Darlington*, *supra*, it is said:

> Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as an increase of capital.

Surely this is no authority to say that appreciation is *earned* when it occurs. Likewise, in *Southern Pacific Co.* v. *Lowe*, *supra*, the distinction is not overlooked as to "surplus earnings" and "the increment due to an appreciation"—though both are in effect classed together as far as the distinction between "capital" and "income" is concerned. However, such observations as are pointed out in the case of *La Belle Iron Works* v. *United States* (256 U. S., 377), affirming the decisions in 55 Ct. Cl., 462, are beside the point when it is recalled that we are not here interested in the distinction between *capital* and *income*, but in a definition of the term "invested capital." And so, too, is the argument sought to be supported by article 1543 of Regulations 62, which, of course, is concerned with "dividends" and, as may be later seen, is more properly persuasive of a conclusion opposite to that contended for.

The court in the La Belle Iron Works case (supra) had under consideration the 1917 Revenue Act, which contained the following (section 207(a)3) in its definition of invested capital:

> * * * paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year.

In passing upon the contention that the increased value of ore lands ought to be included in invested capital as "paid in or earned surplus and undivided profits" the court says:

> Section 207 shows that Congress was fully alive to this and designedly adopted a term "invested capital" and a definition of it that would measurably guard against inflated valuations. The word "invested" in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the Act deals with, "to invest" imports a laying out of money, or money's worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business, in either case involving a *conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains.* See Webster's New International Dictionary, "Invest," 8; Century Dictionary, "Invest," 7; Standard Dictionary, "Invest," 1. [Italics supplied.]
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> The provision of clause (3) that includes "paid in or earned surplus and undivided profits used or employed in the business" recognizes that in some cases contributions are received from stockholders in money or its equivalent for the specific purpose of creating an actual excess capital over and above

the par value of the stock; and, in view of the context, surplus "earned" as well as that "paid in" excludes the idea of capitalizing (for the purposes of this tax) a mere appreciation of values over cost. * * *

* * * it was not improper to attribute the entire $9,914,400 added to the book value of the ore property in the year 1912, to a mere appreciation in the value of the property; in short, to what is commonly known as the "unearned increment," not properly "unearned surplus" within the meaning of the statute.

The application of the principles enunciated in this case to the present inquiry, when regard is had to a reasonably precise understanding of the words used, is comparatively simple.

Etymologically, the word "earn" is akin in its sense to "reap" or "harvest" and is in its present meaning defined as "to acquire by labor, service, or performance." In its transitive use the verb "realize" means "to make real," a sense which is carried into the intransitive verb which is defined as "to convert an intangible right or property into real (tangible) property; hence, to convert any kind of property (considered as fluctuating or uncertain in value) into money." Webster's New International Dictionary.

Appreciation, as is indicated in the La Belle Iron Works opinion, is a term almost antithetic in its connotations to "earning," which implies something more than mere passive acceptance of an advance in value. It is a "lazy" income, as contrasted with "industrious," to use the famous Gladstone expression; "precarious," as differing from "realized," in Seligman's language. Clearly, therefore, appreciation may not be said to be "earned" until something is done, "some labor, service, or performance" whereby that which before was but a nebulous, albeit probable, gain, is made real. And just as clearly, it seems the act which earns appreciation is that of converting it into a form of wealth "suitable for employment in the making of the hoped-for gains"; that is, its "realization." The conclusion, of course, is inevitable that appreciation can be said to be "earned" only at the time it is realized.

Throughout the law and regulations this distinction is seldom lost sight of. It may be noted, as an example, how in article 1543, Regulations 62, cited by counsel for taxpayer, care is taken to specify, in speaking of distributions out of earnings or profits accumulated prior to March 1, 1913, "increase of value of property accrued," thus in effect acknowledging that appreciation is not an earning before realization. Manifestly, appreciation is earned not when it accrues but during the taxable year of its realization; and under the statute and regulations cited it can affect invested capital no sooner than the beginning of the fiscal year immediately following its realization.

ARTICLE 845: Surplus and undivided profits: reserve for income and excess profits taxes. II-27-1132 A. R. R. 2190

REVENUE ACT OF 1918.

Upon the incorporation of a partnership on January 1, 1918, the corporation took over x dollars which had been set aside by the partnership out of earnings of 1917 for the payment of income and excess profits taxes for that year. The corporation used this amount in its business until June 15, 1918, the date payable.

Held, that the amount to be used by the corporation may be included in its invested capital from January 1, 1918, to June 15, 1918. I. T. 1582 (C. B. II-1, p. 191) revoked.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in eliminating from invested capital for 1918 the accrued profits of the predecessor partnership for 1917 and used by the taxpaying corporation as invested capital from December 31, 1917, to June 15, 1918, the date payable.

The taxpayer relies upon article 845, Regulations 45, which reads in part:

> Amounts payable on account of such taxes for the preceding year may be included in the computation of invested capital only until such taxes become due and payable.

It appears that earnings of the partnership for the year 1917 to the amount of x dollars were set aside for the payment of income and excess profits taxes for that year and upon the formation of the corporation on January 1, 1918, this amount was taken over by the corporation and used in its business until the date payable—June 15, 1918.

In view of the foregoing, the Committee is of the opinion that the amount so used by the appellant may be included in invested capital from January 1, 1918, to June 15, 1918.

It is therefore recommended, in the appeal of the M Company, that the action of the Income Tax Unit in this respect be reversed and the appeal be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 851: Intangible property paid in. II-23-1088
A. R. R. 2991

REVENUE ACTS OF 1917 AND 1918.

> The amount of stock issued for intangible property and the subsequent revaluation of such property can not be accepted as proof of the value of the intangibles at date of acquisition.
>
> Earnings of a taxpayer subsequent to the acquisition of intangible property, unsupported by other acceptable proof, can not be adopted as a basis for valuing such property as of the date acquired.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in disallowing in the computation of the appellant's statutory capital for 1917, 1918, and 1919 (1) good will, patents and secret processes, valued by the taxpayer at $10x$ dollars; and (2) accrued dividends in the amount of $.79x$ dollars for 1918 and $1.11x$ dollars for 1919.

The taxpayer was incorporated January —, 1914, under the laws of the State of S. It then acquired from the N Company all the assets, tangible and intangible, of a subsidiary of that company used in connection with the manufacture and sale of certain articles. Preferred stock in the amount of $1.5x$ dollars was issued for the tangible assets, and common stock of $40x$ dollars for the intangibles. The evidence presented upon appeal, as supplemented in much detail orally, shows that the N Company, by virtue of experimentation extending over approximately 17 years prior to 1914, had perfected processes, developed secret formulæ, obtained patents, and made application for other patents, all of which enabled it as at the end of 1913 to manu-

facture an article which the taxpayer contends had a useful life practically double that of any similar article then in the market; that several of the processes and inventions which had been perfected by the N Company but not patented were subsequently patented by the appellant; and that the intangibles acquired constituted the foundation for the success of the business, which began during 1917. The earnings of the predecessor owner of the intangibles are not available to enable the claimed value of these assets to be checked in accordance with A. R. M. 34 (C. B. 2, p. 31). At a meeting of the board of directors of the appellant held on December —, 1917, the officers of the corporation appear to have concluded that the intangibles, acquired for $40x$ dollars common stock, had in fact turned out to be worth less than that amount and the valuation was thereupon reduced to $10x$ dollars, made up as follows: Good will, x dollars; research records and scientific data, $1.9x$ dollars; patents and patent applications, $7.1x$ dollars; and the outstanding common stock was correspondingly reduced.

Aside from the common stock claimed to have been issued for the intangibles in question and the subsequent action of the board of directors with respect to this property, the only evidence of record purporting to substantiate the value claimed for the intangibles at the time acquired by the corporation is the earnings of the company for the years 1917 to 1921, inclusive. The amount of stock issued for the intangible property and the action of the board of directors on December —, 1917, can not be accepted as proof of the value claimed, and the Committee has repeatedly ruled that earnings of a taxpayer subsequent to the acquisition of intangible property, unsupported by other acceptable proof, can not be adopted as a basis for valuing such property as of the date acquired.

The so-called accrued dividends of $.79x$ dollars for 1918 and $1.11x$ dollars for 1919 are shown not to have been paid, declared, or authorized, and were merely set aside as a book entry to record the amount of dividends accumulated on the preferred stock, and the Unit has properly conceded the contention of the taxpayer that the amounts involved should be included in the statutory capital for the years in question.

The Committee accordingly recommends that the action of the Income Tax Unit in excluding from statutory capital for 1917 to 1919, inclusive, the claimed value of intangibles be sustained; that the so-called accrued dividends for 1918 and 1919 be included in the computation of the statutory capital for those years; and that the appeal be sustained in part and denied in part.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 852: Percentage of inadmissible assets. II–26–1122
I. T. 1796

REVENUE ACT OF 1917.

There is nothing in the Revenue Act of 1917 or in Regulations 41 which permits inadmissible assets purchased out of earnings for a taxable year to be considered in computing invested capital. That method of treating inadmissibles was first introduced by section

326(c) of the Revenue Act of 1918, and was carried forward into section 326(c) of the Revenue Act of 1921, but it is not authorized by the Revenue Act of 1917. There may be cases where changes in the amount of inadmissibles held during 1917 will cause an adjustment in invested capital for that year, but a case of that sort never arises out of an increase in inadmissible assets through an expenditure of current earnings.

ARTICLE 857: Method of determining available net income. II–16–1003 A. R. R. 2839

REVENUE ACT OF 1918.

Article 857 is construed to mean that if the books of a corporation do not show the amount of earnings or profits on a dividend date, and the corporation actually closed its books on June 30 and December 31 of each year, the earnings or profits for the accounting period January 1 to June 30 should be deemed to have accumulated ratably in the case of a dividend declared in May.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in prorating the entire net earnings for the year 1918 in the determination of the amount of such earnings available for dividends, and in deducting from such earnings thus ascertained the accrued taxes up to the dividend dates.

It is stated that the nature of the business engaged in by the appellant enables it to keep its accounts in such a manner as to determine its profits within a reasonable degree of accuracy, monthly, upon the basis of perpetual inventories; that physical inventories were taken on June 30 and December 31 of 1918 as well as in other years and that the book inventory on those dates has consistently been adjusted to the physical inventory; that the books were actually closed on both dates and the income accurately determined: that the income from January 1, 1918, to June 30, 1918, thus determined was $1.51x$ dollars; that the net income for the full year ended December 31, 1918, was $1.12x$ dollars resulting from a net loss from operations in the latter half of the year; and that dividends in the amounts of $.02x$ dollars and $1.12x$ dollars were paid on March — and May —, 1918, respectively.

In computing the deductions from invested capital for 1918 on account of the dividends paid on May —, 1918, the Unit averaged the earnings for the full year monthly and from this average deducted the taxes accrued up to the dividend date.

The Unit states in its memorandum to the Committee that it has interpreted article 857 of Regulations 45 to mean that unless an actual closing of the books was made at the dividend date the earnings for the entire year should be averaged monthly.

That article of the regulations provides in substance that average earnings shall be used "unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date," which provision follows in substance the law itself, section 201(e) of the Revenue Act of 1918. This section provides that if the books of a corporation do not show the amount of such earnings or profits to any definite date, the earnings or profits for the accounting period shall be deemed to have been accumulated ratably during such period.

In view, therefore, of the express provisions of the statute, and the regulations issued thereunder, the Committee finds no authority for the Unit's interpretation of article 857, as stated above. It is therefore recommended that the Unit's action in prorating the earnings for the entire year in determining the amount of such earnings available for the dividend paid on May —, 1918, be reversed, that the earnings shown by the books on June 30, 1918, be deemed to have been accumulated ratably from January 1 to the dividend date, May —, and that the deduction from invested capital be recomputed accordingly.

The appellant's representative's protest against the alleged illegality of that portion of article 857 of Regulations 45 which provides that accrued taxes shall be deducted in determining the amount of earnings available for dividends seems to have been filed more as a matter of record than as a serious contention in this appeal. It was admitted at the oral hearing that until this article was changed the Unit's action in following it was correct. This provision has several times in the past been reconsidered and each time adhered to by the Bureau. There is, in this case, no sufficient reason to recommend a change in the established practice relative thereto, and it is therefore recommended that the Unit's action on this point be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

ARTICLE 862: Purchase of stock. II–16–1004
I. T. 1736

REVENUE ACTS OF 1917, 1918, AND 1921.

A corporation purchased its own stock with its own bonds for a price fixed by the parties, which was in excess of the par value of the stock. The difference between the par value of the stock and the face value of the bonds does not represent bond discount.

In 1914 a corporation bought shares of its own stock at 263 per cent of their par value, and issued bonds in payment for the same together with a small cash payment. The taxpayer contended that the bonds were issued at a discount representing the difference between the par value of the stock and the face value of the bonds, and that this bond discount should be set up as an asset, and that the loss represented by such discount should be realized through the income account by a deduction from income each year in an amount determined upon the basis of the life of the bonds. The taxpayer argued that since the bond discount could be amortized over the life of the bonds, this amount represented an asset until it was written off by deductions from the income account.

Held, that the transaction in question had the effect of reducing the invested capital of the taxpayer to the extent of the face value of the bonds, and that this amount should be deducted in determining invested capital for 1917 and subsequent years. The difference between the par value of the stock and the face value of the bonds issued in payment for the stock did not represent bond discount. The price paid for the stock represented its fair market value as fixed by the parties to the contract, and the bonds accordingly were

issued for a value which was received by the corporation as a loan. No deduction from income on account of bond amortization can be made by the corporation.

ARTICLE 869: Insurance companies. II-23-1089
A. R. R. 3202

REVENUE ACT OF 1917.

The reserve funds of life insurance companies, the net additions to which are deductible from gross income under section 12(a) of the statute, can not be included in computing invested capital.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in treating as a liability, in the computation of statutory capital for 1917, the amount of x dollars set up as a legal reserve as at December 31, 1913.

Prior to January 1, 1913, the appellant operated under regulations of the State of S applying to fraternal beneficiary associations, which were not required to set up reserves for protection of policyholders. Pursuant to the provisions of a statute enacted by the State of S Legislature in 1912, the taxpayer since January 1, 1913, has operated on the mutual plan, and as at December 31, 1913, in accordance with the requirements of the State of S statutes, passed to a legal reserve $1.31x$ dollars, of which x dollars represented surplus accumulated as at December 31, 1912, and $.31x$ dollars, the net addition thereto for the year 1913. As at January 1, 1917, the total amount of x dollars (together with additions thereto taken as deductions in the computation of net income for respective years) appears to have stood as a part of the required legal reserve of the company. The taxpayer writes industrial life and sick benefit insurance, and accordingly is within the purview of article 870 of Regulations 45, as amended by T. D. 3153 (C. B. 4, p. 398). Article 870 as so amended provides in part that:

The reserve funds of life insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, can not be included in computing invested capital.

Section 12(a)second allows, in the case of insurance companies, a deduction for the net addition, if any, required by law to be made within the year to reserve funds. This provision is similar to the provisions of section 234(a)10 of the Revenue Act of 1918, so that the rule announced in article 870 is applicable to 1917.

There is no question that the reserve created as at the end of 1913 and maintained during 1917 was a legal reserve, the net additions to which are deductible from gross income under the provisions of the Revenue Act of 1916, as amended, and the total amount of such legal reserve so comprised as at January 1, 1917, must be treated as a liability of the taxpayer in the computation of the statutory capital, in accordance with article 870 of Regulations 45 and paragraph 11 of Bulletin "H," covering rulings peculiar to insurance companies.

The Committee accordingly recommends that the action of the Income Tax Unit be sustained and the appeal denied.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

SECTION 327.—SPECIAL CASES.

ARTICLE 901: Treatment of special cases. II–35–1226
(Also Section 200, Article 1523.) I. T. 1860

REVENUE ACT OF 1917.

The M corporation operated a so-called card-rate advertising agency. The use of capital was an essential income-producing factor in its business, and was essential in order to establish its financial responsibilities and to enable it to secure credit. It is, therefore, not entitled to assessment of 1917 taxes under section 209 of the Revenue Act of 1917.

The M corporation, which conducted an advertising agency, computed its excess-profits tax for the period ended December 31, 1917, under the provisions of section 209 of the Revenue Act of 1917. The corporation secured advertising space from publishers and was allowed a discount of — per cent or less and then it billed such space to its own clients at the full agreed price. Its principal source of income was derived from these discounts. All bills for space were made out to the corporation by the publishers and the corporation in turn rendered its bills to its clients. On receipt of the payments from its clients, the taxpayer remitted the amount to the publishers less its discount. The corporation had an average capital stock in excess of $180x$ dollars for the period from February 1, 1917, to January 1, 1918, and during this period it carried a large amount of accounts and notes receivable and a substantial amount of accounts payable, representing its commitments for advertising space. At the close of the year, $42x$ dollars was invested in Liberty bonds. It was the custom of the corporation to advance the money necessary for mechanical work and printing, engraving, and electrotyping on behalf of its clients.

Advertising agencies with a few exceptions carry on their business as principals and not as agencies. The so-called card-rate agencies are in reality independent contractors with independent relations with publishers and advertisers. In case of default of an advertiser the loss falls upon the agency. This was admitted to be true in the case of the M Company, at an oral hearing which was accorded its representatives, but it was stated that no defaults occurred in the taxpayer's business in 1917. This responsibility has been held to contemplate the employment of capital. Indeed, it would appear that the special rates made to card-rate agencies are not available to an agency unless it can establish its financial responsibility, thus indicating that capital for credit purposes at least is absolutely essential in the conduct of the business. While it was admitted by the taxpayer that it would have to bear any loss caused by the default of a client, it has argued that no income could possibly be produced through such use of capital, since no income could result from loss, and hence that capital is not a material income-producing factor in its business. This argument does not, in the opinion of this office, affect the soundness of the rule. Obviously the use of capital in such manner is a material income-producing factor, since the agency could not hope, if it were not in a position to make good the accounts with the publishers, to continue in this line of business.

The fact that the taxpayer carried on its books a large amount of receivables representing space bills for which at some time it

had been responsible to the publishers; that it carried a substantial amount of accounts payable for such space, and advanced funds in respect of art work and like expenses, indicates the necessity of the use of capital in substantial amounts in excess of that required for mere office expenses. Its investment of $42x$ dollars in Liberty bonds is not to be taken as having withdrawn such funds from the business, for such assets are necessary for the agency to have in order to secure credit with publishers.

It is, therefore, held that the M corporation is not entitled to assessment under section 209 of the Revenue Act of 1917.

PART VI.—REORGANIZATIONS.

SECTION 331.—REORGANIZATIONS.

ARTICLE 941: Valuation of asset upon change of ownership. II-35-1228 A. R. R. 3702

REVENUE ACT OF 1918.

A did not hold an interest or control of 50 per cent or more of a predecessor company except perhaps momentarily and as a mere incident or step in a reorganization. A held but an interest or control of approximately 36 per cent in the old company and he held an interest or control of approximately 80 per cent in the new company. Under the circumstances the provisions of section 331 are not applicable in computing the invested capital of the new corporation.

The Committee has carefully considered the appeal of the M Company from the action of the Income Tax Unit in holding that the provisions of section 331 of the Revenue Act of 1918 are applicable in computing its invested capital for the 10-month period ended August —, 1920, and in accordance with that holding reducing its invested capital, as reported for that period. by the amount of $331.3x$ dollars.

On various dates prior to October —, 1919, A, then the owner of approximately 36 per cent of the total outstanding preferred and common stock of the M Company, secured from the other stockholders an option to purchase all of their holdings in that company. A's purpose in securing such options was to reorganize the company under the laws of the State of Z and to secure control of the new company. Upon the securing of these options by A on all the remaining shares of stock outstanding, the owners of these shares turned them over to a trustee to be held in their interest until the sale thereof was consummated. A at the time of securing these options did not have sufficient personal funds wherewith to exercise these options. He purposed to close the options by purchasing this stock with funds obtained through the sale of securities of the new company. Accordingly, on September —, 1919. A entered into an agreement with the N Company, bankers, wherein it was provided, among other things, that A should, at his own expense, cause the M Company to be reorganized in such a way that either said company or a new company to be organized should have outstanding at the conclusion of the reorganization the following: $300x$ dollars par value 7 per cent bonds, $7y$ shares (par value $\$$——) of 8 per cent cumulative

preferred stock, and $20y$ shares of the par value of $\$$—— each, or without par value as the bankers might elect, of common stock. No par value shares of common were eventually issued. A agreed to sell and the bankers agreed to purchase outright all of the $300x$ dollars par value of bonds, the said $7y$ shares of preferred stock, and $6y$ shares of common stock for $436x$ dollars in cash, delivery of said securities and payment therefor to be made at the office of the bankers on November —, 1919.

On October —, 1919, the M Company, a State of Z corporation, was organized, and on the same date its board of directors, at their first meeting, voted to purchase the assets and business of the old corporation and in consideration of such acquisition authorized its officers to execute and deliver an instrument assuming each and all of the debts, liabilities, contracts, obligations, and undertakings of every kind and character of the old company, and in addition thereto to issue to the stockholders of the old company $300x$ dollars par value of the first mortgage 7 per cent serial gold bonds, $7y$ shares of 8 per cent cumulative preferred stock, and $20y$ shares of common stock without par value.

On November —, 1919, the stockholders of the old company voted to sell the business and assets of the company to the company of the State of Z for and in consideration of the purchase price stated in the preceding paragraph. On the same date the old company executed a deed conveying all its business and assets to the new company. Simultaneously with the execution of the deed the following acts were performed by the parties interested in the reorganization:

(*a*) The State of Z company issued to A the entire issue of $300x$ dollars par value of bonds, $7y$ shares of the par value of $\$$—— each of preferred stock, and $20y$ shares of no par value common stock.

(*b*) A assigned all of the securities of the State of Z company issued to him, except $14y$ shares of no par value common stock, to the N Company, and received in payment thereof $436x$ dollars in cash.

(*c*) The total cash received by A, $436x$ dollars, and $7y$ shares of the O Company were paid over to the other stockholders of the old company, thus closing the options to purchase their holdings in the latter company. All stock certificates were surrendered to the old company and a single certificate for the entire authorized issue of capital stock of the old company, except directors' qualifying shares, was issued to A. It was following the issue of this certificate that the meeting of the stockholders of the old company took place, at which the sale of the company's assets was authorized and the minutes of which meeting show that A was present as the owner of all the outstanding stock except qualifying shares, to which fact the Unit draws attention as evidence that A held an interest and control of more than 50 per cent in the old company prior to the reorganization.

After a thorough consideration of all the foregoing facts, the Committee finds that A did not hold an interest or control of 50 per cent or more in the predecessor company, except perhaps momentarily and as a mere incident or step in the reorganization. It was stated by appellant company's representatives at the hearing that the thing which led up to the reorganization was the inability of A and his father, who virtually exercised a control of the corpora-

tion through his (the father's) wife's holding of more than 50 per cent of the common stock, to agree on questions of business policy necessitating the retirement of one of them from the company. As A's father virtually owned the O Company, he chose to devote his future endeavor to that company, leaving the future of the M Company in the hands of his son. It was because of A's father's action that the son was required to give up his holdings in the O Company in part payment of his mother's holdings in the M Company. Looking at the transaction after the whole reorganization scheme had been accomplished, the Committee finds that whereas A held but an interest or control of approximately 36 per cent in the old company, he held an interest or control of approximately 80 per cent in the Z State corporation. Under the circumstances, the Committee is constrained to hold that the provisions of section 331 of the Revenue Act of 1918 are not applicable in computing the invested capital of appellant company.

Accordingly, it is recommended that the action of the Income Tax Unit in holding that the provisions of section 331 of the Revenue Act of 1918 are applicable in computing the invested capital of appellant company be reversed, and the appeal in that respect be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1324.—INTEREST ON REFUNDS AND JUDGMENTS.

ARTICLE 1040: Interest on refunds and judgments. II-20-1055
I. T. 1758

REVENUE ACT OF 1921.

A return showed no tax liability. Later an assessment was made in connection with the return which afterwards was determined to be erroneous and the tax paid was refunded. The tax assessed was not an additional assessment within the meaning of section 1324.

The taxpayer filed a return for 1918 showing no tax liability. As a result of an examination by a deputy collector, a tax of x dollars was assessed in connection with this return. It was later determined that the assessment was erroneous and the amount paid was refunded to the taxpayer upon the allowance of a claim for refund filed by him.

Inquiry is made as to whether or not the amount assessed under the circumstances described above was an additional assessment within the meaning of section 1324(a) of the Revenue Act of 1921.

Section 1324(a) of the Revenue Act of 1921 defines the term "additional assessment" as a further assessment for a tax of the same character previously paid in part.

Inasmuch as the taxpayer did not pay any tax at the time he filed his 1918 return, the tax assessed as a result of the investigation by the deputy collector was not an additional assessment within the meaning of the section above quoted.

SECTION 1325.—PAYMENT OF TAXES BY CHECK OR UNITED STATES SECURITIES.

ARTICLE 1731: Payment of tax by certificates of indebtedness. II–23–1091 T. D. 3510

Instructions as to acceptance of Treasury notes for income and profits taxes.

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

To collectors of internal revenue and others concerned:

1. Collectors of internal revenue are authorized and directed until further notice to receive at par with an adjustment of accrued interest, in payment of income and profits taxes payable at or within six months before their respective maturities, Treasury notes of the United States of Series A–1924, dated June 15, 1921, maturing June 15, 1924; Series B–1924, dated September 15, 1921, maturing September 15, 1924; Series A–1925, dated February 1, 1922, maturing March 15, 1925; Series B–1925, dated June 15, 1922, maturing December 15, 1925; Series C–1925, dated December 15, 1922, maturing June 15, 1925; Series A–1926, dated March 15, 1922, maturing March 15, 1926; Series B–1926, dated August 1, 1922, maturing September 15, 1926; Series A–1927, dated January 15, 1923, maturing December 15, 1927; and Series B–1927, dated May 15, 1923, maturing March 15, 1927. Collectors are authorized to receive Treasury notes which are acceptable as herein provided in payment of income and profits taxes in advance of the respective tax-payment dates. All matured coupons attached to the notes must be detached by the taxpayer before presentation to the collector and collected in ordinary course when due, but all coupons that have not matured must be attached to the notes when presented. The amount at par of the Treasury notes thus presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the notes or accept them for any amount other or greater than their face value. Accrued interest from the last interest payment date on any notes accepted to the tax payment date will be remitted to the taxpayer by the Federal reserve bank with which the collector makes a deposit on the basis of schedules to be furnished by the collector to the Federal reserve bank. Receipts given by collectors to taxpayers should show the amount and description of the notes received in payment of taxes.

2. Deposits of Treasury notes received in payment of income and profits taxes hereunder must be made by collectors, unless otherwise specifically instructed by the Secretary of the Treasury, with the Federal reserve bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch Federal reserve bank, with such branch Federal reserve bank. Specific instructions may be given to collectors by the Secretary of the Treasury in special cases for deposit with Federal reserve banks of other districts or branch Federal reserve banks. The term "Federal reserve bank," where it appears herein, unless otherwise indicated by the context, includes branch Federal reserve banks. Treasury notes accepted hereunder by collectors in advance

of the tax payment date should be forwarded by the collector to the Federal reserve bank, to be held for account of the collector until the tax date, and for deposit on such date.

3. Treasury notes accepted hereunder should in all cases be indelibly stamped by the collector on the face thereof as follows, and when so stamped should be delivered to the Federal reserve bank in person if the collector is located in the same city, and in all other cases forwarded by registered mail, uninsured:

_____, 192__.

This note has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

_____,
Collector of Internal Revenue,
For the ____ district of _____.

Each unmatured coupon attached to each such note must be indelibly stamped across the face by the collector with the word "Paid," followed by his name and title.

4. Collectors should make in tabular form a schedule in duplicate of the Treasury notes to be forwarded to the Federal reserve bank, showing, by series, the face amount transmitted, the serial number of each note, the denomination, and the name and address of the taxpayer presenting the note. Notes accepted in advance of the tax-payment date must be scheduled separately, and Treasury notes should in all cases be scheduled separately from Treasury certificates of indebtedness. At the bottom of each schedule there should be written or stamped, "Income and Profits Taxes $_____," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany notes sent to the Federal reserve bank and the other be retained by the collector. The income and profits tax deposits resulting from the deposits of such notes must in all cases be shown on the face of the certificate of deposit (Form 15) separate and distinct from the item of miscellaneous internal revenue collections (formerly called Ordinary). Until certificates of deposit are received from the Federal reserve banks, the amounts represented by the Treasury notes forwarded for deposit must be carried by collectors as cash on hand or in banks, and not credited as collections, as the dates of certificates of deposit determine the dates of collections.

5. For the purpose of saving taxpayers the expense of transmitting such notes as are held in Federal reserve cities or Federal reserve branch bank cities to the office of the collector in whose district the taxes are payable, taxpayers desiring to pay income and profits taxes by Treasury notes should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such notes with the Federal reserve bank in the city in which the notes are held. Collectors are authorized to permit deposits of Treasury notes in any Federal reserve bank, with the distinct understanding that the Federal reserve bank is to issue a certificate of deposit in the collector's name covering the amount of the Treasury notes at par and to state on the face of the certificate of deposit that the amount represented thereby is in payment of income and profits taxes. The Federal reserve bank should forward the original certificate of deposit to the Treasurer of the United

States, with its daily transcript, and transmit the duplicate to the Commissioner of Internal Revenue, Accounts and Collections Unit, Washington, D. C., and the triplicate to the collector, accompanied by a statement giving the name of the taxpayer for whom the payment is made in order that the collector may make the necessary record.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 4, 1923.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 1732: Procedure with respect to certificates of indebtedness. II-24-1104 T. D. 3512

Instructions as to cancellation and transmittal of Treasury notes and Treasury certificates of indebtedness accepted for income and profits taxes.

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

To collectors of internal revenue and others concerned:

1. Referring to instructions heretofore issued to collectors of internal revenue and others concerned, with respect to the acceptance of Treasury notes and Treasury certificates of indebtedness in payment of income and profits taxes, attention is directed to the requirements, therein set forth, governing the cancellation and transmittal of such notes and certificates. These requirements are as follows:

2. Deposits of Treasury notes and Treasury certificates of indebtedness received in payment of income and profits taxes must be made by collectors, unless otherwise specifically instructed by the Secretary of the Treasury, with the Federal reserve bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch Federal reserve bank, with such branch Federal reserve bank. Specific instructions may be given to collectors by the Secretary of the Treasury in special cases for deposit with Federal reserve banks of other districts or branch Federal reserve banks. The term "Federal reserve bank," where it appears herein, unless otherwise indicated by the context, includes branch Federal reserve banks.

3. Notes and certificates acceptable in payment of income and profits taxes should in all cases be indelibly stamped on the face thereof as follows by the collector; and when so stamped should be delivered to the Federal reserve bank in person if the collector's head office is located in the same city, and in all other cases forwarded by registered mail uninsured:

_____, 19__

This note/certificate has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

_____
Collector of Internal Revenue
For the_____ district of_____.

4. Each unmatured coupon attached to such note or certificate must be indelibly stamped across the face by the collector with the word: "Paid," followed by his name and title.

5. Collectors should make, in tabular form, a schedule, in duplicate, of the notes or certificates of indebtedness to be forwarded to the Federal reserve bank, showing by series the face amount transmitted, the serial number of each note or certificate, the denomination, and the name and address of the taxpayer presenting the notes or certificates. Notes or certificates accepted in advance of the tax date must be scheduled separately, and Treasury notes should in all cases be scheduled separately from Treasury certificates of indebtedness. At the bottom of each schedule there should be written or stamped, "Income and Profits Taxes $_____," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany notes or certificates of indebtedness sent to the Federal reserve bank, and the other copy retained by the collector.

6. The foregoing instructions will continue in effect with respect to Treasury notes or Treasury certificates of indebtedness delivered to the Federal reserve bank in person, rather than by registered mail, where the collector's head office and the Federal reserve bank are located in the same city.

7. Where the collector's head office and the Federal reserve bank are not located in the same city, and it is necessary to transmit the notes or certificates to the Federal reserve bank by registered mail uninsured, the following requirements, with respect to the preparation of shipments, must be observed: The notes or certificates, and each unmatured coupon attached thereto, must in all cases be stamped on the face thereof as indicated in paragraphs 3 and 4 hereof. The schedule of securities transmitted should be prepared as prescribed in paragraph 5 hereof, except that it should be prepared in *triplicate*. The original copy of such schedule should be forwarded to the Federal reserve bank by *separate* registered mail, and should bear a certificate signed by two employees of the office of the collector, stating (*a*) that they inspected and checked the shipment before sealing; (*b*) that each note or certificate listed was properly canceled by stamping on the face thereof the prescribed legend; (*c*) that each unmatured coupon attached thereto was stamped "Paid" on its face; (*d*) that the shipment was sealed in their presence before it left their immediate control; and (*e*) that each and every security listed was in the package when mailed. The duplicate copy of the schedule should be inclosed with the securities and the triplicate retained by the collector. It is important that the collector's retained copy be carefully preserved, and in this connection it is recommended that the certificate of the two employees be entered also on the retained copy, in order that no complication may arise in the event that the original copy should be lost or destroyed.

8. The foregoing instructions shall apply also to shipments of any obligations of the United States which collectors of internal revenue may hereafter be authorized to accept in payment of income and profits taxes.

9. This Treasury decision amends article 1732 of Regulations 62 and Treasury Decisions 3421 [C. B. II–1, p. 230] and 3510 [see p. 280].

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 6, 1923.
A. W. MELLON,
Secretary of the Treasury.

ARTICLE 1734: Procedure with respect to dishonored checks. II–39–1273 T. D. 3541

INCOME TAXES—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME TAXES—PAYMENT—LIABILITY UNDER SECTION 1314.

A check tendered in payment of Federal taxes does not, under the provision of section 1314 of the Revenue Act of 1918, discharge the liability of the taxpayer until the check is actually paid in money.

2. SAME.

The stamping of a check tendered in payment of Federal taxes as "paid" by the drawee bank and the return of the canceled check to the drawer does not constitute payment where due to insolvency of the drawee bank the amount of the check is not received in money by the collector.

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

To collectors of internal revenue and others concerned:

The following decision of the United States District Court for the Western District of Washington, Southern Division, in the case of *United States* v. *H. E. McKenney*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 19, 1923.
A. W. MELLON,
Secretary of the Treasury.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION. No. 3799.

United States of America, plaintiff, v. *H. E. McKenney, defendant.*

CUSHMAN, District Judge: This cause has been submitted upon the following statement of facts:

"It is hereby agreed and stipulated by and between Thos. P. Revelle, United States attorney for the western district of Washington and attorney for the above-named plaintiff, and T. P. Fisk, attorney for the above-named defendant, that the following statement of facts may be submitted to the court as the evidence in the above entitled cause:

"On March 10, 1921, Mr. H. E. McKenney, above-named defendant and a resident of the city of Kelso, Wash., was indebted to the United States Government in the amount of four hundred thirty-two and 8/100 ($432.08) on account of in-

come tax for the year 1920. On the day above mentioned Mr. McKenney drew his personal check on the Kelso State Bank payable to David J. Williams, then the collector of internal revenue for the district of Washington, for the sum of $432.08. His check was immediately transmitted to the collector of internal revenue at Tacoma, Wash. Upon receipt of this check in the office of the collector of internal revenue at Tacoma there was stamped across the face of the check the following words: 'This check is in payment of an obligation of the United States and must be paid at par. No protest. David J. Williams, Collector Internal Revenue.' The following indorsement was made on the back of the check: 'Pay to the order of Seattle Branch, Federal Reserve Bank of San Francisco, California. Income and Profits Tax Account. David J. Williams, Collector of Internal Revenue.' The check was received at the office of the collector of internal revenue at Tacoma, Wash., on the 11th day of March, 1921. On the same day it was transmitted to the Seattle branch of the Federal Reserve Bank of San Francisco, Calif., and deposited on March 12 to the credit of the collector of internal revenue. The Kelso State Bank, upon which institution the check was drawn, is located within the business zone covered by the Portland branch of the Federal Reserve Bank of San Francisco, and following the usual custom in such cases the aforementioned check was forwarded by the Seattle branch to the Portland branch of the Federal Reserve Bank of San Francisco. By the Portland branch this check was forwarded direct to the Kelso State Bank. Upon receipt of the check this latter institution drew a draft on the United States National Bank of Portland, Oreg., and sent the draft to the Portland branch of the Federal Reserve Bank of San Francisco. The check drawn by H. E. McKenney was canceled 'paid' and returned to the drawer, and his account was debited in the amount of $432.08. At the time this transaction occurred the First National Bank of Kelso, a member of the Federal Reserve System and a national bank, was transacting a banking business in the City of Kelso, Wash.

"Subsequent to the time that the Kelso State Bank forwarded the draft on the United States National Bank of Portland to the Portland branch of the Federal Reserve Bank of San Francisco and prior to the receipt of the draft by such branch of the Federal reserve bank, the supervisor of banking of the State of Washington, on the 17th day of March, 1921, closed the Kelso State Bank. The draft was duly presented to the United States National Bank of Portland, Oreg., for payment, but was refused on account of the failure of the Kelso State Bank. The Portland branch of the Federal Reserve Bank of San Francisco thereupon returned to the Seattle branch a copy of the original check, which copy has been protested for nonpayment. The Seattle branch in turn returned the copy of the original check to the collector of internal revenue and charged the account of the collector of internal revenue with the amount of the McKenney check, to wit, four hundred thirty-two and 8/100 ($432.08)."

Section 1314 (Internal Revenue Act), 40 Statutes at Large, page 1057 (vol. 1, Supplemental U. S. Compiled Statutes, sec. 5371½ O), provides:

"SEC. 1314. That collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered."

Whatever want of uniformity there may be in the reported cases upon the general question of when a check will be treated as payment, in view of the language of the foregoing section it is clear that Congress intended the person tendering a check in payment to the collector to remain liable for the payment of the tax until it was actually paid in money. The fact that the Kelso State Bank marked the check when presented "paid" and issued its draft on the Portland Bank in payment, did not amount to payment or in any way lessen defendant's liability to the United States. Former Acts show the same intention, a change in which intention is not to be lightly presumed. (Act of Mar. 2, 1911, 36 Statutes at Large, 965; sec. 1010 of the Act of October 5 [3], 1917, 40 Statutes at Large, 327.)

In the course adopted in the transmitting of the check for collection no departure is shown from well established banking customs in such cases, unless it be that the check was sent by the Portland branch of the Federal Reserve Bank of San Francisco for collection to the drawee, the Kelso State Bank. The want of uniformity in the discussion upon the question whether this constituted negligence is sufficiently indicated by the following: 5 Cyc. (D), pages 506-507; *Kershaw* v. *Ladd* (34 Ore., 375; 56 Pac., 402); *Morris Miller Co.* v. *Von Pressentin* (53 Wash., 74, at 78 and 79); *First Nat'l Bank Trinidad* v. *First Nat'l Bank Denver* (Federal cases 4810); *Farwell et al.* v. *Curtis* (Fed. Cases 4690).

If it be conceded to be negligence on the part of the Portland Bank to so send the check to the Kelso State Bank, yet under the language of the Act (sec. 1314) before quoted, such negligence is not to be attributed to the United States. If agency then be in the matter the collectors and banks are agents of the taxpayers and not of the United States, until such time as the tax is paid in money.

Judgment will be for the plaintiff.

MISCELLANEOUS.

II-13-964
A. R. R. 2615

REVENUE ACT OF 1916.

The Commissioner is without authority to excuse a taxpayer from the payment of munitions taxes legally due and collectible on the grounds that the transaction upon which the tax arose would have been completed prior to the inception of the statute imposing the tax had it not been for causes beyond the control of the taxpayer.

The Committee has had under consideration the appeal of the M Company from the action of the Income Tax Unit in rejecting claim for refund of x dollars munitions tax assessed and collected for the year 1916.

Upon examination of the record it is found that the grounds upon which the claim for refund and the appeal are based are three in number, two of which, as now conceded by the taxpayer, may be abandoned as having been made untenable by decisions of the United States Supreme Court.

The third ground, however, raises a legal question as to the propriety of applying in the instant case a well-settled rule of law generally applicable as between contracting parties. This third point was referred to the Solicitor of Internal Revenue for an expression of his opinion upon the question involved, and under date of March —, 1923, the Solicitor's opinion was received.

The said opinion, in which the relevant facts are set forth, follows:

The case of the M Company was referred to this office for an opinion as to the liability of the above company for the payment of the munitions tax imposed by Title III of the Revenue Act of 1916 upon certain income derived in 1916 under a contract entered into in 1915.

Briefly stated, the facts are as follows: Under date of May —, 1915, the corporation entered into a contract with the N Company for the furnishing of certain parts to be used in the manufacture of a munitions device. Under the terms of the contract, a metal conforming to certain specifications was to be used in the manufacture of the parts and deliveries were to have been practically completed prior to January 1, 1916. Soon after the corporation started furnishing the said parts, however, it was determined that the metal used was too hard and tough to permit of its being properly machined and many of the parts were rejected and returned to the corporation as unsatisfactory, although

they conformed in every respect to the specifications in the contract. Thereafter the composition of the metal was from time to time changed and experiments were conducted which resulted in a modification of the specifications in the original contract by the N Company, and the contract was finally consummated during the year 1916. The parties to the contract thereafter agreed to a settlement whereby the N Company paid to the M Company the sum of $5x$ dollars in full settlement of any and all claims of the latter corporation.

The taxpayer now contends that the proposed additional assessment of taxes is highly inequitable, for the reason that the contract would have been completed prior to January 1, 1916, had it not been for the action of the N Company in delaying manufacture and rejecting parts which were in fact in accordance with the specifications in the contract. The taxpayer states that it is a well-settled principle of law generally applicable between contracting parties that where one of the parties is prevented from carrying out the terms of the contract due to causes beyond its control, then such defaulting party is not liable for any resultant damages or losses sustained. Applying this principle to the instant case, it is contended that the Government should not assess the munitions tax upon that portion of the earnings of the corporation which would have been realized in 1915 had it not been for the unavoidable delay in carrying out the terms of the contract, which resulted through no fault of the manufacturer, and that such assessment would be particularly inequitable by reason of the fact that the taxpayer may not look to the N Company for reimbursement of any amount so paid, a release from all claims having been given during the year 1916 prior to the passage of the Revenue Act of 1916.

Section 301(1) of Title III of the Act of September 8, 1916, provides that every person manufacturing certain articles—

"shall pay for each taxable year, in addition to the income tax imposed by Title I, an excise tax of 12½ per centum upon the entire net profits actually received or accrued for said year from the sale or disposition of such articles manufactured within the United States: *Provided, however*, That no person shall pay such tax upon net profits received during the year 1916 derived from the sale and delivery of the articles enunciated in this section under contracts executed and fully performed by such person prior to January 1, 1916."

Article 10 of Regulations 39, promulgated under the above-quoted provision of the statute, provides in part that:

"If, however, the contracts were not 'fully performed' prior to January 1, 1916, any profits resulting from that part of the contract performed subsequent to January 1, 1916, must be returned for the purpose of this tax."

It is not contended that the above regulation does not represent a proper interpretation of the statute. On the contrary, at a hearing held in this office with the taxpayer's representative on March — it was specifically stated that the allocation of profits made by the revenue agent for the years 1915 and 1916 was entirely satisfactory. The sole contention of the taxpayer at the present time is that the imposition of the tax in the instant case is inequitable by reason of the fact that the delay in consummating the contract was due to causes beyond its control and that under the principles of law generally applicable between contracting parties it is not responsible for any damages or losses resulting from such delay.

Obviously, the misfortune of the taxpayer in the instant case does not operate to relieve it from the necessity of complying with the express provisions of the statute and the regulations promulgated thereunder. The Commissioner is without authority to excuse a taxpayer from the payment of taxes legally due and collectible on the grounds that a certain transaction would have been completed prior to the inception of the statute imposing the tax had it not been for causes beyond the control of the taxpayer. The authority of the Commissioner is limited to the refundment of taxes erroneously or illegally assessed or collected, and no equity powers are conferred upon the Commissioner in disposing of "*hard* cases where, strictly speaking, the tax is *legal*." (Ridgway case, 16 Ops. Atty. Gen., 667.)

Furthermore, the contention that the general principle of contract law exempting a party to a contract from liability on account of unavoidable delays constitutes a sufficient basis for relieving the taxpayer from the payment of the

tax is untenable. The statute, in plain and unambiguous language, imposes the tax upon the "person manufacturing" the articles specified. Whether or not the taxpayer may look to the N Company for reimbursement under the principle of contract law announced above is a matter which has no bearing upon the determination and assessment of the tax by the Commissioner.

In view of the foregoing, it is concluded that the assessment of the tax against the M Company upon the profits derived from that portion of the contract completed during the year 1916 was proper.

In view of the foregoing opinion, in which the Committee concurs, it is recommended that the appeal be denied and the action of the Income Tax Unit be sustained.

KINGMAN BREWSTER,
Chairman Committee on Appeals and Review.

II–15–986

The present practice of holding conferences with taxpayers or their representatives without previous arrangement has been found inexpedient because of its interference with the schedules of prearranged conferences. Therefore, effective immediately, the practice of holding conferences with taxpayers or their representatives without previous arrangement will be discontinued and they will hereafter be required to arrange for conferences and file sworn statements of facts as set forth in Conference and Practice Requirements Circular 1185 at least five days in advance of the conference date. Cases in which taxpayers or their representatives can submit some unusual reason for requesting an immediate conference without previous arrangement as required above will be given consideration by heads of divisions of the Income Tax Unit, who may, if the circumstances warrant, make an exception to the rule.

In order that the case under consideration may be closed at one conference, if at all possible, paragraph 6 of circular 1185 will be strictly observed to the effect that brief submitted in advance of conference must meet all issues raised, and another conference will not be granted on the same case except to meet new issues raised by the Income Tax Unit in the course of the first conference which could not have been anticipated prior to such conference.

The brief submitted shall cover not only points in controversy as to income and statutory invested capital, but if it is the intention to make claim for consideration under the relief provisions, such claim must be embodied in the brief at the same time the contentions are raised on the points in controversy. It is absolutely necessary that all facts pertaining to such claim for relief shall be set forth specifically in such brief so that the audit section may consider the merits of such claim.

SALES TAX RULINGS.

TITLE V.—TAX ON TELEGRAPH AND TELEPHONE MESSAGES. (1921)

SECTION 500, REGULATIONS 57, ARTICLE 16(b): Exemptions—Foreign diplomats. II–17–1024 S. T. 421

Spanish consuls and Swedish consuls are held to be exempt by virtue of certain existing treaty provisions.

TITLE V.—TAX ON TRANSPORTATION AND OTHER FACILITIES, AND ON INSURANCE. (1918)

INSURANCE.

SECTION 503, REGULATIONS 58, ARTICLE 13: Life, health, and accident insurance. II–32–1185 S. T. 429

SECTION 503, REVENUE ACT OF 1918, AND SECTION 504, REVENUE ACT OF 1917.

The agreement by a certain railroad in its contract of employment to furnish employees hospital facilities and to pay a fixed sum in event of death is subject to tax under section 504(a) of the Revenue Act of 1917 and section 503(a) of the Revenue Act of 1918.

The question arises whether a certain railroad company is liable for the tax imposed by section 504 of the Revenue Act of 1917 and section 503 of the Revenue Act of 1918 with respect to its agreements with its employees to furnish such employees hospital facilities and to pay a fixed sum in event of death.

Under this agreement, which forms a part of its contract of employment, and in consideration of the payment of 75 cents per month, the railroad undertakes to furnish its employees medical treatment and hospital facilities in the event of sickness or injury necessitating such treatment. It is further agreed by the railroad that:

In all cases of death occurring while the contributor is under the care of the hospital department, or occurring within 48 hours after an accidental injury, contributors will be entitled to benefits from the department for burial purposes, not to exceed thirty (30) dollars.

It is apparent from this provision of the agreement that the payment of the death benefit is not limited to death by accident but includes also death from any cause while in the care of the hospital department.

In Law Opinion 1111 (C. B. II-1, p. 249) it was held that certificates of membership in an employees' benefit association organized for the relief of members or their dependents in the event of sickness or death are subject to tax under section 504(a) of the Revenue Act of 1917 and section 503(a) of the Revenue Act of 1918 as a "policy of insurance or other instrument by whatever name the same is called" by which a life is insured. The ruling contained in that Law Opinion is equally applicable to the instant case and it is not affected by the fact that the rights of the beneficiaries are fixed by the regulations of the hospital department rather than by the certificate of membership or similar instrument.

It is accordingly held that the railroad is liable for the tax imposed by section 504(a) of the Revenue Act of 1917 and section 503(a) of the Revenue Act of 1918 upon policies of insurance or other instruments whereby a life is insured.

SECTION 503, REGULATIONS 58, ARTICLE 13: Life, health, and accident insurance. II-35-1229 S. T. 433

No tax should be assessed under section 504 of the Revenue Act of 1917 or section 503 of the Revenue Act of 1918 with respect to certificates of membership issued by the relief departments of the various railroads for the period during which those roads were under Federal control.

A hearing was had in this office in August, 1923, relative to the question whether or not assessments may be levied against the relief departments of the various railroads on account of the tax imposed by section 503 of the Revenue Act of 1917 and section 504 of the Revenue Act of 1918, with respect to certificates issued by these relief departments during the period of Federal control. At this hearing it was contended by the representatives of the United States Railroad Administration that during the period of Federal control the railroad relief departments, with their assets and income, were taken over by the Government and operated in connection with the operation of the carrier; that, as a matter of fact, the railroads had nothing to do during Federal control with the issuance of relief department certificates, but that they were issued by officers of the relief department in the employ of the United States Railroad Administration to employees of the Railroad Administration, and therefore the railroads are not liable for the tax in question. It was further contended that if this tax should be assessed against the carrier, under the provisions of the standard contract entered into with some of the companies the carrier would be entitled to reimbursement by the Railroad Administration for the tax paid; and that because of the fact that the Government was operating the relief associations of the noncontract railroads, the United States Government is primarily liable for the tax, if any, due with respect to certificates issued during the period these railroads were so operated.

The tax imposed by section 504 of the Revenue Act of 1917 and section 503 of the Revenue Act of 1918 is payable by the insurer. See article 8, Regulations 58.

The relief department of one of the railroad companies in question is operated on the cash premium plan, as a department of the railroad, in the executive charge of the superintendent appointed

by the railroad, and under the control of the president. The railroad company has general charge of the department, guarantees fulfillment of its obligations, and pays all operating expenses thereof.

It is apparent, therefore, that the tax due with respect to the certificates issued by its relief department is an obligation of the railroad company, and not that of the members composing its relief department.

Speaking of the status of the railroads and their employees while under Federal control, the Supreme Court, in the case of *Missouri Pac. R. Co.* v. *Ault* (256 U. S., 554, 557), said:

> The Railroad Administration established by the President in December, 1917, did not exercise its control through supervision of the owner companies, but by means of a Director General through "one control, one administration, one power for the accomplishment of the one purpose, the complete possession by governmental authority to replace for the period provided the private ownership theretofore existing." (*Northern Pacific Ry. Co.* v. *North Dakota*, 250 U. S., 135, 148; 39 Sup. Ct., 502, 505 (63 L. Ed., 897).) This authority was confirmed by the Federal Control Act of March 21, 1918 (ch. 25, 40 Stat., 451), and the ensuing proclamation of March 29, 1918 (40 Stat., 1763). By the establishment of the Railroad Administration and subsequent orders of the Director General, the carrier companies were completely separated from the control and management of their systems. Managing officials were "required to sever their relations with the particular companies and to become exclusive representatives of the United States Railroad Administration." (U. S. R. R. Adm. Bulletin No. 4, pp. 113, 114, 313.) The railway employees were under its direction and were in no way controlled by their former employers. (See Bulletin No. 4, p. 168, sec. 5; p. 198 et seq.; p. 330 et seq.) It is obvious, therefore, that no liability arising out of the operation of these systems was imposed by the common law upon the owner companies as their interest in and control over the systems were completely suspended.
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> * * * The Government undertook as carrier to observe all existing laws; it undertook to compensate any person injured through a departure by its agents or servants from their duty under such law; but it did not undertake to punish itself for any departure by the imposition upon itself of fines and penalties or to permit any other sovereignty to punish it. Congress is not to be assumed to have adopted the method of fines paid out of public funds to insure obedience to the law on the part of the Government's railway employees. * * *

It is apparent, therefore, that membership certificates issued by the relief departments of the railroads during the period the railroads were under Federal control were issued by agents of the United States Railroad Administration, an agency or instrumentality of the United States. (*Director General* v. *Zirkle*, 138 N. E., 266, 267.) Furthermore, in the control and operation of the railroads through such an agency the United States was acting in its capacity as a sovereign. (*Davis, Director General*, v. *E. I. Dupont De Nemours & Co.*, 287 Fed., 522, 523.)

The principle is fundamental that in the absence of express contrary language the Government will not be presumed to intend to tax itself or its agencies or instrumentalities. However, this presumption must not be indulged in where the tax does not fall directly upon a governmental agency, nor in cases where a clear statutory intent to the contrary is evident. (Law Opinion 864 (not published) and cases cited.)

This presents for determination the intention of Congress with respect to the liability of the railroads for taxes during the period of Federal control as expressed in the Act of March 21, 1918 (40

Stat., 451), entitled "An Act to provide for the operation of transportation systems while under Federal control," etc. Sections 1 and 12 of this Act read in part as follows:

SEC. 1. * * *

Every such agreement shall provide that any Federal taxes under the Act of October 3, 1917, or Acts in addition thereto or in amendment thereof, commonly called war taxes, assessed for the period of Federal control beginning January 1, 1918, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation; that other taxes assessed under Federal or any other governmental authority for the period of Federal control or any part thereof, either on the property used under such Federal control or on the right to operate as a carrier, or on the revenues or any part thereof derived from operation (not including, however, assessments for public improvements or taxes assessed on property under construction, and chargeable under the classification of the Interstate Commerce Commission to investment in road and equipment), shall be paid out of revenues derived from railway operations while under Federal control; that all taxes assessed under Federal or any other governmental authority for the period prior to January 1, 1918, whenever levied or payable, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation.

* * * * * * *

SEC. 12. That moneys and other property derived from the operation of the carriers during Federal control are hereby declared to be the property of the United States. * * * Disbursements therefrom shall, without further appropriation, be made in the same manner as before Federal control and for such purposes as under the Interstate Commerce Commission classification of accounts in force on December 27, 1917, are chargeable to operating expenses or to railway tax accruals and for such other purposes in connection with Federal control as the President may direct, except that taxes under Titles One and Two of the Act entitled "An Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917, or any Act in addition thereto or in amendment thereof, shall be paid by the carrier out of its own funds. * * *

It will be noted that section 12 of the Federal Control Act, after providing that the money derived from the operation of the carriers during Federal control shall be regarded as property of the United States, makes provision for the disbursement thereof, and further provides that the taxes imposed by Titles I and II of the Revenue Act of 1917 "shall be paid by the carrier out of its own funds." This language of section 12 has been accepted by the officers of the United States Railroad Administration as defining the taxes "commonly called war taxes" referred to in section 1 of the Federal Control Act. Under this construction of the Federal Control Act, the liability of the railroads for taxes under the Revenue Act of 1917 has been limited to those imposed by Titles I and II of that Act, and those taxes imposed under other titles of that Act are payable, if due at all, from money which, under the Federal Control Act, is designated Federal property.

That the construction placed on the Federal Control Act by the officers of the Railroad Administration was adopted by Congress is apparent from the provisions of section 230(b) of the Revenue Act of 1918. This provision reads as follows:

For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as levied by an Act in amendment of Title I of the Revenue Act of 1917.

The tax imposed upon the issuance of policies of insurance is not imposed by Title I or II of the Revenue Act of 1917 or by the provisions of the Revenue Act of 1918, referred to in section 230(b) (supra) of that Act.

It is apparent, therefore, that a tax assessed with respect to certificates issued by the relief departments of the railroads during the period those roads were under Federal control either would be imposed directly upon a United States governmental agency or would be payable out of Government funds.

Therefore, this office is of the opinion that no tax should be assessed under section 504 of the Revenue Act of 1917 or section 503 of the Revenue Act of 1918 with respect to certificates of membership issued by the relief departments of the various railroads for the period during which those roads were under Federal control.

TITLE VI.—WAR EXCISE TAXES. (1917)

SECTION 600, REGULATIONS 44: Sales for export. II–16–1005
T. D. 3495

EXCISE TAXES—SECTIONS 313, 315, AND 600 OF THE REVENUE ACT OF OCTOBER 3, 1917.

Sales of articles exported.—Modification of T. D. 2739 and T. D. 2781.

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

To collectors of internal revenue and others concerned:

In view of the recent decision of the Supreme Court in the case of *Spalding & Bros.* v. *Edwards* (43 Sup. Ct., 485; T. D. 3476) [C. B. II–1, p. 263], all prior rulings with respect to the tax paid under sections 313, 315, and 600 of the Revenue Act of October 3, 1917, on sales by the manufacturer of articles exported to a foreign country are hereby modified to conform to the ruling laid down in that decision.

Section 600 imposes a tax in respect of automobiles and other enumerated articles and sections 313 and 315 in respect of nonalcoholic beverages and other enumerated articles sold by the manufacturer, producer, or importer. Section 9 of Article I of the Constitution of the United States provides that "no tax or duty shall be laid on articles exported from any State."

The determining circumstance with respect to whether or not the sale of an article is exempt from taxation under the above section of the Constitution is whether or not the sale was a step in the exportation of the article to its real and ultimate destination in a foreign country. If the sale and delivery by the manufacturer actually start the article to its destination in a foreign country, either by the immediate carrier or through connecting carriers, the sale is exempt from taxation, and the fact that further acts are to be done before the goods get to sea does not matter so long as they are only the

regular steps to the contemplated result—exportation. It is not necessary that shipment be upon through bills of lading.

In the cases where a manufacturer sells an article to a domestic purchaser not engaged exclusively in the export business and who at the time of the sale has no contract with foreign purchasers for the fulfillment of which the purchase is made, such sales are subject to tax even though the article is ultimately exported. A sale to a concern doing business in the United States is a sale for domestic delivery unless compliance with the terms of the order or contract of sale results in starting the article on its course for delivery in a foreign country.

Articles normally may be exported by the manufacturer tax free in several ways: (1) They may be shipped by the manufacturer to an agent in a foreign country and after reaching there may be sold by the agent; (2) they may be shipped by the manufacturer to a foreign purchaser to fill orders received by an agent in a foreign country; (3) they may be shipped by the manufacturer to a foreign purchaser to fill orders received by the manufacturer in the United States; (4) they may be shipped by the manufacturer to a foreign purchaser to fill orders solicited by mail and received by mail from the foreign purchaser. Articles may also be exported in certain other ways which will exempt the sale thereof from taxation.

Examples of sales by a manufacturer which are not made direct to a purchaser in a foreign country, but which are nevertheless not subject to tax, are: (1) A sale to a dealer in the United States, effected by compliance with the terms of the contract and shipping instructions to export; (2) a sale to an export commission house in the United States purchasing on behalf of a foreign buyer, which is effected by a shipment, either direct to the foreign buyer or consigned to the commission house at a domestic port and which is followed by immediate exportation by the commission house to the foreign buyer in whose behalf the purchase was made; (3) a sale to a dealer located in the United States under a contract which prohibits a disposition of the article in the United States; (4) a sale to an agent for a foreign purchaser who conducts a buying business in the United States for his principal and exports all articles bought.

No sale is exempt from taxation under the above-named section of the Constitution, regardless of the circumstances under which made, unless the article sold is actually exported.

The application of the tax in respect of positive moving-picture films leased by the manufacturer, producer, or importer is governed by the same rules.

The taxes apply to articles sold in foreign commerce by a manufacturer located in a Territory elsewhere in the United States than a State, and to articles going from the United States to any of its island or other possessions, including the Canal Zone, except that under Acts of Congress articles going from the United States into the West Indian islands acquired from Denmark, or into the Philippine Islands or Porto Rico, are exempt from the taxes to the same extent as articles exported from a State to a foreign country.

This decision is supplemental to Regulations No. 44, approved May 31, 1918, and supersedes T. D. 2739[1] and T. D. 2781.[1]

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 10, 1923.
S. P. GILBERT, JR.,
Acting Secretary of the Treasury.

TITLE VI.—TAX ON BEVERAGES. (1918)

BEVERAGES SOLD IN BOTTLES OR OTHER CLOSED CONTAINERS.

SECTION 628, REGULATIONS 52(1919), ARTICLE 8: II-22-1075
Basis for tax: Sale price. S. T. 425

Where company's price list shows only "Federal tax paid," and no separation of the tax from the price of the beverage is shown on the price list or on the bills, the tax is on the price including the tax.

The facts in the case indicate that during the period from February, 1919, to June, 1920, a certain company paid the 10 per cent beverage tax on the charges made by it for the sale of its beverages. It was later claimed that the charge made by it was not in fact the price of the beverage but was the price of the beverage and an additional item representing the tax. Acting upon this representation, the deputy collector reported that the company was entitled to a refund or to take credit on subsequent payments of the excess amount already paid. The company chose to take credit. Later it appeared that the tax had been properly paid during the period in question, and consequently the credit claimed was denied, thus leaving the amount outstanding on subsequent liability. The company then filed claim for abatement.

The evidence shows that the company's price list showed "Federal tax paid." That is the only notice the customer had relative to the tax. Price lists and bills do not show that tax was charged in addition to price but indicate entire charge was represented as the price for which product was sold. In some cases, the price of the beverage was raised and in some it was not. In the cases where it was raised the increase was not in the exact amount of the tax but covered other items as well as the tax.

The law and the regulations (section 628 of the Revenue Act of 1918 and article 8 of Regulations 52 (1919)) provide that the tax is upon the sale by the manufacturer and is measured by the price for which the beverage is sold. In Law Opinion 1007 (not published, but partially incorporated in article 3 of Regulations 47, revised 1920 and 1921) it was held that if the quotations or agreement shows what amount or portion of the quoted price represents tax, and the manufacturer subsequently invoices the goods to the purchaser, separating the quoted price into two items of tax and selling price, the tax is computed only upon that part of the original quotation which represents the selling price. It was also specifically held in

[1] Not published in Bulletin service.

the same opinion that "mere general statements or agreements that the price includes tax do not operate to exclude from tax any part of the total amount paid by the purchaser to the manufacturer." This opinion has never been overruled, but has been followed in every case coming before this office. A careful consideration of the arguments presented in this case does not seem to warrant any change in the above rulings.

The facts in the present claim show clearly that no separation of the tax from the price of the beverage was made either in the quotations or billings, and the claim should be rejected.

TITLE VI.—TAX ON BEVERAGES AND CONSTITUENT PARTS THEREOF.

SECTION 603(b), REGULATIONS 52, ARTICLE 26: Registration. II–19–1047 T. D. 3504

Time for registry under the provisions of article 37, Regulations 43, Part 1, and article 26 of Regulations 52, extended.

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

To collectors of internal revenue and others concerned:

The first paragraph of article 26 of Regulations 52 (revised December, 1921) is hereby amended to read as follows:

ART. 26. *Registration.*—Every manufacturer of cereal beverages; of unfermented fruit juices or imitations thereof; of still drinks; of natural or artificial mineral waters or table waters, or imitations thereof; of finished or fountain sirups; of carbonic-acid gas who sells such gas to a manufacturer of carbonated beverages, or to a person conducting a soda fountain, ice cream parlor, or other similar place of business; of carbonic-acid gas who uses such gas in the production of carbonated beverages; of carbonated beverages made with concentrates, essences, or extracts; of carbonated beverages made by use of finished or fountain sirups manufactured by such manufacturer; and every person conducting a soda fountain, ice cream parlor, or other similar place of business who manufactures any sirups of the kind mentioned in article 13, shall annually, on or before the last day of July, or if that day fall on a Sunday or legal holiday, then on the next secular or business day, or within 10 days after commencing business, make an application for registry, by filling out Form 848, with all information there called for, and duly execute it under oath.

NOTE.—Superseded by T. D. 3417, below.

SECTION 603(b), REGULATIONS 52, ARTICLE 26: Registration. II–25–1114 T. D. 3517

Change in the provisions of article 37, Regulations 43, Part 1, and article 26 of Regulations 52, relating to registry.

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

To collectors of internal revenue and others concerned:

Article 26 of Regulations 52 (revised December, 1921), previously amended by Treasury Decision 3504 [above], is hereby further amended to read as follows:

ART. 26. *Registration.*—Every manufacturer of cereal beverages; of unfermented fruit juices or imitations thereof; of still drinks; of natural or arti-

ficial mineral waters or table waters, or imitations thereof; of finished or fountain sirups; of carbonic-acid gas who sells such gas to a manufacturer of carbonated beverages, or to a person conducting a soda fountain, ice cream parlor, or other similar place of business; of carbonic-acid gas who uses such gas in the production of carbonated beverages; of carbonated beverages made with concentrates, essences, or extracts; of carbonated beverages made by use of finished or fountain sirups manufactured by such manufacturer; and every person conducting a soda fountain, ice cream parlor, or other similar place of business who manufactures any sirups of the kind mentioned in article 13, shall, on or before January 1, 1922, or within 10 days after commencing business, make an application for registry, by filling out Form 848 with all information there called for, and duly execute it under oath. Such application shall be made to the collector in whose district his place of business is located.

Upon receipt of application on Form 848 the collector will execute and mail to the applicant Form 848–A certificate of registry, which must be kept posted in a conspicuous place in the registrant's place of business at all times. This certificate is not transferable from one person to another or from one place of business to another.

The law provides a penalty of $1,000 for failure to register or for failure to keep certificate of registration posted.

TITLE VIII.—TAX ON ADMISSIONS AND DUES.

TAX ON ADMISSIONS.

SECTION 800, REGULATIONS 43–I, ARTICLE 37: Application for and certificate of registry. II–19–1048 T. D. 3504

The first sentence of article 37, Regulations 43, Part 1 (revised January, 1922), previously amended by Treasury Decision 3394 [C. B. I–2, p. 289], is hereby further amended to read as follows:

Application for and certificate of registry.—Every individual, corporation, partnership, or association (1) required by the provisions of the Act to collect any tax on admissions (see art. 35) or (2) being the owner or lessee of any place which is ordinarily or at times leased to other persons who impose charges for admissions to it (see art. 42) or (3) required to pay any tax on charges in excess of established price (see art. 36) shall annually, on or before the last day of July, or if that day fall on a Sunday or legal holiday, then on the next secular or business day, or within 10 days after commencing business, make an application for registry, by filling out Form 752 (revised), with all information there called for, and duly execute it under oath.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved August 4, 1923.

S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

NOTE.—Superseded by T. D. 3517, below.

SECTION 800, REGULATIONS 43–I, ARTICLE 37: Application for and certificate of registry. II–25–1115 T. D. 3517

Article 37, Regulations 43, Part 1 (revised January, 1922), previously amended by Treasury Decisions 3394 [C. B. I–2, p. 289] and 3504 [above], is hereby further amended to read as follows:

Application for and certificate of registry.—Every individual, corporation, partnership, or association (1) required by the provisions of the Act to collect

any tax on admissions (see art. 35) or (2) being the owner or lessee of any place which is ordinarily or at times leased to other persons who impose charges for admissions to it (see art. 42) or (3) required to pay any tax on charges in excess of established price (see art. 36) shall on or before July 31, 1922, or within 10 days after commencing business make an application for registry, by filling out Form 752 with all information there called for, and duly execute it under oath: *Provided,* That registration shall not be required of any such individual, corporation, partnership or organization required to file Form 11 and pay tax under section 1001, subdivision (5), of the Act.

In cases falling within the first of the above classes (except such as are considered in art. 38) such an application must be filed in the office of the collector of internal revenue of each district in which is located a place to which admissions are charged on account of which a duty to collect admissions taxes is imposed on the person making such application. In cases falling within class (2) the application must be filed in the office of the collector of internal revenue of each district in which such a place is owned or leased. In cases falling within class (3) the application must be filed in the office of the collector of internal revenue of the district in which is located the principal place of business of the person making the application, or in which is located his residence, if he have no fixed place of business. The collector, if satisfied that all the statements made in the application for registry are correct, will issue a certificate of registry on Form 753 to the person who made such application. This certificate must be kept conspicuously posted in the principal place of business of such person, or be carried about with him, if he has no fixed place of business. This certificate is not transferable from one person or firm to another, or, except in the case of a traveling show, or similar organization, from one place of business to another.

EXAMPLE: A certain hotel has a number of rooms which it rents from time to time for dances and other parties. This hotel falls within class (2) of article 37 and must make application for registry.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 17, 1923.

A. W. MELLON,
Secretary of the Treasury.

TAX ON DUES.

SECTION 801, REGULATIONS 43–II, ARTICLE 9: Dues or membership fees. II–27–1133 S. T. 427

Where an amount designated for capital expenditures is included in the dues imposed by the by-laws of a club such dues are subject to the tax on the whole amount.

It will be observed that under the language of article 9 of Regulations 43, Part 2, revised April, 1919, as amended by T. D. 3439 (C. B. II–1, p. 270), the tax imposed by section 801 of the Revenue Acts of 1918 and 1921 attaches to amounts paid as dues and assessments, excepting that portion of assessments imposed for capital expenditures. The commonly accepted meaning of the term "dues" when used to describe the obligations of a club member means the obligation into which the member enters to pay a sum, fixed usually by the by-laws, at recurring intervals, for the maintenance of the organization. The term "assessment" when used in the same connection means a levy or burden imposed as a single act as distinguished from recurring acts.

Where an amount designated for capital expenditures is included in the dues imposed by the by-laws for regularly recurring pay-

ment, such dues are subject to the tax on the whole amount as dues, and no part comes within the exception provided by T. D. 3439 for assessments imposed for capital expenditures. Such regularly recurring payments are not assessments within the meaning of that term as commonly understood, but come more properly within the term " dues " as above set out.

COLLECTION, RETURN, AND PAYMENT OF TAX.

SECTION 802, REGULATIONS 43–I, ARTICLE 35; REGULATIONS 43–II, ARTICLE 12: Duty to collect, return, and pay tax. II–36–1244 S. T. 435

> Where a theater has kept a special account with a national bank for the deposit of admissions taxes collected and the bank closes its doors, adjustment may be made with the theater through a claim for abatement of the amount actually lost when the amount of such loss is determined after the affairs of the bank have been liquidated and settlement made with its depositors.

The M Theater had always kept a special account for the deposit of admissions taxes collected in a national bank, which closed its doors in March, 1923, and due to this fact the theater was unable to pay any tax for the month of February, the total amount of which was deposited in the account referred to, as well as a portion of the amount for the month of March. In filing returns for these months the theater attempted to take credit for the amount deposited in the admissions tax account with the bank.

Under the Regulations of the Department dealing with the admissions tax, the right to claim credit exists only in case of " overpayment or overcollection," where, as a result of an error, an excess amount has been collected or paid. (See article 43, Regulations 43, Part 1 (revised January, 1922).) The M Theater can not, therefore, be permitted to take credit in its monthly return for the amount on deposit at the national bank at the time that bank closed its doors.

Under Law Opinion 1112 (C. B. II–1, p. 274), a special collector of admissions taxes is relieved of liability for taxes collected only to the extent of the loss actually sustained through the failure of the bank in which the tax money was deposited. The actual amount of such loss in the instant case can be determined only after the affairs of the bank have been liquidated and settlement has been made with its depositors. When through such settlement the actual loss has been determined adjustment may be made with the special collector through a claim for abatement of the amount actually so lost.

In this connection it is noted that section 3466, R. S., which gives the United States priority for all claims it has against insolvent debtors, does not apply to the case of an insolvent national banking association. (*Cook County Nat. Bank* v. *United States*, 107 U. S., 445, 450; *Jackson* v. *United States*, 20 Ct. Cls., 298.)

TITLE IX.—EXCISE TAXES.

SALES BY THE MANUFACTURER.

SECTION 900. REGULATIONS 47. ARTICLE 3: Basis of tax. II–32–1186 S. T. 430

Where a manufacturer of automobiles refunds to a distributor $5 of the amount named in the contract of sale as the price of the car, upon receipt from the distributor of a so-called owner's reference card, the manufacturer is not entitled to a reduction in the amount of tax paid on the original sale.

Where, however, the contract of sale provides for the deposit by the distributor with the manufacturer of a stipulated sum to insure the return of the "owner's reference card," and such sum is billed as a separate item, it is not a part of the sale price of the car for the purpose of computing the tax.

Where under a contract between a manufacturer of automobiles and a distributor the distributor agrees to deposit with the manufacturer a certain sum to guarantee the carrying out by him of a specified advertising program, such sum to be collected by the manufacturer by adding as a separate item on the invoice of each car sold to the distributor, until the amount of the guaranty is collected, an advertising charge of $25, such charge is not taxable as a part of the sale price of the cars.

SECTION 900, REGULATIONS 47, ARTICLE 6: Credit for taxes already paid. II–36–1245 S. T. 436

> Credit under article 6 of Regulations 47 can not be taken on account of taxable parts purchased by a dealer or assembler from another dealer or assembler who reimbursed the manufacturer for the tax.

The going business of an automobile dealer was taken over by a purchaser. Among the assets acquired were automobile bodies and chassis the taxes on which had been reimbursed to the manufacturer by the former dealer, and the question arose whether credit for such taxes may be taken by the successor in the business when he makes return and payment of taxes on automobile trucks manufactured by him.

Article 6, Regulations 47 (revised), specifically limits the right to take credit to those cases where the tax on the component parts of the taxable article manufactured is "in fact" reimbursed by the manufacturer of such article to the manufacturer of such component parts. In other words, the purchaser in the instant case is entitled under the regulations to take credit for the tax paid on chassis and bodies used by him in the manufacture of cars only in those cases where he himself reimburses the manufacturers of such chassis and bodies for the tax paid thereon. But under the facts stated not he but the dealer from whom he purchased the chassis and bodies reimbursed the manufacturers thereof for the tax. He is, therefore, not entitled to take credit for the tax paid on such chassis and bodies.

SECTION 900, REGULATIONS 47. ARTICLE 8: Tax payable by the manufacturer. II-15-993 S. T. 419

Certain manufactured fur articles taxable under section 900(19) of the Revenue Act of 1918 were received as collateral on loans made by certain bankers to the manufacturers. Upon default in the conditions of the loans the greater part of the furs were sold at public auction by the bankers.

The manufacturers were subject to the tax upon the basis of the prices received by the bankers, and the bankers were not subject to the tax.

It appears that, among other activities, a certain firm is engaged in business as private bankers. In this capacity they made advances to a certain manufacturing furrier, and received as collateral security certain manufactured fur articles. Under the terms of a written agreement between the parties, the bankers were given the right upon default in payment of principal or interest by the pledgor to make an immediate sale of the collateral deposited and to apply the receipts in discharge of the obligations. The manufacturing furrier being unable to discharge his obligations, the greater part of the furs were sold at public auction by the obligee, and the proceeds applied in discharge of the obligation.

Section 900 of the Revenue Act of 1918 provides in part:

That there shall be levied, assessed, collected and paid upon the following articles sold or leased by the manufacturer, producer or importer a tax equivalent to the following percentages of the price for which so sold or leased.

* * * * * * *

(19) Articles made of fur on the hide or pelt, or of which any such fur is the component material of chief value, * * *.

Article 7 of Regulations 47 (revised December, 1920) contains the following definition of a manufacturer:

A manufacturer is generally a person who (1) actually makes a taxable article, or (2) by changes in the form of an article produces a taxable article, or (3) by the combination of two or more articles produces a taxable article.

It is thus seen that the Act imposes the tax in question upon sales or leases of the specified articles by the manufacturer, producer, or importer. A manufacturer is defined by the regulations as one who makes or produces a taxable article. The plain meaning of the taxing Act and the regulations promulgated thereunder is that a sale to be taxable must be made by the manufacturer of the taxable article sold. Any other construction of section 900 would destroy the character of the tax as a manufacturer's sales tax in respect to the articles therein enumerated. In view of the foregoing, it is clear that the bankers in this case do not incur liability to the payment of the above tax under the circumstances involved. (See S. T. 378, C. B. I-1, p. 440.)

An examination of the provisions of the written instrument signed by the manufacturing furrier, a copy of which has been furnished, indicates that it is nothing more than a simple contract of pledge. It does not possess the essential elements of a chattel mortgage. A mortgage of goods is something more than a pledge. It is a pledge to become an absolute interest if not redeemed at the specified time. After the condition forfeited the mortgagee has an absolute interest in the thing mortgaged. The agreement in question does not transfer

title to the goods pledged to the obligee either presently or upon default by the obligor. The instrument merely recited that—

> Upon default in any payment of principal or interest at the times or on the terms herein provided or upon the nonperformance by the undersigned of any of the agreements or conditions herein contained * * * said bankers are hereby authorized immediately to sell the whole or any part of the aforesaid collateral or any substitutes therefor or additions thereto at any broker's board or at public or private sale, at the option of the said bankers * * *.

With regard to the respective rights of the parties to a contract of pledge, it is well settled that the general property in the thing pledged remains in the obligor. (*McLeod* v. *St. Louis Fourth National Bank*, 122 U. S., 528; *Anderson* v. *Pac. Bank*, 44 Pac., 1063; *Rochester Bank* v. *Jones*, 4 N. Y., 497.) The general property in the pledge remains in the obligor after as well as before default. The default of an obligor to pay his debt at maturity in no way affects the nature of the obligee's rights concerning the property pledged except that he then becomes entitled to proceed to make the security available in the manner prescribed by law or by the terms of the contract. (21 R. C. L., 651, and cases cited.)

In a note in 4 L. R. A. at page 305 it is stated that:

> The obligee acquires only a special property which is not enlarged by the mere fact that the obligor fails to pay the debt at the time specified; whereas by such a failure the legal estate of the mortgagee becomes ipso facto complete and absolute.

Numerous cases in support of this principle are cited in the note.

Under the doctrine of the above authorities it is clear that the general property in the manufactured fur articles never vested in the present bankers but on the contrary such property remained in the manufacturer, subject only to the outstanding lien of the obligee. It follows necessarily, therefore, that in making sales of the pledged articles the obligee is in effect acting merely as a special agent or representative of the obligor. It is true that he has authority to sell the pledged article, but this authority is vested in him only by reason of the contract of pledge under the provisions of which the owner confers upon him such authority to be exercised in the event of a certain contingency, namely, the default of the obligor. The fact that the powers which may be exercised by the obligee under the terms of the contract of pledge are limited does not render him any the less an agent of the obligor while effecting a sale of the pledged articles and applying the profits in the discharge of the obligations of the obligor.

Accordingly, it is held that the manufacturer of the fur articles in question incurs the manufacturer's tax liability upon the sale of the pledged articles by the bankers, and that the basis for the assessment of such tax is the sum for which the fur articles were sold at public auction by the pledgee.

The above ruling does no violence to the opinion in the case of In re Whipple File Company (1870) (Fed. Cas. 17522). In that case it was held that the assignees of a bankrupt manufacturer selling his goods in the course of their trust in the condition in which they found them were not bound to pay the tax imposed by the Act of March 31, 1868, on manufacturers. The report of that case, supple-

mented somewhat by remarks from 12 Internal Revenue Record, 98, refers to the status of the assignees and reads in part as follows:

> Nor can it be said that they (the assignees) are agents of the manufacturer. No doubt they have full power over the property, but not as agents. They are trustees appointed by the creditors under the authority of the court, and not by the bankrupt, and their sales are not the bankrupt's sales. These goods have reached the market, undoubtedly, without being taxed, but this is by the misfortune of the owners who ceased to be able to sell and pay the tax thereon.

The facts in the instant case are readily distinguishable from those in the Whipple case. In the latter the assignees are appointed by the creditors under the authority of the court; in the former the obligee is selected by the obligor and derives his authority to make the sales directly from the obligor under the terms of a contractual relation which the parties enter into. Furthermore, the pledgor could at any time prior to the sale by the pledgee have sold the articles pledged to a third party and such third party would thereby secure title to the goods subject only to the lien of the pledgee. (*Austin* v. *Vanderbilt* (Ore.), 85 Pac., 519; 6 L. R. A. (N. S.), 298.)

SECTION 900, REGULATIONS 47, ARTICLE 10: Sales to the Government or a State.

(See T. D. 3536; sec. 900, Reg. 47, art. 11.) Sales to a city held taxable.

SECTION 900, REGULATIONS 47, ARTICLE 11: Automobiles: Scope of tax. II-38-1268 T. D. 3536

EXCISE TAXES—SALES BY MANUFACTURER—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

1. EXCISE TAX—AUTOMOBILE TRUCKS AND AUTOMOBILE WAGONS—DEFINITION.

The term "automobile" as employed by Congress in section 600(a), Revenue Act of 1917, and section 900 (1) and (2), Revenue Act of 1918, was used in a broad sense and intended to include all self-propelled vehicles that by common speech come within the category of automobiles, automobile trucks, and automobile wagons.

2. SAME—FIRE-FIGHTING APPARATUS, SELF-PROPELLED.

The characteristics of an automobile are not materially altered by fixing to the chassis or frame devices or machinery of one kind or another that may make or tend to make the completed vehicle useful for a special purpose, and fire-fighting apparatus having a specially designed chassis adaptable for riveting pumps, retaining hooks for ladders and axes, etc., or motors constructed for greater speed, is nevertheless taxable as an automobile truck or automobile wagon.

3. STATUTORY CONSTRUCTION—AUTOMOBILE TRUCKS AND AUTOMOBILE WAGONS.

It is a familiar rule of statutory construction that the words, phrases, and terms used by the legislative body must always be given effect by the court in its endeavor to ascertain and determine the intention of Congress in passing a statute. To hold that self-propelled fire engines and other motor-driven fire machines

were not intended to be taxable, because not specifically described as one of the objects to be taxed, or because a term or phrase of wider scope was not used, would disregard the similitude that modern fire engines and self-propelled apparatus for conveying hose, hooks and ladders, firemen, etc., to a fire bears to the general terms selected by Congress for the imposition of the tax upon all vehicles of that particular class.

4. EXEMPTIONS FROM TAX—EXCISE TAX—STATE AGENCIES—AUTOMOBILE TRUCKS AND AUTOMOBILE WAGONS SOLD TO MUNICIPALITIES.

The tax on the sale of automobile trucks and automobile wagons by the manufacturer thereof is not a direct tax on the municipality to which such articles are sold, nor on the articles acquired, but is imposed upon the manufacturer for the privilege of vending and dealing in the manufactured articles.

5. DEPARTMENTAL RULING—ERRONEOUS INTERPRETATION—RETROACTIVITY.

An erroneous interpretation of a statute by the Commissioner of Internal Revenue does not exclude the United States from the right to collect a tax on subsequent modification of the earlier ruling, nor has the later interpretation created equities which in fairness require the judicial adoption of the first interpretation.

6. EXCISE TAX—SALES BY MANUFACTURERS—ASSESSMENT.

The taxes imposed by section 600 of the Revenue Act of 1917 required no assessment and monthly returns were necessary under oath by each manufacturer or producer, and payment of the tax became self-executing.

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

To collectors of internal revenue and others concerned:

The appended decision of the United States District Court for the Western District of New York in the case of *American LaFrance Fire Engine Company* v. *Riordan, collector*, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 11, 1923.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF NEW YORK.

American LaFrance Fire Engine Company, Inc., v. *Vincent H. Riordan, Collector of Internal Revenue.*

[November 7, 1923.]

HAZEL, District Judge: In this action the plaintiff, American LaFrance Fire Engine Company, Inc., asks to have refunded to it by the defendant, Collector of Internal Revenue Vincent H. Riordan, an excise tax of $30,578.17 (less tax of $222.49 on two sales) paid at different times in the years 1918 and 1919 under compulsion and protest (sec. 3220 R. S.). The taxes were assessed as manufacturers' sales taxes on automobile trucks to which fire-extinguishing appliances were for the most part permanently attached by plaintiff. The claim for refund was rejected by the Commissioner of Internal Revenue on the ground that the motor fire-fighting vehicles were taxable under the Revenue Acts as automobile trucks and automobile wagons. Plaintiff

alleges in the complaint that the assessments were wrongfully, unjustly, and illegally made in that its manufactured motor-driven apparatus were not included in the statute and are therefore not subject to taxation. The evidence largely relates to structure and function of plaintiff's apparatus and various facts have been stipulated by the parties.

It is stated that this is a test case and that a much larger amount is involved than the recovery sought herein.

The first question is whether certain specified fire-fighting apparatus is included in the statute and classification, and, second, whether the products of plaintiff, sold to municipalities, were exempt from taxation. Section 600 reads as follows:

"That there shall be levied, assessed, collected, and paid—

"(a) Upon all automobiles, automobile trucks, automobile wagons, and motor cycles, sold by the manufacturer, producer, or importer, a tax equivalent to 3 per centum of the price for which so sold; * * *"

Subsequently the Revenue Act of 1918, in effect February 25, 1919, was passed by Congress. It reads as follows:

"SEC. 900. That there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold or leased—

"(1) Automobile trucks and automobile wagons (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), 3 per centum;

"(2) Other automobiles and motor cycles (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), except tractors, 5 per centum."

In these provisions Congress classified and referred to various kinds of motor vehicles which were subject to the tax. The apparatuses in question are embodiments of self-propelled vehicles designed to traverse roads and streets at different speeds. It is necessary to determine on the issues, first, whether plaintiff's vehicles were taxable as automobile trucks and automobile wagons. The proofs are that some of the chassis used to carry the fire machinery were manufactured by plaintiff, others (Ford motor trucks) were purchased in the open market, and chassis of another manufacturer (Brockway auto trucks) were also utilized for attaching thereto fire-extinguishing appliances, pumps, chemical engines, ladders, etc. Hose and tools are carried to fires, together with 8 to 10 firemen who stand on running boards of some of the motor vehicles.

The term "Automobile, automobile truck" was concededly interpreted by the Commissioner of Internal Revenue on January 12, 1918, to include any self-propelled vehicle irrespective of the nature of its use, and that to fall within those terms it was essential that the vehicle or conveyance be used primarily for the transportation of persons or property other than the machine itself. By this interpretation motor fire engines and fire-fighting machines, if constructed to carry only such persons as were required to drive them, were excluded from the scope of the tax. Regulations No. 47 as amended (arts. 11, 12, and 13), stating that the tax applied to automobile trucks even though "persons may incidentally be transported at the same time," modified the previous rulings. Hook and ladder trucks, hose wagons, and squad cars were held taxable, and taxes were paid thereon by plaintiff under protest even though the sales were made to municipalities. It was afterwards ruled (Regulations 44) that sales of motor fire engines and motor transporting apparatus to States and political subdivisions were not taxable as automobiles or as automobile trucks, and the taxes paid were refunded. Fire engines designed to carry only such persons as are necessary to drive them were ruled not taxable, but those designed to carry firemen not particularly employed in driving the machine were taxable as automobiles. On October 7, 1919, article 11 was amended [T. D. 2930] to hold fire engines nontaxable if designed to carry only persons necessary to drive them and to operate the pumps, but if they were manufactured to carry firemen beyond the required number to operate the machine they were separately taxable as passenger-carrying automobiles. Automobile trucks equipped as hook and ladder trucks and hose carts were also held taxable.

The uncertainty and indefiniteness of some, if not all, the various rulings by the Commissioner was finally laid at rest on July 22, 1919, by the promul-

gation of a revised regulation [T. D. 2987] that motor fire engines and motor fire-fighting apparatus, hose carts, hook and ladder trucks, water-tower trucks, etc., were subject to taxation as automobile trucks and automobile wagons regardless of sales to municipalities.

It is strongly urged by plaintiff on the first point that this was an erroneous ruling, since the fire engines and fire apparatuses were not primarily designed to carry either persons or property, their construction plainly showing that their sole object and purpose was to function as machines in extinguishing fire. It is argued that if Congress had intended to include self-propelling fire engines and other motor-driven fire machines it would, in view of the history of such machines and apparatuses, have embodied a particular description of the objects to be taxed, or used a term or phrase of wider scope than is to be imputed to any generic designation, and having failed to do so, the inference is justifiable that fire-fighting engines and apparatus were not intended to be taxable. The argument, however, disregards, as it seems to me, the similitude that modern fire engines and self-propelled apparatus for conveying hose, hook and ladders, firemen, etc., to a fire bears to the general terms selected by Congress for the imposition of the tax upon all vehicles of that particular class. It is a familiar rule of statutory construction that the words, phrases, and terms used by the legislative body must always be given effect by the court in its endeavor to ascertain and determine the intention of Congress in passing a statute. Its enactments are never to be defeated by adhering too strictly to the letter thereof (*Gates* v. *Nat. Bank*, 100 U. S., 244; Lewis's Sutherland on Statutory Construction, Vol. II (2nd ed.), sec. 363), and when the Revenue Act of 1917 was passed Congress saw fit to use the words "all automobiles, automobile trucks," fixing a tax of 3 per cent; but in 1918 it specifically included automobile trucks and automobile wagons in fixing the tax at 3 per cent, tending to show that automobile wagons not previously included were then being sold. The classifying words "other automobiles," in fixing a higher rate, were used to include all forms and types of passenger-carrying motor vehicles, and hence the term "automobile" is employed, in my opinion in a broad sense and with a view of including all self-propelled vehicles that ordinarily by common speech come within the category of automobiles, automobile trucks, and automobile wagons.

It is a uniform rule of interpretation of tax-levying statutes not to extend their provisions by implication or to enlarge their scope with a view of including matters or articles not specifically mentioned, and in case of doubt they are construed against the Government and in favor of the citizen. (*Gould* v. *Gould*, 245 U. S., 151.) But as said in *Baltimore Talking Board Co.* v. *Miles* (280 Fed., 661), a doubt as to the meaning of a statute must be one which remains after all recognized rules for ascertaining its meaning have been tried, and such a doubt is often removed by consideration of the legislative intent as appearing by the entire statute. A narrow meaning of a word is rarely given a revenue statute, and the adjudications uniformly hold that words of general description often embrace an unnamed article or one that was not thought of by the enacting power at the time the act was passed.

The characteristics of an automobile vehicle are not materially altered by fixing to the chassis or frame devices or machinery of one kind or another that may make or tend to make the completed vehicle useful for a special purpose. It makes no difference that the chassis is specially designed or enlarged or made adaptable for riveting pumps, retaining hooks for ladders and axes, the fire extinguisher, and running board for use of the firemen, or that the motors are constructed for greater speed than automobiles or other self-propelled vehicles. The ordinary meaning of the term "automobile" in its early stages was, I believe, restricted to self-propelled vehicles used for the transportation of passengers, as testified by Prof. Krapp, but I think Congress, in fixing the excise taxes applicable to self-propelled vehicles, used the terms "automobile," "automobile wagon," "automobile truck," in a broader sense and intended to include all power vehicles generally that were ordinarily used for transportation on streets and roads. It was a war measure to increase revenue for required governmental purposes and hence technical or illiberal construction should be avoided. Indeed, freedom for taxation should not "be assumed unless the language used is too clear to admit of doubt." (*Vicksburg* v. *Rd. Co.*, 116 U. S., 668.) It must be conceded that motor-driven fire apparatus at the time the tax was imposed was in a formative stage, and there existed perplexity as to the exact meaning of the terms used and their applicability. In Webster's International Dictionary the noun "automobile" is defined "an

automobile vehicle or mechanism; a specially self-propelled vehicle suitable for use on the street or roadway," while the adjective is defined as containing "means of propulsion within itself, self-propelling, as an automobile, torpedo, or car." These definitions and others found in the briefs lead to the conclusion that the omission to mention motor vehicles used for conveying fire apparatus was not intentional, but on the contrary the language used, in its entirety, contemplated their inclusion.

In the Act of 1918, establishing a tax at different rates, there is contained the exception of tractors—an exception following the words "Other automobiles and motor cycles," from which the point is contended that if Congress intended to exempt self-propelled fire vehicles it would undoubtedly have made a similar exception. The point has significant merit. The terms "automobile," "motor vehicles," "motor car," are often used synonymously with each other (Railroad [Ruling] Case Law, vol. 2, p. 1167; *Bethlehem Motor Corp.* v. *Flynt*, 100 S. E., 693); and in this view it can not be doubted that plaintiff's productions, motor trucks and carts, with its different fire-fighting parts, clearly constituted automobile trucks, for by that term is implied and ordinarily understood every description of conveyance for the transportation of either person or property on land with perhaps the single exception of the street car. (*Balthasar* v. *Pacific El. Ry. Co.*, 19 A. L. R., 452.)

Plaintiff's point that its vehicles or machines were not primarily intended for transporting persons or property or things, and hence are not included in the classification of section 900 or any of the definitions of the words "automobile" and "automobile truck," is not in my opinion sustained, since firemen and drivers and loads of course were intended to be carried to and from fires. To argue that their transportation was merely incidental to the operation of the machines or the extinguishing of fires is beside the point if the view taken is correct that Congress used broad and comprehensive terms in which plaintiff's productions are fairly included.

The next contention arises from the sales of fire trucks and apparatus to municipalities. It is perfectly true that the Federal Government can not burden the State or subdivision thereof to which automobile trucks, etc., were sold by plaintiff by imposing taxes upon them, although there is no express provision of the Constitution prohibiting it. The well-established exception of States and their subdivisions from tax by the Federal Government is implied from our dual system of government and the principle that the National and State Governments must function separately and separately maintain instrumentalities for conducting their governmental operations, and accordingly the States and municipalities can not be hampered or impaired in administering their own affairs by the taxing power of the National Congress. The tax in the present instance, however, was not a direct tax on the municipalities to which articles were sold, nor on the articles acquired. The tax imposed on plaintiff was for the privilege of vending and dealing in the manufactured articles. (Sec. 602.) There was no connection as agent or otherwise between plaintiff and the municipalities. It does not relieve plaintiff that sales to municipalities were under contract. This principle of taxation on sales finds support by analogy in various cases decided by the Supreme Court, of which *U. S.* v. *Perkins* (163 U. S., 625); *Snyder* v. *Bettman* (190 U. S., 249 (T. D. 666)); and *South Carolina* v. *U. S.* (199 U. S., 433 (T. D. 961)) are believed fair examples. The first two cases related to taxation of bequests to the United States and to States and municipalities. The court held that the taxes imposed were upon the right to acquire property by succession or will and not upon the property of the State or municipality. In the South Carolina case certain persons, as agents of the State, were selling intoxicating liquor, and the court held that the salesmen were not relieved from paying the internal revenue tax even though they had no interest in the profits since the tax was not upon the property of the State but upon the means by which that property was acquired. By a parity of reasoning the municipalities which bought fire vehicles are not in fact required to pay the tax, and hence the liability therefor is upon the manufacturer or salesman.

It is next urged that the earlier ruling by the Commissioner that the excise tax did not apply shows a persuasive uncertainty as to the inclusion of plaintiff's structures. In answer to this contention it must suffice to say that the erroneous interpretation of the statute by the Commissioner did not exclude the United States or the defendant from the right to impose and collect the tax on subsequent modification of the earlier rule. Nor has the later interpretation created equities which in fairness require the judicial adoption of the first in-

terpretation. The tax is prescribed by statute, and, under section 601 of the Revenue Act of 1917, no assessment was required, but monthly returns were necessary under oath by each manufacturer or producer, and payment of the tax apparently became self-executing. (*Dollar Savings Bank* v. *U. S.*, 19 Wall., 227 (T. D. 111); *Christi[e] St. Com. Co.* v. *U. S.*, 129 Fed., 506.) It is true that a construction by an executive department upon an Act of Congress ought not to be lightly overturned either by the department itself or by the court (*Edwards* v. *Wabash Rd. Co.*, 264 Fed., 610 (T. D. 3002)), and it should not be done without cogent and persuasive reasons.

In the present case careful consideration has been given to the various questions involved, but in view of the conditions prevailing at the time the statute was passed, the emergency of war, and what seems to me to have been the evident intention of Congress to impose an excise tax on all kinds of automobiles and automobile trucks and wagons, in which, without express exception, plaintiff's productions are included, I am constrained to the view that the ruling in favor of imposing the tax was correct and the original rulings were erroneous. The exception of tractors in the enactment adds force to the view that the intention of Congress is clearly expressed in the general language employed in both Acts. A case of long-continued executive construction and payment of tax thereunder and adoption by Congress in consequence thereof is not presented, and hence the adjudications cited by plaintiff on that point are not controlling.

My conclusion is that the excise taxes paid by the plaintiff under sections 600 and 900 of the Revenue Acts were legally exacted. A decree may be entered dismissing the bill with costs.

SECTION 900, REGULATIONS 47, ARTICLE 11: Automobiles: Scope of tax. II–36–1246 S. T. 437

Electric trucks complete except for batteries and paint are substantially completed within the meaning of the regulations, and their sale is taxable when made by a manufacturing corporation to another corporation purchasing and continuing its business.

SECTION 900(3), REGULATIONS 47, ARTICLE 15: Definition of parts. II–22–1076 S. T. 426

Spark plugs are not subject to the excise tax imposed by sections 900(3) of the Revenue Acts of 1918 and 1921.

Sections 900 of the Revenue Acts of 1918 and 1921 impose a tax upon certain articles sold or leased by the manufacturer, as follows:

(1) Automobile trucks and automobile wagons (including tires, inner tubes, parts and accessories therefor, sold on or in connection therewith or with the sale thereof), 3 per centum;

(2) Other automobiles and motor cycles (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof), except tractors, 5 per centum;

(3) Tires, inner tubes, parts, or accessories for any of the articles enumerated in subdivision (1) or (2), sold to any person other than a manufacturer or producer of any of the articles enumerated in subdivision (1) or (2), 5 per centum;

Article 15 of Regulations 47 (revised December, 1921) defines a part as follows:

A "part" for an automobile truck, automobile wagon, other automobile, or motor cycle is any article designed or manufactured for the special purpose of being used as or to replace a component part of any such vehicle and which by reason of some peculiar characteristic is not such a commercial commodity as would ordinarily be sold for general use and which is primarily adapted only for use as a component part of such vehicle.

The term includes bodies, wheels, engines, springs, axles, radiators, etc. When sold separately a side car and a so-called trailer or "semitrailer" so designed that a portion of the load or the weight thereof is carried or borne by the tractor or "semitractor" are taxable as "parts."

Mere stock or commercial commodities, such as bolts, nuts, washers, screws, etc., though used as components for such vehicles, are not "parts" within the meaning of subdivision (3). Articles, however, which would ordinarily be classed as commercial commodities become parts when, because of their design or construction, they are primarily adapted for uses as component parts of such vehicles.

It is a well-known fact that spark plugs were in use for many years before automobiles came into existence. It is also common knowledge that they are used on all kinds of internal-combustion engines, both stationary and portable. It is stated that all the drawings and illustrations in the files of the Patent Office show the use of spark plugs in stationary engines. Spark plugs are made in a few standard sizes, and all engines in which they are to be used are designed for the standard size plugs. There is no question but that the same spark plugs are interchangeable in both stationary and portable engines. While they are used very extensively in automobiles, the same plugs are used in motor boats, airplanes, farm tractors, road graders, railway locomotive engines, thrashing engines, concrete mixers, water pumps, hoisting machines, and for innumerable other purposes.

In S. T. 380 (C. B. I–1, p. 444) it was held that piston rings not designed or manufactured with some peculiar characteristic which made them primarily adaptable only on or in connection with automobiles are not taxable. In S. T. 395 (C. B. I–2, p. 295) it was held that leaf springs, other than highly specialized leaf springs such as auxiliary shock-absorbing devices using the leaf-spring principle, which are not primarily adapted only for use as a component part of an automobile or motor cycle are not taxable. In S. T. 408 (C. B. II–1, p. 285) it was held that miniature incandescent electric light bulbs for use in automobile lamps are commercial commodities and not subject to tax. These rulings were made on the principle that under the definition contained in the regulations it is clear that an article which is sold for general use other than in connection with automobiles and which has no peculiar characteristic in its design or manufacture which adapts it primarily only for use in connection with automobile trucks, automobile wagons, other automobiles, or motor cycles, is not subject to tax as a part, although sold for use in or upon any such vehicle.

Applying the principle in the above cases to spark plugs, where it is clearly shown that the articles in question are not specially designed nor primarily adaptable only for use on or in connection with automobiles but are interchangeable and extensively used in many other industries, it is the opinion of this office that spark plugs should be held to be commercial commodities and not subject to the excise tax imposed by sections 900(3) of the Revenue Acts of 1918 and 1921.

SECTION 900(3), REGULATIONS 47, ARTICLE 16: Definition of accessories. II–17–1025 S. T. 422

High-pressure grease guns are not taxable as accessories.

From the information submitted it appears that high-pressure grease guns are not primarily designed and adaptable for use on automobiles but are used in many industries where lubrication is necessary. It is also noted that the same grease gun may be and is used for lubricating either industrial machinery or automobiles by merely attaching a hose with the proper couplings to it.

It is therefore held that high-pressure grease guns are not automobile accessories within the meaning of section 900(3) and no tax attaches to their sale by the manufacturer thereof.

SECTION 900(11), REGULATIONS 47, ARTICLE 23: Automatic slot-device machine. II–27–1134 S. T. 428

Coin-controlled automatic player pianos are taxable as automatic slot-device vending machines.

An opinion is requested as to whether so-called coin-controlled automatic player pianos are taxable as automatic slot-device vending machines under section 900(11) of the Revenue Act of 1921. The pertinent part of such section reads as follows:

That from and after January 1, 1922, there shall be levied, assessed, collected, and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentage of the price for which so sold or leased—

* * * * * * *

(11) Automatic slot-device vending machines, 5 per centum, and automatic slot-device weighing machines, 10 per centum; if the manufacturer, producer, or importer of any such machine operates it for profit, he shall pay a tax in respect to each such machine put into operation equivalent to 5 per centum of its fair market value in the case of a vending machine, and 10 per centum of its fair market value in the case of a weighing machine.

It has been contended that only such slot machines as sell or vend physical commodities are vending machines; that music is not such a commodity, hence that coin-controlled automatic player pianos are not taxable.

This office is unable to concur in such a view. The Century Dictionary and Cyclopaedia, in defining vending machine, specifically states that such term properly includes "slot gas meters, slot weighing machines, card-printing machines, and musical and moving-picture machines." Appleton's Cyclopaedia of Applied Mechanics (supplement, 1895) also classes slot-device weighing machines and similar coin-controlled apparatus as vending machines.

In the opinion of this office, coin-controlled automatic player pianos are, therefore, taxable as automatic slot-device vending machines under the provisions of section 900(11) of the Revenue Act of 1921.

SECTION 904(5), REGULATIONS 47, ARTICLE 34: Portable lighting fixtures. II–15–994 S. T. 420

It is held that portable lighting fixtures are taxable only under section 904, subdivision (5), of the Revenue Act of 1921, regardless

of whether or not they are ornamented, mounted, or fitted with precious metals or imitations thereof, or ivory, when sold or leased by the manufacturer, producer, or importer, at 5 per cent of the amount for which so sold or leased as is in excess of $10 each. The same is true when the base or other portion of these articles is made of pieces of sculpture or statuary. However, the sale of sculpture or statuary to the manufacturer of the lamp is taxable under section 902.

SALES BY THE DEALER.

SECTION 905(a), REGULATIONS 48. ARTICLE 2: Rescission of sales. II-32-1187 S. T. 431

When a tax-paid sale is rescinded by a jeweler taking back an article in trade at its original selling price, credit may be taken for the tax previously paid thereon in computing the tax due on the new sale. But this may be done only when the original and the new sale are made and the taxes paid by the same dealer. Every sale of jewelry subsequent to its return on a rescinded sale is subject to tax when made by a dealer for consumption or use.

A customer bought an article of jewelry for $500. In settlement the merchant took back an article which he has previously sold for $100 (in connection with which he had paid tax) at its selling price, receiving the balance in the amount of $400 as cash. The tax on the last sale—that is, on the sale for $500—is $25, but as the original sale, made by the same dealer, was rescinded by virtue of his taking back the article previously sold at its full selling price, he can take credit for the tax paid on the previous sale; that is to say, he can take credit for the $5 paid on the $100 sale.

If in a similar transaction the article taken in exchange by the merchant had been sold by another jeweler, the tax, as in the previous case, would be $25, but as he had not made the original sale of the article which he takes in exchange, and had not paid any tax in connection with the sale of that article, he would not be permitted to take credit for any tax that might have been paid by some other dealer. In short, a dealer can take credit only for taxes he himself has paid on articles which are returned to him and the sales of which are rescinded.

The tax is imposed upon the dealer upon his sales, and the fact that an article has previously been sold, and tax paid on the sale, does not operate to exempt any subsequent sales of such an article from tax. Regardless of how many times an article may be sold, each sale when made by a dealer for consumption or use is taxable, and credit for taxes paid on any previous sale can be taken only when the article is taken back and the sale rescinded by the jeweler making the original sale.

SECTION 905(a), REGULATIONS 48, ARTICLE 21: Jewelry. II-17-1026 S. T. 423

Under article 21 of Regulations 48 shoe buckles are taxable as jewelry regardless of the substance of which made and regardless of their utilitarian value only when designed to be worn on the person or apparel for the purpose of adornment and display.

Advice is requested as to the construction to be placed on article 21 of Regulations 48, and where the line can be drawn between shoe buckles which are taxable as jewelry and those which are not.

Article 21, Regulations 48, reads in part as follows:

> The following articles are taxable as jewelry: (1) Articles to be worn on the person or apparel for purpose of adornment, which according to general custom or ordinary usage are worn so as to be displayed, such as brooches, rings, chains, cuff buttons, necklaces, fobs, and shoe buckles. Such articles are taxable regardless of the substance of which made * * * and regardless of their utilitarian value.

It is apparent from the reading of this paragraph that shoe buckles are taxable as jewelry regardless of the material of which made and regardless of the utilitarian value only when designed to be "worn on the person or apparel for the purpose of adornment." Clearly the samples submitted were not designed to be worn as an article of adornment. These buckles are ordinary commercial steel buckles, which might properly be designated as shoe buckles by virtue of a use as such, but could with equal propriety be and are used on rubber boots, galoshes, and similar articles, where they serve a purely utilitarian purpose. Such buckles, it is apparent, when used on shoes or the other articles mentioned, are not intended as an article of adornment or display, but are intended to serve a purely utilitarian purpose, and are not taxable as jewelry.

Section 905 of the Revenue Act of 1921 imposes a tax upon "all articles commonly or commercially known as jewelry whether real or imitation." It is apparent from this that it was the intention of Congress to make the statute comprehensive and it is difficult to formulate a comprehensive definition of or to lay down a line of demarkation between articles taxable thereunder and those that are not, as the question in each particular case is one of fact. It is not, however, in the opinion of this office, intended by article 21 of Regulations 48 to impose a tax on shoe buckles regardless of the material of which made and regardless of their utilitarian value, but it is intended to tax shoe buckles primarily designed for use as articles of personal adornment. A shoe buckle primarily designed as an article of personal adornment and display is taxable as jewelry, even though it may also possess utilitarian value.

Under article 24 shoe buckles are taxable as jewelry if they are made of or ornamented, mounted or fitted with precious metals or imitations thereof, or ivory; and they are also taxable as jewelry, regardless of the material of which made, when they are ornamented, mounted or fitted with pearls, precious or semiprecious stones, or imitations thereof.

When taxable buckles are sold attached to shoes the tax is measured by the price of the combination unless the buckle is separately priced. When separately priced and sold the tax is measured by the price of the buckle only.

SECTION 905(a), REGULATIONS 48, ARTICLE 21: Jewelry. II-35-1230 S. T. 434

Ships' chronometers are not taxable either as clocks or as watches under sections 905 of the Revenue Acts of 1918 and 1921.

TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1305, REGULATIONS 47, ARTICLE 41: Sales for export. II–32–1188 S. T. 432

Automobiles sold for export and in due course so exported are not subject to the manufacturer's excise tax. A machine, however, that is sold to a foreigner to be used in this country is not considered sold for export, even though it is known the foreigner will subsequently take the machine out of the country with him.

SECTION 1314: Retroactive regulations. II–17–1027 S. T. 424

The authority granted the Commissioner under section 1314 of the Revenue Act of 1921 is confined to the case where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision.

It appears that a certain company has not until recently been paying the tax on the sale of shoe buckles in accordance with the regulations of the Bureau, and that while there is no disposition on the part of the company to take issue with the regulations, it does desire to invoke the provisions of section 1314 of the Revenue Act of 1921.

Section 1314 of the Revenue Act of 1921 reads as follows:

That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

It will be noted that the authority granted the Commissioner under the above section is confined to the case where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision. Regulations 48, dealing with the tax on shoe buckles in their present form, are identical with the regulations published in Treasury Decision 2833 (not published in Bulletin service), dated May 2, 1919, under the Revenue Act of 1918. It is apparent, therefore, that in the instant case the liability of the taxpayer does not arise through a reversal of regulation or Treasury decision with respect to the excise tax on shoe buckles.

The Commissioner of Internal Revenue is without authority to waive the collection of taxes which may be found to be due.

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ESTATE TAX RULINGS.

TITLE II.—ACT OF 1916.

REGULATIONS 37 (1917). II-24-1106
T. D. 3514

ESTATE TAX—REVENUE ACT OF 1916 AS AMENDED—DECISION OF COURT.

1. DEDUCTIONS—MARYLAND COLLATERAL INHERITANCE TAX.

The Maryland collateral inheritance tax is not an inheritance tax but an estate tax and in computing the Federal estate tax is deductible from the gross estate under the provisions of Title II of the Revenue Act of 1916 (as amended by the Act of October 3, 1917).

2. Judgment of the District Court (276 Fed., 845) affirmed.

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

To collectors of internal revenue and others concerned:

The following decision of the United States Circuit Court of Appeals for the Fourth Circuit in the case of *Joshua W. Miles, former Collector of Internal Revenue for the United States in and for the District of Maryland and Delaware*, v. *John J. Curley, John M. Dennis, and William A. Dixon, executors of the last Will and Testament of Helen M. H. Grafflin, deceased*, affirming the decision of the United States District Court for the District of Maryland, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 7, 1923.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

Joshua W. Miles, former collector of Internal Revenue for the United States in and for the District of Maryland and Delaware, plaintiff in error, v. *John J. Curley, John M. Dennis, and William A. Dixon, executors of the last will and testament of Helen M. H. Grafflin, late of Baltimore County, deceased, defendants in error.*

Writ of error to the District Court of the United States for the District of Maryland.

[July 3, 1923.]

MCCLINTIC, District Judge:

The defendants in error (hereinafter called the plaintiffs) brought an action at law in the District Court of Maryland to recover a certain sum of money

paid to the collector of internal revenue for the district of Maryland and Delaware, being the amount of certain Federal estate taxes assessed by the collector on the estate of Helen M. H. Grafflin, who died a resident of Maryland, which sum was claimed by the plaintiffs to be in excess of the amount lawfully chargeable thereon. Such sum of money had been paid under protest, and all proper steps had been taken to bring such action for the recovery thereof.

The taxes were assessed and collected by such collector (hereafter called the defendant) under the provisions of the Act of Congress approved September 8, 1916, as amended by the Act approved March 3, 1917.

The executors claimed a deduction from the total taxable estate of $48,759.44 paid to the State of Maryland as an estate tax. The collector claimed that the deduction was not proper because the tax under the laws of Maryland was a legacy tax.

The defendant interposed a demurrer to the declaration, which was overruled.

By stipulation, it was agreed that there was no dispute as to the facts alleged in the declaration, and the court being of opinion that the law was with the plaintiffs, a final judgment was entered therein on the 26th day of April, 1922, for the plaintiffs, and against the defendant, for the sum of $3,710.25, and $26.05 costs.

There is but one question in this case, and that is, Does the Maryland collateral inheritance tax attach to an estate before distribution? If so, the plaintiffs are entitled to recover the amount above named. (*Lederer* v. *Northern Trust Co.*, 262 Fed., 52; 253 U. S., 487 (T. D. 3027 [not published in Bulletin service]).)

If, on the other hand, the Maryland tax is a legacy tax, and not an estate tax, the sum in controversy was properly collected. (*New York Trust Co.* v. *Eisner*, 256 U. S., 345 (T. D. 3267 [not published in Bulletin service]).)

The decision by the highest court of Maryland, directly deciding this question, and construing the statute imposing such collateral inheritance tax, would be binding upon this court. Is there any such decision?

In discussing this question, the learned district judge, in his opinion overruling the demurrer to the declaration herein, says:

"In the case at bar, each side has argued that the Court of Appeals of this State has interpreted the act in the sense for which it contends, and each quotes language which, if standing alone, might sustain its position. That each is able to do so is perhaps the best proof that the attention of that high court never had been drawn to the precise point now at issue, in such sense, at least, as to call for its definite determination."

We have examined the cases decided by the Court of Appeals of Maryland, and referred to in the briefs of counsel, and have reached the conclusion that no decision upon this point has been really made.

The Pennsylvania statute upon the subject of collateral inheritance tax is believed to be the first that was passed by any State in America. This statute was enacted in 1826.

In 1884, the Legislature of the State of Maryland, in substance and effect, adopted the Pennsylvania statute.

In the case of *Jackson* v. *Myers* (257 Pa., 104) the Supreme Court of Pennsylvania decided that the collateral inheritance tax of Pennsylvania is not levied upon the inheritance or legacy, but upon the estate of the decedent, holding that what passes to the legatee is simply the portion of the estate remaining, after the State has been satisfied by receiving the tax.

An examination of other cases in that State shows that this case only follows the previous holdings on this subject.

The question presented herein for decision was directly presented to the Circuit Court of Appeals of the Third Circuit in the case of *Lederer* v. *Northern Trust Company, supra*, and that case held, that under the Pennsylvania statute, and the decisions of the court of last resort in the State of Pennsylvania, such tax was an estate tax, and not a legacy tax, and that the plaintiff therein should recover from the collector the amount so paid under protest.

Upon the authority of that case, and under all the circumstances and conditions surrounding this case, we hold that the proper construction of the collateral inheritance statute of Maryland makes such tax an estate tax, and not a legacy tax, and, therefore, the judgment below is affirmed.

TITLE IV.—ESTATE TAX.

GROSS ESTATE—PROPERTY PASSING UNDER POWER OF APPOINTMENT.

SECTION 402(e), REGULATIONS 37, ARTICLE 30: General rules. II–29–1143
T. D. 3524

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. GROSS ESTATE—POWER OF APPOINTMENT.

Section 402(e) of the Revenue Act of 1918 provides that property passing under a general power of appointment shall be included in the gross estate of a decedent. Under the law of Pennsylvania the appointee of a power takes under the will of the donor and not under the will of the donee of the power. Where a general power of appointment is exercised by a decedent the value of the appointed property should be included in the decedent's gross estate regardless of the fact that the appointees and their respective interests in the appointed property are the same as would have been the case had the power not been exercised.

2. ESTATE TAX—MEASURE—STATUTORY CONSTRUCTION.

The will of Congress to tax must be found expressed in the language of the Act interpreted in the light of the situation presented to the legislature. The estate tax levied by the Revenue Act of 1918 measures the tax by the gross value of all the property of a decedent which passed by will plus the value of all property which passed in practical effect by the same will, although it passed not by virtue of dominion over property but by virtue of a power of appointment.

3. ESTATE TAX—EXCISE TAX.

The estate tax is an excise tax levied upon the privilege enjoyed by one who makes disposition of property to take effect at his death and the measure is wholly within the control of Congress.

4. CONSTITUTIONALITY.

Legislation is not unconstitutional in the legal sense unless the legislation be in conflict with a provision of our written Constitution and Acts of Congress are not unconstitutional merely because unwise or in conflict with sound principles of legislation. Under this rule, section 402(e) of the Revenue Act of 1918 is constitutional.

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

To collectors of internal revenue and others concerned:

The following decision of the United States District Court for the Eastern District of Pennsylvania in the case of *The Pennsylvania Company for Insurances on Lives and Granting Annuities, and Catherine M. Colfelt Taylor, Executors of the Estate of Rebecca Colfelt, deceased*, v. *Ephraim Lederer, Collector of Internal Revenue of the First District of Pennsylvania*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved October 8, 1923.

A. W. MELLON,
Secretary of the Treasury.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA. SEPTEMBER SESSIONS, 1921. No. 8634. ASSUMPSIT.

The Pennsylvania Company for Insurances on Lives and Granting Annuities, and Catherine M. Colfelt Taylor, Executors of the Estate of Rebecca Colfelt, deceased, v. *Ephraim Lederer, Collector of Internal Revenue of the First District of Pennsylvania.*

Sur rule for judgment.

THE GENERAL QUESTION.

DICKINSON, J.: The question raised is a demurrer question. The proposition of law upon which it is founded is that the plaintiffs by their statement of claim show no cause of action. This in its turn is founded wholly upon the answer for which the defendant contends to the question of whether the payment of a tax exacted of the plaintiffs was lawfully demanded.

The opposing contentions of the parties are best disclosed by a broadly outlined statement of the facts.

THE FACTS.

Plaintiff's decedent, Rebecca Colfelt, was the daughter and only child of the late James McManes. The father by his will disposed of what in his day was a large estate. He devised the residue to trustees to hold for the benefit of his daughter for life, with a general power of appointment, and named the beneficiaries of the principal of the residue in case the daughter did not exercise the power given. There is no particular significance in the verbiage of the will of the father and nothing out of the usual in the substance or form of the trust, not even in its spendthrift trust feature. The daughter exercised this power of appointment not only by the Pennsylvania statutory mode of exercising it but also by a specific reference to the power. No question of the valid exercise of the power is raised. It is otherwise of no value but is a help to our grasp of the practical importance of the question to be ruled to have in our minds the two facts that the estate of the daughter (in addition to the value of the trust estate above mentioned) had a value approximately of a half million dollars, about one-half of which must be applied to meet the tax herein involved, if it was lawfully levied.

DISCUSSION.

The mind is prone to incline to that view of any question raised which is suggested by the form in which the question is set forth or the result which is sure to follow a given answer to the question raised. The question before us may be set forth in such a way as to impress anyone with the thought that the exaction of the tax claimed would be a grievous hardship. The estate, in the sense of the interest which a donee by will takes, is determined by the law of the State in which the testator was domiciled at the time of his decease. It is well settled that under the law of Pennsylvania the appointee of a power takes when he takes not under the will of the donee of the power but under the will of the donor. In other words, the principal of this trust estate when it passed to the appointees of the daughter, although the exercise of the power of appointment was made by the will of the daughter, none the less passed under the will of the father.

Another feature of the fact situation in the instant case is that the final recipients of the gift who take by virtue of the exercise of the power are the same persons who would have taken had the power not been exercised. The father died before the enactment of the tax laws which control the ruling of the question before us. The daughter died before the passage of the pertinent Acts of Congress. It follows that this tax, if lawful, may be levied upon the estate of the daughter but not upon the estate of the father. The consequence is, as already stated, that the upholding of this tax levy takes one-half of the estate of the daughter, and that the whole of the estate proper of the donee of a power who exercises it might be taken to pay the tax on that which passed by the exercise of the power, and indeed an estate might be rendered insolvent by being insufficient to pay the tax levied.

A retort to the argument implied in such a presentation of the question is already at hand. It is that the donee of the power (if it be a general power of appointment) has control over such a situation and can impose the payment of

the tax upon the beneficiaries of the exercise of the power or (at least possibly) may avoid liability to the tax altogether by its nonexercise.

The whole question is clearly one of the interpretation of the will of Congress. The Pennsylvania doctrine above outlined does not prevail in many jurisdictions. The doctrine applied in these other jurisdictions is that of the courts of England, which is, generally speaking, that one who receives the income of property for life, coupled with a general power of appointment, has an estate which is the equivalent of an out and out ownership and has that ownership at least to the extent of subjecting it to liability for the debts of the donee of the power. The early taxing Acts measured the tax by the value of the estate of the decedent passing at his or her death without reference to the existence of any power of appointment. It thus followed that estates of like character and of equal value paid a different tax, as the law of the State which controlled the distribution differed in the feature noted. This was without doubt the inducement to the amendment of the taxing law. The tax as now levied is measured by what the law terms "the value of the net estate." This net estate is further defined by the value of the gross estate less certain deductions, and this gross estate is defined as the value of all property of the estate including that passing to an appointee "to the extent of any property passing under a general power of appointment exercised by the decedent."

The argument on behalf of the plaintiff begins with the proposition that no tax is imposed other than one imposed by the will of Congress, and that neither the executive nor the judiciary department of the Government can add to the burden by construction.

The next premise is that Congress has measured the tax by the value of the property of the decedent and of property passing under the power of appointment only to the extent to which property thus passes, and that in Pennsylvania (however the law may be elsewhere) property to no extent whatever passes under such a power.

One consequence of the acceptance of this view is that the amendment of 1918 made no change (at least so far as affects the estates of decedents in Pennsylvania) in the law. This view, although strongly urged and plausibly supported, we can not accept. We do, however, accept the premise first laid down. The will of Congress to tax must be found expressed in the language of the Act of Congress. The language employed must, however, be interpreted in the light of the situation presented to the law-making power when the statute was enacted. That situation was that a testator might be possessed of what may be properly called an estate of great value, consisting, however, in large part, as here, in the power possessed to name the beneficiaries of property held in trust. We can discover in the words of Congress no other meaning than the intention of measuring the tax to be paid by the gross value of all the property of the decedent which passed by will plus the value of all property which passed in practical effect by the same will, although it passed not by virtue of dominion over property but by virtue of a power of appointment. The thing done might in respect to the one be called the exercise of a right and in respect to the other a power, but both were possessed and had a value which could be used as a measure.

We are unable to see any insurmountable obstacle to the acceptance of this construction of the Act in the criticism that the tax levied is computed by a measure which has no relation to the thing measured. A measure of the tax which the estate of one person should pay [by] the value of the estate of another person deserves as a scheme of taxation all the censure which counsel for defendant has heaped upon it. This is not what Congress has done. Congress, as already noted, has recognized that a person may have indicated two things of value, and has adopted as its measure the value of that which belonged to the decedent, to which is added as an increment the value of that over which the testator had the power of control to the extent to which that control was exercised. This tax is an excise tax. It is levied upon the privilege enjoyed by one who makes disposition of property to take effect at his death. How such a tax shall be measured is wholly within the control of Congress. The measure which Congress has adopted may be one which the executive or members of the judiciary might commend or condemn, but neither their condemnation nor commendation changes or can change what Congress has done. When legislation is passed which is in conflict with what are recognized to be sound principles of legislation, the expression is an intelligible one that such legislation is unconstitutional. This only means, however, that it is

based upon wrong or unsound principles of legislation. Whatever else may be said of legislation, it is not unconstitutional in the legal meaning of that term as used in America unless the legislation be in conflict with a provision of our written Constitution. In other words, the enactments of our legislatures and of Congress are not unconstitutional merely because unwise or in conflict with sound principles of legislation but because the statutory enactment conflicts with a constitutional provision. The same thought of unconstitutionality in the American sense is best conveyed by the phrase that a constitutional provision and a statutory enactment must be read as two conflicting statutory enactments are read, the only difference being that in the first case the meaning of the Constitution, although earlier, prevails, while in the latter instance the meaning of the latter enactment would prevail, if there was a conflict between them.

We have been pointed to no conflicting provision of the Constitution. No stress is laid upon the identity of the persons who take under the two wills, but as mention has been made of it, we are of opinion that the doctrine that the heir who is also devisee takes as heir and not as devisee has no application, and that this power of appointment was exercised.

CONCLUSION.

The conclusion reached is that the plaintiff's statement of claim sets forth no cause of action or right of action in that the tax payment was lawfully levied, and the claim of the plaintiff to recover the tax paid can not be upheld.

We are of opinion that judgment should be entered in favor of the defendant, with costs, but, in accordance with the usual practice, no judgment is now entered, but either party has leave to move for judgment, in accordance with this opinion.

SECTION 406, REGULATIONS 63, ARTICLE 80: Payment by bonds or uncertified checks. II–24–1105 T. D. 3513

Estate or inheritance taxes: Receipt of Liberty bonds, Treasury bonds, and Treasury notes in payment thereof.

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

To collectors of internal revenue and others concerned:

The appended Department circular, issued under date of July 31, 1923, with reference to receipt of Treasury bonds of the United States in payment of Federal estate and inheritance taxes, is published for the information of internal-revenue officers and others concerned. This circular supplements Department Circular No. 225, dated January 31, 1921 (T. D. 3144 [not published in Bulletin service]), as supplemented by Department circular dated June 30, 1922 (T. D. 3383 [C. B. I–2, p. 315]).

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 7, 1923.
A. W. MELLON,
Secretary of the Treasury.

RECEIPT OF LIBERTY BONDS, VICTORY NOTES, AND TREASURY NOTES FOR ESTATE OR INHERITANCE TAXES.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, July 31, 1923.

1. The provisions of Department Circular No. 225, dated January 31, 1921, as supplemented June 30, 1922, prescribing regulations governing the receipt of bonds and notes of the United States for Federal estate or inheritance taxes are hereby extended and made applicable to Treasury bonds of the United States now or hereafter issued under authority of the Act of Congress approved September 24, 1917, as amended, bearing interest at a higher rate than 4 per centum per annum, and any such Treasury bonds shall accordingly be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law, upon the same terms and conditions as provided in said Department Circular No. 225, dated January 31, 1921, with respect to the acceptance of bonds and notes bearing interest at a higher rate than 4 per centum per annum.

2. The bonds and notes at this date outstanding, bearing interest at a higher rate than 4 per centum per annum, which come within the provisions of Department Circular No. 225, dated January 31, 1921, as thus supplemented, are:

Description.	Date of issue.	Short title.
(*a*) First Liberty loan converted 4¼ per cent bonds of 1932–47	May 9, 1918	First 4¼s.
(*b*) First Liberty loan second converted 4¼ per cent bonds of 1932–47	Oct. 24, 1918	First second 4¼s.
(*c*) Second Liberty loan converted 4¼ per cent bonds of 1927–42	May 9, 1918	Second 4¼s.
(*d*) Third Liberty loan 4¼ per cent bonds of 1928	do	Third 4¼s.
(*e*) Fourth Liberty loan 4¼ per cent bonds of 1933–38	Oct. 24, 1918	Fourth 4¼s.
(*f*) 4¼ per cent Treasury bonds of 1947–52	Oct. 16, 1922	Treasury bonds of 1947–52.
(*g*) 5⅜ per cent notes, payable June 15, 1924	June 15, 1921	Series A–1924.
(*h*) 5½ per cent notes, payable Sept. 15, 1924	Sept. 15, 1921	Series B–1924.
(*i*) 4¾ per cent notes, payable Mar. 15, 1925	Feb. 1, 1922	Series A–1925.
(*j*) 4¾ per cent notes, payable Mar. 15, 1926	Mar. 15, 1922	Series A–1926.
(*k*) 4⅝ per cent notes, payable Dec. 15, 1925	June 15, 1922	Series B–1925.
(*l*) 4¼ per cent notes, payable Sept. 15, 1926	Aug. 1, 1922	Series B–1926.
(*m*) 4½ per cent notes, payable June 15, 1925	Dec. 15, 1922	Series C–1925.
(*n*) 4½ per cent notes, payable Dec. 15, 1927	Jan. 15, 1923	Series A–1927.
(*o*) 4¾ per cent notes, payable Mar. 15, 1927	May 16, 1923	Series B–1927.

3. For the calculation of accrued interest on the current coupons of bonds and notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in Exhibit B to Department Circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by the various issues, or for other or future issues, may be obtained from the Treasury Department, Division of Loans and Currency, Washington, upon request.

S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

CLAIMS FOR ABATEMENT AND REFUND.

SECTION 1315, REGULATIONS 63, ARTICLE 92: Kinds of relief. II–35–1227 E. T. 1

COMMITTEE ON REVIEW AND APPEALS (ESTATE TAX).

The Committee on Review and Appeals is composed of a chairman and four members, selected from the personnel of the Estate Tax

Division. While the chairman and members are technically attached to this division, they are in effect under the direct supervision of the Deputy Commissioner in charge thereof. The principal function of the committee is to hear and determine appeals taken from rulings of the Estate Tax Division.

Hearings will be granted upon the request of the executor or his attorney in all cases after the completion of the review and audit by the Estate Tax Division. In the discretion of the Deputy Commissioner, hearings may also be granted before the review and audit in cases where intricate and technical questions are involved. There shall be filed with the committee at the time the request is made, or at least five days before the appeal is to be heard, a written statement setting forth all of the issues which the executor desires to contest.

At the hearing before the committee, the executor or his attorney will be expected to make his full oral argument on the law as well as the facts, and this presentation shall be the only oral presentation except in unusual circumstances, or unless a further argument of the facts or the law is deemed desirable by the chairman. If the executor or his attorney does not wish an oral argument his argument may be made in the form of a written statement or brief, and he may file in addition thereto such supporting evidence as he may desire. These statements or briefs and the supporting evidence may be either printed or typewritten.

Where stock items are involved, the chief of the valuation section, Estate Tax Division, may be notified to sit with the committee for the purpose of hearing the appeal with reference to these items. All memoranda in connection with hearings prepared by the chief of the valuation section shall be approved by the chairman of the committee and the Deputy Commissioner.

The findings of the committee will be reduced to writing and when signed by the chairman and approved by the Deputy Commissioner will be accepted for the guidance of the Estate Tax Division. After the findings have been so approved a rehearing will be granted only (1) where a showing is made of new and material facts accompanied by a satisfactory explanation as to the failure to produce such facts at the hearing or (2) where the case is materially affected by the change of regulations or by the final decision of another case either by the Commissioner of Internal Revenue or by a court of competent jurisdiction.

A power of attorney from the executor in proper form will be required of attorneys and others appearing before the committee. The provisions of Treasury Department Circular No. 230, dated April 25, 1922 [see p. 372], as amended, must also be strictly complied with.

All hearings with reference to estate tax matters before completion of the review and audit shall, except as otherwise directed by the Deputy Commissioner, be referred to the Estate Tax Division.

R. M. Estes,
Deputy Commissioner.

Approved.
D. H. Blair, *Commissioner.*

TITLE XIV.—GENERAL PROVISIONS.

SECTION 1400(b) (1918), REGULATIONS 37 (1919), ARTICLE 119: Scope of repeal. II–33–1190 T. D. 3529

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF COURT.

1. ESTATE TAX—EFFECT OF REPEAL.

Where a decedent died on September 4, 1918, the Federal estate tax should be computed at the rates provided by the Revenue Act of 1916 as amended by the Act of March 3, 1917, and the Revenue Act of 1917.

2. ESTATE TAX—EFFECT OF REPEAL.

Section 1400(b) of the Revenue Act of 1918 does not repeal the Revenue Act of 1916 as amended by the Act of March 3, 1917, or the Revenue Act of 1917 as to the imposition of an estate tax on the estates of decedents dying prior to the passage of the Revenue Act of 1918. The Revenue Act of 1916 as amended by the Act of March 3, 1917, and the Revenue Act of 1917 impose a tax which impresses itself on the estate of a decedent dying prior to the Revenue Act of 1918, and the liability thus imposed is saved by section 13 of the Revised Statutes.

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

To collectors of internal revenue and others concerned:

The following decision of the United States District Court for the District of Colorado in the case of *Louise B. Page* v. *Skinner, Collector*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved November 10, 1923.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT, DISTRICT OF COLORADO.

Louise B. Page, plaintiff, v. *Mark A. Skinner, defendant.*

[August 6, 1923.]

MEMORANDUM.

William Byrd Page died testate on September 4, 1918, leaving one-half of his property to his widow, the plaintiff. The defendant, as collector of internal revenue for Colorado, assessed and collected as an estate tax on the net value of the deceased's estate, $41,745.20, which was paid under protest. The plaintiff now seeks to recover in the first cause of action $19,398.08, alleged to be the excess collected over what the estate was actually liable for. The second cause of action seeks to recover the entire amount paid as being wholly illegal and void. Defendant demurs to both causes of action.

At the time of the death of Page the Revenue Act of 1916 (39 Stat., 756), as amended by the Act of March 3, 1917 (39 Stat., 1000), was in effect. Five months thereafter the Revenue Act of 1918 (40 Stat., 1057), approved February 24, 1919, took effect. The amount referred to was assessed and collected under

the Act of 1916, as amended, and if that Act was applicable to this estate the demurrer must be sustained. Before the amount referred to had been actually paid to the Government the Revenue Act of 1918 (40 Stat., 1057) had gone into effect, which, if applicable, would decrease the amount of the tax by $19,398.08.

The discussion of the points raised by the demurrer is mostly highly technical, and necessarily so, but after a careful consideration thereof, the questions resolve themselves into a few very simple propositions. First, it is clear that the Act of 1918 does not apply to the estates of persons dying prior to its going into effect, for the simple reason that it says so in so many words, and this is not seriously opposed by counsel for plaintiff. The 1916 Act clearly "imposed" a tax which impresses itself on this particular estate before the latter Act became a law, and this was not affected by the fact that the amount could not be determined or collected until a later date.

The death of Mr. Page was the only act or event necessary to affix a liability that could not be removed except by Congress. It also vested an interest in the estate of the plaintiff, in spite of the fact that she could not demand possession until the will was probated. It is therefore hard to see how section 1400(b) of the 1918 Act applies, because, in the absence of very explicit language, it can only refer to the Act of which it is a part, and can not make an exception to the general statement it contains that it only applies to estates of decedents dying after its passage. Counsel for plaintiff calls our attention to part of section 1400(b), as follows:

"Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of any such part of an Act shall be available for the administration of this Act or the corresponding provision thereof."

"In the case of any tax imposed by any part of an Act herein repealed, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act."

This section in effect says that the former Act shall remain in force until the new Act takes effect. It seems to me to be a simple proposition that no "corresponding tax" under the later Act can take effect on this estate, in view of the fact that it applies only to the estates of persons dying after its passage. Counsel for plaintiff also suggests another construction of the two Acts, which would result in a hiatus, the practical effect of which would be that this estate would wholly escape taxation. Such a proposition can only be sustained where expressed by Congress in the most explicit terms. I find nothing to show that such was the intention of Congress, and in fact it is directly contrary to the legislative policy since this particular class of taxes was first created, and overlooks section 13 of the Revised Statutes. If the Act of 1918 had never been passed, then the former Act would have applied without question, and under section 13 it did apply, as the repealing part does not "expressly" otherwise provide. The plaintiff is in error in not distinguishing the mere administrative features of the Act from the more important part imposes (ing?) the tax.

The demurrers to both causes of action will be sustained.

CAPITAL STOCK TAX RULINGS.

TITLE X.—SPECIAL TAXES.

SECTION 1000, REGULATIONS 50 (REVISED), ARTICLE 10; REGULATIONS 64, ARTICLE 11: Basis of the tax: "Carrying on or doing business." II–13–966 T. D. 3493

CAPITAL STOCK TAX—REVENUE ACTS OF 1916 AND 1918—DECISION OF COURT.

1. CAPITAL STOCK TAX—EXCISE TAX.

The tax levied by section 407, Title IV, of the Revenue Act of 1916 and by section 1000, Title X, of the Revenue Act of 1918 is an excise tax on the privilege of doing business as a corporation measured by the fair average value of the capital stock of the corporation for the preceding year.

2. CAPITAL STOCK TAX—CORPORATIONS ENGAGED IN EXPORT BUSINESS—CONSTITUTIONALITY.

The capital stock tax imposed by the above-mentioned Acts is not unconstitutional as applied to corporations the business of which is confined to the exportation of goods from the United States and their sale in foreign countries and to the sale of such goods to export commission merchants in this country with the intent and purpose that they shall be exported and with the result that such goods are in fact exported. Such a tax is not "a tax or duty on articles exported from any State" and hence is not violative of Article I, section 9, clause 5, of the Constitution of the United States.

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

To collectors of internal revenue and others concerned:

The attached decision of the District Court of the United States, Southern District of New York, in the case of *National Paper and Type Company* v. *William H. Edwards, Collector of Internal Revenue for the Second District of New York*, is published for the information of internal-revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved June 22, 1923.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF NEW YORK.

National Paper and Type Company, plaintiff, v. *William H. Edwards, Collector of Internal Revenue for the Second District of New York, defendant.*

[June 1, 1923.]

MACK, Circuit Judge:

This is a suit to recover taxes paid under protest. The amended complaint sets forth two alleged causes of action. The first relates to a payment of

$487.50 alleged to have been exacted under section 407 of Title IV of the Act of Congress approved September 8, 1916; and the second relates to a payment of $581.50 alleged to have been exacted under section 1000 of Title X of the Revenue Act of 1918. The pertinent provisions of the Acts in question are set forth in the margin.[1] It is contended that the capital stock tax imposed by these Acts is unconstitutional as applied to the plaintiff corporation, the business of which is confined to the exportation of goods from the United States to foreign countries and the sale of goods to export commission merchants in this country, with the intent and purpose that the same should be exported, and with the result that such goods are in fact exported. It is alleged that the tax as applied to the plaintiff corporation is a tax on exports prohibited by Article I, section 9, clause 5, of the Constitution. The defendant moves for judgment on the pleadings on the ground that the facts alleged are not sufficient to constitute a cause of action.

The Government contends that the first as well as the second tax was levied under section 1000 of the Revenue Act of 1918. But since no question is raised as to the amount of the tax, it is immaterial for the purposes of the present suit whether the tax was imposed under the Revenue Act of 1916 or 1918.

The tax in question is in form an excise tax on the privilege of doing business as a corporation measured by the fair average value of the capital stock of the corporation for the preceding year. (*Washington Water Proof [Power] Co.* v. *United States*, 56 Ct. Cl., 76; *Flint* v. *Stone-Tracy Co.*, 220 U. S., 107.)

In *Peck & Co.* v. *Lowe* (247 U. S., 165) the Supreme Court, in sustaining a Federal tax on the net income of a domestic corporation derived from the business of shipping goods to foreign countries and there selling them, thus summarizes its previous decisions:

"The Constitution broadly empowers Congress not only 'to lay and collect taxes, duties, imposts and excises,' but also 'to regulate commerce with foreign nations.' So, if the prohibitory clause invoked by the plaintiff be not in the way, Congress undoubtedly has power to lay and collect such a tax as is here in question. That clause says 'No tax or duty shall be laid on articles exported from any State.' Of course it qualifies and restricts the power to tax as broadly conferred. But to what extent? The decisions of this court answer that it excepts from the range of that power articles in course of exportation. (*Turpin* v. *Burgess*, 117 U. S., 504, 507; the act or occupation of exporting, *Brown* v. *Maryland*, 12 Wheat., 419, 445; bills of lading for articles being exported, *Fairbank* v. *United States*, 181 U. S., 283; charter parties for the carriage of cargoes from State to foreign ports, *United States* v. *Hvoslef*, 237 U. S., 1; and policies of marine insurance on articles being exported—such insurance being uniformly regarded as 'an integral part of the exportation' and the policy as 'one of the ordinary shipping documents.' *Thames and Mersey Insurance Co.* v. *United States*, 237 U. S., 19.) In short, the court has interpreted the clause as meaning that exportation must be free from taxation, and therefore as requiring 'not simply an omission of a tax upon the articles exported, but also a freedom from any tax which directly burdens the ex-

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[1] SEC. 407. That on and after January 1, 1917, special taxes shall be, and hereby are, imposed annually, as follows, that is to say:

Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, * * * shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each $1,000 of the fair value of its capital stock and in estimating the value of capital stock the surplus and undivided profits shall be included.

SEC. 1000. (a) That on and after July 1, 1918, in lieu of the tax imposed by the first subdivision of section 407 of the Revenue Act of 1916—

(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

(2) Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to $1 for each $1,000 of the average amount of capital employed in the transaction of its business in the United States during the preceding year ending June 30.

* * * * * * *

(c) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or in the case of a foreign corporation not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in section 231. * * *

portation.' (*Fairbank* v. *United States, supra*, pp. 292–293.) And the court has indicated that where the tax is not laid on the articles themselves while in course of exportation the true test of its validity is whether it 'so directly and closely' bears on the 'process of exporting' as to be in substance a tax on the exportation. (*Thames and Mersey Insurance Co.* v. *United States, supra*, p. 25.) In this view it has been held that the clause does not condemn or invalidate charges or taxes, not laid on property while being exported, merely because they affect exportation indirectly or remotely. Thus a charge for stamps which each package of manufactured tobacco intended for export was required to bear before removal from the factory was upheld in *Pace* v. *Burgess* (92 U. S., 372) and *Turpin* v. *Burgess* (117 U. S., 504); and the application of a manufacturing tax on all filled cheese to cheese manufactured under contract for export and actually exported was upheld in *Cornell* v. *Coyne* (192 U. S., 418 [T. D. 757]). In that case it was said (p. 427):

"'The true construction of the constitutional provision is that no burden by way of tax or duty can be cast upon the exportation of articles, and does not mean that articles exported are relieved from the prior ordinary burdens of taxation which rest upon all property similarly situated. The exemption attaches to the export and not to the article before its exportation.'"

The Supreme Court then added that the income tax there in question was not laid on articles in the course of transportation or anything which inherently or by usage is embraced in transportation, or any of its processes. It was a tax laid generally on net income. While it could not be applied to any income which Congress had no power to tax, it was both nominally and actually a general tax. It was not laid on income from exportation because of its source or in a discriminatory way, but just as it was laid on other income; exportation was affected only indirectly and remotely. If articles manufactured and intended for export were subject to taxation under general laws up to the time they were put in the course of exportation, the conclusion was unavoidable that the net income from the venture when completed was likewise subject to taxation under general laws.

In a companion case (*United States Glue Co.* v. *Oak Creek*, 247 U. S., 321), wherein the power of a State under a general income law to include income derived from transactions in interstate commerce, was sustained, the Supreme Court stated:

"It is settled that a State may not directly burden interstate commerce, either by taxation or otherwise. But a tax that only indirectly affects the profits or returns from such commerce is not within the rule. Thus, it was declared in *Postal Telegraph Cable Co.* v. *Adams* (155 U. S., 688, 695–696):

"'It is settled that where by way of duties laid on the transportation of the subjects of interstate commerce, or on the receipts derived therefrom or on the occupation or business of carrying it on, a tax is levied by a State on interstate commerce, such taxation amounts to a regulation of such commerce and can not be sustained. But property in a State belonging to a corporation, whether foreign or domestic, engaged in foreign or interstate commerce, may be taxed, or a tax may be imposed on the corporation on account of its property within a State, and may take the form of a tax for the privilege of exercising its franchises within the State, if the ascertainment of the amount is made dependent in fact on the value of its property situated within the State (the exaction, therefore, not being susceptible of exceeding the sum which might be leviable directly thereon), and if payment be not made a condition precedent to the right to carry on the business, but its enforcement left to the ordinary means devised for the collection of taxes.'

"Again, in *Atlantic & Pacific Telegraph Co.* v. *Philadelphia* (190 U. S., 160, 163), the court upon a review of numerous previous cases laid down certain propositions as established, among them these: (*a*) That the immunity of an individual or corporation engaged in interstate commerce from State regulation does not prevent a State from imposing ordinary property taxes upon property having a situs within its territory and employed in interstate commerce; and (*b*) that the franchise of a corporation, although that franchise be the business of interstate commerce, is, as a part of its property, subject to State taxation, provided at least the franchise be not derived from the United States. See also *St. Louis Southwestern Ry. Co.* v. *Arkansas* (235 U. S., 350, 365).

"Yet it is obvious that taxes imposed upon property or franchises employed in interstate commerce must be paid from the net returns of such commerce, and diminish them in the same sense that they are diminished by a tax imposed upon the net returns themselves.

"The distinction between direct and indirect burdens, with particular reference to a comparison between a tax upon the gross returns of carriers in interstate commerce and a general income tax imposed upon all inhabitants incidentally affecting carriers engaged in such commerce, was the subject of consideration in *Philadelphia & Southern S. S. Co.* v. *Pennsylvania* (122 U. S., 326, 345), where the court, by Mr. Justice Bradley, said:

"'The corporate franchises, the property, the business, the income of corporations created by the State may undoubtedly be taxed by the State; but in imposing such taxes care should be taken not to interfere with or hamper, directly or by indirection, interstate or foreign commerce, or any other matter exclusively within the jurisdiction of the Federal Government.'" [1]

Under the principles above enunciated by the Supreme Court it would seem clear that the Federal Government may levy a general excise tax on the privilege of doing business in corporate form measured by the fair value of the capital stock and that the tax is not invalid in so far as or because the property or capital is employed in the export trade.

The plaintiff relies strongly upon the analogy afforded by cases like *Western Union Telegraph Co.* v. *Kansas* (216 U. S., 1); *International Paper Co.* v. *Massachusetts* (246 U. S., 135), wherein it was held that an excise tax levied by a State on the privilege of doing business within the State, measured by the entire capital of the corporation within and without the State, was under the circumstances of the particular case invalid because the purpose or necessary effect of the act was to burden interstate commerce or tax property beyond the jurisdiction of the State. (C. F. *Baltic Mining Co.* v. *Massachusetts*, 231 U. S., 68; *Kansas City, etc., R. R. Co.* v. *Botkin*, 240 U. S., 226; *Kansas City, etc., R. R. Co.* v. *Stiles*, 242 U. S., 111.)

To this contention it may be answered that not only is the power of the Federal Government with reference to foreign commerce not as limited as is the power of a State with reference to interstate commerce, but under the decisions, a State may, in nondiscriminatory manner, tax property, tangible or intangible, employed in interstate commerce, so long as it does not reach out for more than its fair share. A State may thus tax that proportion of the entire capital of a corporation that its property or business in the State bears to all its property and business. (*St. Louis S. W. R. Co.* v. *Arkansas*, 235 U. S., 350; *New York* v. *Roberts*, 171 U. S., 658; *Adams Express Co.* v. *Ohio State Auditor*, 165 U. S., 194; *Western Union* v. *Taggart*, 163 U. S., 1; *Postal Co.* v. *Adams*, 155 U. S., 688; *Pittsburgh C. C. & St. L. R. Co.* v. *Backus*, 154 U. S., 429.) Such analogy, therefore, as these cases afford would seem to support the power of the Federal Government to levy a general excise tax on the privilege of doing business in corporate form measured by the fair value of the capital stock, without any exemption to any corporation by reason of its capital being employed in whole or in part in the export trade.

The defendant's motion for judgment on the pleadings will be granted.

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[1] A State, however, may not levy a direct tax on the gross receipts from interstate commerce, even though the tax is general, and applies as well to the internal commerce of the State (*Crew Levick Co.* v. *Pennsylvania*, 245 U. S., 295); nor may the United States levy such a tax on export sales or the gross receipts therefrom; the tax is not bein (?) by reason of the fact that it may be equally applicable to domestic commerce. (*A. G. Spalding & Bros.* v. *Edwards, Collector*, decided by the Supreme Court on April 23, 1923 [T. D. 3476; C. B. II-1, p. 263].)

MISCELLANEOUS TAX RULINGS.

TITLE III.—WAR TAX ON BEVERAGES. (1917)

SECTION 304: Additional tax on rectified spirits. II–18–1037
T. D. 3502

DISTILLED SPIRITS—SECTION 304, REVENUE ACT OF 1917—COURT DECISION.

1. RECTIFIED SPIRITS—FILTRATION—RECTIFICATION.

The filtration of gin, subsequent to its original and completed production, by forcing it through a Karl Kiefer filter, thus removing a cloudy condition of the liquid which resulted from its reduction in proof, is rectification within the meaning of and subject to the tax levied by section 304 of the Revenue Act of 1917. The case of *Mayes* v. *Paul Jones Company* (270 Fed., 121) distinguished.

2. REDISTILLATION—RECTIFICATION—EXEMPTION.

The proviso of section 304 of the Revenue Act of 1917 does not exempt from tax a subsequent rectification of gin by filtration. The proviso exempts from tax only gin produced "by the redistillation of a pure spirit over juniper berries and other aromatics."

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

To collectors of internal revenue and others concerned:

The attached decision of the District Court of the United States, Southern District of New York, in the case of *Fleischmann Manufacturing Company* v. *Roscoe Irwin, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved July 30, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF NEW YORK.

Fleischmann Manufacturing Company, plaintiff, v. *Roscoe Irwin, Collector of Internal Revenue.*

[June 29, 1923.]

AUGUSTUS N. HAND, District Judge:

This is an action to recover a tax of 15 cents per gallon on gin manufactured by the plaintiff, paid under protest. The sum so sought to be recovered is $28,343.29 and interest.

The Revenue Act of 1917 went into effect October 4 of that year. Prior to that date the plaintiff had manufactured a large quantity of gin and stored it in barrels at 140 proof in a bonded warehouse.

It was then taken from the warehouse and the distiller's tax paid, and taken to a reducing house, where distilled water was added to reduce it from 140 to 95 proof. The addition of the water threw the essential oils out of solution. It was then pumped to the top floor of the building into a Kiefer filter and the cloudy precipitate caused by these oils was removed by the filtration. This last process was a rectification not accompanying redistillation. It was different from a mere straining out of foreign matter, such as the particle of charcoal referred to in the case of *Mayes* v. *Paul Jones Co.* (270 Fed., 121), but was the removal of a chemical substance originally integral with the gin.

The exemption under section 304 of the Act of 1917 of "gin produced by the redistillation of a pure spirit over juniper berries and other aromatics" from the 15 (per) cent tax relates only to gin rectified in the process of redistillation and not to a separate process of rectification after the gin is produced.

Moreover, I think there was in the process used in this case no redistillation "over juniper berries and other aromatics." The vapors did not pass over or through the berries but the berries were here placed in the pure spirits and boiled and the redistillation followed.

The method of redistillation does not come within the terms of the proviso and there was also a rectification subsequent to and independent of the redistillation. The plaintiff, therefore, can not recover the tax.

TITLE VII.—TAX ON CIGARS, TOBACCO, AND MANUFACTURES THEREOF.

SECTION 701(b); REGULATIONS 8, SECTIONS 27(b) AND 70: Miscellaneous. II–31–1174 T. D. 3527

TOBACCO.

"Black Fat" or "Black Horse" tobacco prepared by manufacturers of tobacco for sale must be put up in packages not exceeding 16 ounces net weight.

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

To collectors of internal revenue and others concerned:

Section 27(b) of Regulations 8, relating to the tax on tobacco, snuff, cigars and cigarettes, and purchase and sale of leaf tobacco, provides that leaf tobacco which is manipulated in a manner to produce what is known as "Black Fat," "Black Horse," etc., tobacco, when intended for use as ship's stores or consumption in the United States, is subject to tax and must be put up in proper packages by a manufacturer of tobacco and stamped tax-paid.

Section 70 of the same regulations sets forth the sizes of packages of tobacco and snuff, in which such product shall be put up by a manufacturer of tobacco, as prescribed by law.

Cavendish, plug, and twist tobacco only may be put up in packages exceeding 16 ounces. Black Fat tobacco can not be considered by even the most liberal interpretation, or by any ascertained trade usage, as ever being within either of these three classifications. It is leaf tobacco, notwithstanding the special treatment, which changes its appearance or color.

Therefore, "Black Fat" or "Black Horse" tobacco, which is put up by a manufacturer of tobacco for sale or consumption in the United States, or for use as ship's stores, shall be packed in packages

as prescribed by law in respect to all other kinds of tobacco not otherwise provided for, containing not exceeding 16 ounces net weight, and as prescribed in section 70 of Regulations 8, revised February, 1922, in respect to leaf tobacco intended to be sold to consumers by a person other than the farmer or grower thereof.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved October 27, 1923.
A. W. MELLON,
Secretary of the Treasury.

SECTION 704, REGULATIONS 8, SECTION 15: Definitions and classifications. II-32-1178 T. D. 3528

LEAF TOBACCO.

An association or corporation composed of growers of leaf tobacco which contracts with its members to handle cooperatively as principal the purchase and sale of leaf tobacco grown by them is in no sense a farmer or grower of leaf tobacco, and is, therefore, not exempt from liability as a dealer in leaf tobacco under the provisions of subdivision (f) of section 3360, R. S., as amended.

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

To collectors of internal revenue and others concerned:

An association or corporation without capital stock, organized by a group of farmers for the purpose of selling cooperatively leaf tobacco grown by them, the sales being conducted by the association or corporation as principal, can not claim exemption from liability as a dealer in leaf tobacco upon the theory that it regards itself as identical with its members, or, in other words, that it is a farmer or grower itself and, as such, is entitled to the same exemption accorded to that class.

In the sale of the tobacco produced by the farmer and delivered by him to the association as a member thereof, the establishment of a contractual relationship between the two parties is inevitable, which destroys at once the theory of their identity. The association in selling the tobacco produced by its members must act either as principal or as agent. When the association agrees to buy, and the grower agrees to sell and deliver to the association all the tobacco produced by him or for him, the delivery of the tobacco by a member to the association operates as a transfer of title thereto and in the subsequent sale of the tobacco by the association the association acts as principal, not as agent, and is, therefore, clearly within the statutory definition of a dealer in leaf tobacco, as one "whose business it is, for himself * * *, to sell, or offer for sale, * * * leaf tobacco."

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 6, 1923.
A. W. MELLON,
Secretary of the Treasury.

TITLE X.—SPECIAL TAXES.

SPECIAL TAXES UPON BUSINESSES AND OCCUPATIONS.

SECTION 1001(1).—BROKERS.

SECTION 1001(1), REGULATIONS 59, ARTICLE 5: Brokers: Persons liable. II–39–1275 MS. 22

It is held that brokers whose business it is to negotiate purchases or sales of meat or peanuts for others are liable for the special tax imposed by section 1001(1) of the Revenue Act of 1921.

Inquiry is made relative to the liability to special tax under section 1001, subdivision (1), Revenue Act of 1921, of a person engaged in business as a meat broker. Inquiry is further made as to whether meat is considered as produce or merchandise within the meaning of the statute.

The word "meat" when used in its narrow sense is the flesh of animals as distinguished from fish or fowl, used most commonly as an article or product of food, which is produced through the slaughter or killing of live stock or animals. Since produce, in the meaning of the statute, applies generally to those products which are brought forth, yielded, or produced, this office is of the opinion that meat is clearly defined as a commodity of this character, and brokers handling such product are held liable to the special tax imposed under the above section of the law.

Inquiry is also made relative to liability to special tax of a peanut broker, and information is sought as to whether peanuts are considered produce or merchandise within the meaning of the Act.

Peanuts are defined as a nutlike seed of a plant or agricultural product brought forth or yielded on the farm and as such are considered produce. However, when sold as a product of food, they might also be classified as merchandise, since this term applies in a general way to objects of commerce and whatever is usually bought or sold in trade or market by merchants or others.

It is therefore held that brokers whose business it is to negotiate purchases or sales of meat or peanuts for others are liable to the special tax imposed under the above section of the law.

SECTION 1001 (5) AND (7), REGULATIONS 59, ARTICLE 20: Transfer of stamp. ARTICLE 24: Other public exhibitions or shows for money: Taxable exhibitions. II–36–1247 MS. 20

It is held that in changing a theater to a dance hall, where only one admission fee (carrying with it the privilege of dancing) is charged, no liability is incurred as proprietor of a public exhibition. Should a charge for admission be made, however, and an additional and separate amount be charged for each dance or for the privilege of using the dance surface, liability will be incurred as proprietor of a public exhibition.

Receipt is acknowledged of your letter with reference to the payment of special tax incurred under section 1001, subdivision 5, of the Revenue Act of 1921.

Under the provisions of section 3237, Revised Statutes, all special taxes become due on the 1st day of July in each year or on the commencing of any trade or business on which such tax is imposed.

In the former case the tax is reckoned for one year and in the latter case it is reckoned proportionately from the 1st day of the month in which liability to special tax commenced to the 1st day of July following.

There is no provision under the statute whereby the Commissioner of Internal Revenue may redeem or make allowance on special-tax stamps for unexpired portions of periods for which such stamps have been obtained to conduct a business upon which a special tax is imposed. In view of these conditions, there is no way in which you may obtain a refund of the unexpired portion of the special-tax stamp purchased by you during July for the purpose of conducting the M Theater.

It is noted that you closed your theater on September 29 with the intention of reopening it as a dance hall about December 1, and make inquiry as to whether the above stamp may be transferred to cover the operation of such business. If, in this instance, you intended charging only one admission fee, carrying with it the privilege of dancing, no liability will be incurred as a proprietor of a public exhibition and no special-tax stamp will be required. However, should a charge for admission be made to the building or hall, and an additional and separate amount be charged for each dance, or for the privilege of using the dance surface, liability will be incurred under section 1001, subdivision 7, of the Revenue Act of 1921, as imposed upon proprietors of public exhibitions.

This office is of the opinion that a person ceases to be the proprietor of a theater when he discontinues such business and dismantles or remodels the edifice in order to operate another separate and distinct character of business. It is therefore held that if you operate your dance hall under the conditions set forth in the last sentence of the foregoing paragraph, a separate and distinct liability will be incurred and the special-tax stamp purchased by you as proprietor of the M Theater can not be transferred to cover your new business.

SECTION 1001(8).—BOWLING ALLEYS.

SECTION 1001(8), REGULATIONS 59, ARTICLE 27: II–35–1224
Bowling alleys: Scope of tax. MS. 19

> Section 1001(8) of the Revenue Act of 1921 imposes upon proprietors of bowling alleys and billiard rooms a special tax of $10 on each alley or table. The replacement of a specific number of alleys or tables with a like number of tables or alleys would not change the unit taxation or affect the special tax in any manner and will not subject a proprietor to additional tax.

Receipt is acknowledged of your letter relative to liability to special tax incurred by A as proprietor of a bowling alley. You state that A has disposed of two pool tables and has installed in their stead two bowling alleys, which raises a question as to additional special tax liability.

Under the provisions of section 1001, subdivision (8), Revenue Act of 1921, a special tax is imposed upon proprietors of bowling alleys and billiard rooms at the specific rate of $10 for each alley or table. Since it appears that the replacement of a specific number of tables or alleys by a like number of tables or alleys would

not change the unit taxation or affect the special tax stamp in any manner, this office is of the opinion that A is not subject to an additional special tax.

Whenever such change is made, the collector of internal revenue for the district in which the taxpayer resides should be informed and notation made on his Form 11 showing the replacement of tables or alleys.

SECTION 1001(8), REGULATIONS 59, ARTICLE 27: Bowling alleys—Scope of tax. II–36–1248 MS. 21

It is held that a license forfeited by a taxpayer for violation of law can not be transferred to another without that other becoming liable for the special tax provided by the statute.

Receipt is acknowledged of your letter with reference to the special tax imposed upon A of the city of M, as proprietor of a pool room.

It is noted that A operated a pool table and paid the necessary special tax imposed thereon during the fiscal year ending June 30, 1923, and that he operated under the name of A on both his Federal special tax and the city license which was granted him by the city of M.

It is also noted that on December 12, 1922, taxpayer A was convicted of violating the State prohibition law, and under the State statutes his city permit to sell beverages, and also his city permit to operate a pool room, was automatically revoked upon his conviction. You state that immediately after his conviction his wife filed application for a pool-table license with the city of M, and a new license was issued in the name of said wife commencing on December 13, 1922.

You inquire whether the wife of taxpayer A can be held for the special tax imposed upon proprietors of pool rooms under the above circumstances. Under the provisons of section 1001, subdivision 8, proprietors of bowling alleys and billiard rooms shall pay a special tax of $10 for each alley or table.

Under the above section of the law, it is the opinion of this office that immediately upon filing application for a city license as proprietor of a pool room a new liability is established. There appears to be no provision in the law or regulations whereby a wife may take over her husband's business upon which a special-tax stamp has been issued under the circumstances set forth in your request. It is therefore held that the wife of taxpayer A is subject to the special tax imposed upon a proprietor of a pool room, commencing on December 13, 1922.

SECTION 1001(10).—RIDING ACADEMIES.

SECTION 1001(10), REGULATIONS 59, ARTICLE 30: Riding academies: Liability to tax. II–21–1063 MS. 13

REVENUE ACT OF 1921.

It is held that a fenced-in area where a charge is made for the use of ponies for amusement purposes but where no instruction in horsemanship is given is not a riding academy within the meaning of section 1001(10) of the Revenue Act of 1921.

A operates a fenced-in area where a charge is made for the use of ponies. Instructions are not given but facilities for the practice of horsemanship are provided, a charge being made for each ride.

Children ride the ponies around the space, which is a few hundred feet in length, and a charge of 10 cents is made for each ride. There is no instruction in horsemanship given, nor is the place maintained for the practice of horsemanship.

The law imposing a special tax on proprietors of riding academies provides:

> Proprietors of riding academies shall pay $100. Every building, space, tent, or area, where a charge is made for instruction in horsemanship or for facilities for the practice of horsemanship shall be regarded as a riding academy.

The terms used in the taxing statutes, unless defined therein, are to be interpreted in their general and commonly accepted meaning. "Facilities for the practice of horsemanship" is commonly understood to mean some form of systematic exercise for instruction or discipline in the art of horsemanship. It can hardly be considered that a small area in which children are permitted to ride ponies once around the track for 10 cents primarily for amusement, such as appears to be the facts in the present case, could be an area where a charge is made for facilities for the practice of horsemanship within the meaning of the law. From the facts presented, it is held that the proprietor of this area is not subject to the special tax imposed on proprietors of riding academies.

SECTION 1001(11).—PASSENGER AUTOMOBILES.

SECTION 1001(11), REGULATIONS 59, ARTICLE 32: II–33–1199
Passenger automobiles: Special-tax stamps. MS. 18

> A taxpayer having paid the special tax for operating a passenger automobile for hire, later trading his larger automobile for two smaller cars, may have the stamp originally issued to him transferred to cover the operation of one of the smaller cars but can receive no refund because of the difference in rate of tax between the old and the new car. It would also be necessary for him to purchase new stamp at the lower rate of tax covering operation of the additional car.

Receipt is acknowledged of your letter requesting a ruling as to the liability to special tax under section 1001, subdivision (11), where an operator of a passenger automobile for hire who, after paying the special tax of $20, trades said automobile for two cars, each having a seating capacity of not exceeding seven. You inquire whether the owner may operate the two cars under the stamp covering the tax paid on the one automobile, or if a new special tax liability is incurred.

Under article 32, Regulations 59 (1922 edition), a taxpayer must secure a stamp for each car operated. He may replace a given number of cars with a like number of new cars without incurring additional liability, unless the new car is of a seating capacity subject to a higher rate of tax than the car replaced. There is no provision under the law or regulations whereby a taxpayer may replace a given number of cars subject to the higher rate of tax with a larger number of cars subject to the lower rate of tax without incurring additional liability.

It is clearly evident that the above section of the statute imposes a tax upon the "business" of operating or renting passenger automobiles for hire, which is computed on the basis of the total number of cars operated and the seating capacities of each. While the above taxpayer in question appears to reduce his liability to the lower unit of taxation, he actually increases the number of automobiles operated, and this office is of the opinion that under these circumstances an additional liability is incurred.

In the above instance the taxpayer may have the original stamp issued him for the large car transferred to cover the operation of one of the smaller cars but no refund can be made because of the difference in the rate of tax between the old and new automobiles. It would also be necessary for him to purchase a new stamp at the lower rate of tax covering the operation of the additional car.

SECTION 1008.—STAMP TAXES; NARCOTICS.

SECTION 1008, REGULATIONS 35 (REVISED), ARTICLE 67: Manner of payment. II-26-1123 T. D. 3520

NARCOTIC LAW—STRIP STAMPS—REVENUE ACT OF 1918.

Manner of payment of narcotic stamp tax and sizes and denominations of stamps—Amendment of articles 67 and 70, Regulations No. 35 (revised).

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

To collectors of internal revenue, importers and manufacturers of narcotics, and others concerned:

Adhesive strip stamps to be used in payment of the tax imposed on narcotic drugs and preparations under section 1 of the Act of December 17, 1914, as amended, are now issued in all the required denominations and sizes. Packages of narcotics have been sold on which stamps of larger size than those attached should have been used. For the information of those concerned and in order more nearly to effectuate the payment of this tax in the manner prescribed by the Act, articles 67 * * *, Regulations No. 35 (revised), are hereby amended, effective immediately, to read as follows:

ART. 67. *Manner of payment.*—The tax is paid by attachment of stamps to the package forming the unit of tax (see art. 68). One or more stamps of an appropriate size must be so affixed in the case of bottles, tins or other manufactured containers as to securely seal the stopper, lid, or covering at two opposite points. If the package is not constructed with a stopper or covering designed for ready removal one or more stamps must be so affixed as to afford a secure seal for the package.

SECTION 1008, REGULATIONS 35 (REVISED), ARTICLE 70: Kinds of stamps. II-26-1124 T. D. 3520

* * * Articles * * * 70, Regulations No. 35 (revised), are hereby amended, effective immediately, to read as follows:

ART. 70. *Kinds of stamps.*—Adhesive strip stamps are issued in the following denominations and sizes:

Sizes.	Denominations.
1½ by ¼ inches.....	1 cent.
2½ by ⅜ inches.....	1 and 2 cent.
4 by ½ inches.....	1, 2, 5, 6, 8, 10, and 16 cent.
6 by ¾ inches.....	1, 2, 5, 6, 8, 10, 16, 25, and 40 cent, and $1 and $1.28.

As to cancellation of stamps see article 79.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved September 26, 1923.

A. W. MELLON,
Secretary of the Treasury.

TITLE XI.—STAMP TAXES.

SCHEDULE A-1. BONDS OF INDEBTEDNESS.

REGULATIONS 55, ARTICLE 3: Bonds accompanying real estate mortgages. II-33-1195 T. D. 3530

STAMP TAXES—REVENUE ACT OF 1918—DECISION OF THE COURT.

1. BONDS OF INDEBTEDNESS—SCOPE OF TITLE XI, SECTION 1100, REVENUE ACT OF 1918 (SUBDIVISION 1, SCHEDULE A).

Title XI, section 1100, of the Revenue Act of 1918 (subdivision 1, Schedule A), lays a documentary stamp tax upon an instrument in writing, under seal, conditioned for the repayment of money borrowed and obligating the borrower to do certain things under penalty of forfeiture and foreclosure, regardless of whether the seal is necessary or unnecessary, regardless of whether the instrument is called by some other name than a bond of indebtedness, and regardless of whether it is negotiable or assignable or nonnegotiable and nonassignable.

2. BONDS OF INDEBTEDNESS—TAXABILITY DETERMINED BY THE FACE OF THE INSTRUMENT.

Under Title XI, section 1100, of the Revenue Act of 1918 (subdivision 1, Schedule A) the taxability of an instrument is determined by looking to its form and substance, and not particularly to its operation. Denominating a writing as a "contract" does not serve to exempt it from the tax if it is apparent from its face and substance that it is a taxable instrument.

3. CERTIFICATE OF INDEBTEDNESS—NEGOTIABILITY AND ASSIGNABILITY.

Title XI, section 1100, of the Revenue Act of 1918 (subdivision 1, Schedule A), taxing certificates of indebtedness, makes no exception in favor of such certificates as are nonnegotiable and nonassignable and have none of the attributes of investment securities.

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

To collectors of internal revenue and others concerned:

The following decision of the United States District Court for the Southern District of Illinois in the case of *Danville Building Association, a Corporation*, v. *John L. Pickering, collector*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved November 10, 1923.
A. W. MELLON,
Secretary of the Treasury.

IN THE DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF ILLINOIS, SOUTHERN DIVISION. AT LAW. No. 17061.

Danville Building Association, a Corporation, plaintiff, v. *John L. Pickering, etc., et al., defendants.*

This is an action at law to recover of the defendant Pickering, as collector of internal revenue, stamp taxes paid under protest. Plaintiff is a building and loan association, operating under the Illinois building, loan and homestead act, which makes loans to members or shareholders. When a loan is made, the member is required to assign his certificate of shares to the association as collateral security for the amount of the loan, to execute an instrument called a "Contract," and to convey by mortgage to the association the real estate upon which the loan is used, to secure the repayment of the loan, according to the provisions of the contract. The collector of internal revenue found the instrument described as a contract to be in fact a bond within the description of Title XI, Schedule A, paragraph 1, of the Revenue Act of 1918. A tax was collected in the sum of $1,537.90. It was paid under protest by the association, an appeal was prosecuted to the Commissioner, as required by the statute, and the findings and the action of the collector were affirmed.

The alleged document, labeled on its back a "Contract," is as follows:

"BE IT KNOWN, THAT ———, party of the first part, are justly indebted to Danville Building Association, a corporation, of Danville, Illinois, party of the second part, in the sum of —— dollars, which has been by said second party loaned to said first party in full payment of —— shares of the —— class —— series of the capital stock of said second party, owned by first party, and evidenced by certificate No. ——, which certificate is hereby assigned to said second party as collateral security for said loan, under and by virtue of the by-laws of said second party.

"And in consideration of said advanced loan so being made said first party hereby agrees to pay said second party on the last Saturday of each month hereafter, at the office of its secretary, in Danville, Illinois, the sum of —— dollars as the monthly dues on said —— shares of stock and interest at the rate of —— per cent per annum, plus or minus such an amount as may be hereafter fixed by the by-laws of said corporation as additional or lesser interest, it being hereby expressly agreed and understood that the present by-laws of said association provide for loans at —— per cent per annum, but that in the event said by-laws are hereafter modified or changed so that said interest rate is lowered or raised, then and in that event said party of the first part agrees to pay on the last Saturday of each month interest at the rate so fixed by any such amended by-law or by-laws. Said second party shall also pay all fines assessed on said stock, as provided in the by-laws of said second party. This agreement shall remain in full force until each member of said second party owning stock in said class and series above mentioned shall have received on each share of his stock One hundred dollars.

"And said first party further agrees that they will in due season pay all taxes and assessments of the premises mentioned in a mortgage executed

this day by said first party to said second party to secure this agreement, and will exhibit once a year to the secretary of said second party receipts of the proper persons or officers, showing payment thereof, until the expiration of the time for which this agreement is to run; and will keep constantly insured, in a company or companies and agency party of the second part may designate, all buildings that may at any time be on said premises during the continuance of said indebtedness for not less than —— dollars against loss or damage by fire; lightning, and —— dollars against loss or damage by cyclone; loss, if any, on all policies carried payable to party of the second part to the extent of its mortgage interest, and deposit the policy or policies with party of second part before the expiration of existing insurance; and in case said party of first part shall fail to keep or pay for keeping said buildings insured, and to deposit the policy or policies as aforesaid, and to pay said taxes and assessments, then, without notice, party of the second part shall have full right and authority to procure and pay for said insurance, and to pay said taxes and assessments, and pay for continuation of abstract of title for said premises, and the amount so paid shall constitute a part of the debt secured by this instrument, and shall bear seven per cent interest per annum from the time of such payment.

"And said first party hereby agrees that in case default shall be made for the space of six months in the payment of any installment of dues, or interest, or in the payment of any fine, or if default shall be made for the space of sixty days in the payment of any insurance premium or tax or special assessment, or abstract bill, said party of the second part shall have the right to declare the said share of stock forfeited and the entire debt due, payable and recoverable, in which event said second party shall have the right to apply the amount so paid in dues on said indebtedness. Said second party shall thereupon have the right by virtue hereof, and by virtue of the by-laws of said second party, which by-laws now in force and hereafter enacted are hereby declared to be a part of this contract.

"In case of such foreclosure, said first party agrees to pay all costs of suit, including a reasonable attorney's fee, to be added to and made part of said judgment or taxed as costs, and does hereby agree that on the filing of such bill a receiver of said premises may be appointed without notice and before summons served, which said receiver shall have a right to take immediate possession of said premises or collect rent therefor.

"Dated this — day of ——, A. D. ——.

"Signed, sealed and delivered in presence of_____[SEAL]

_____[SEAL]

_____[SEAL]

_____[SEAL]

It is contended by the plaintiff that the document is a "contract or evidence of indebtedness," and is not subject to taxation within the meaning of Schedule A; that the stamp tax was wrongfully collected and that it should be recovered. Defendant demurs to the declaration.

The following sections of the statute are material to the determination of the issues raised by the pleadings:

Revenue Act of 1918 (Act of February 24, 1919), Title XI (40 Stat., 1057):

"SEC. 1100. That on and after April 1, 1919, there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule. The taxes imposed by this section shall, in the case of any article upon which a corresponding stamp tax is now imposed by law, be in lieu of such tax."

"SEC. 1102. That whoever—

"(a) Makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document, or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid; * * *

"Is guilty of a misdemeanor and upon conviction thereof shall pay a fine of not more than $100 for each offense."

"SCHEDULE A.—STAMP TAXES.

"1. Bonds of indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any person, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue: *Provided further*, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured."

Schedule A requires the stamps shall be affixed to "bonds" and "certificates of indebtedness." The question is, Does the instrument in question come within that description?

It has been very tersely said that a bond is merely an obligation under seal. *Commonwealth* v. *Smith* (92 Mass. (Allen), 448). In *Rawsin* v. *Taylor* (95 N. W., 1033) it is said:

"A bond may be briefly defined to be a sealed obligation to pay money."

Blackstone defines a bond as:

"A deed whereby the obligor obligates himself, his heirs, executors, or administrators, to pay a certain sum of money on a day appointed."

(*Williams* v. *State*, 6 So., 831; *Rondot* v. *Rogers, Twp.*, 99 Fed., 202.)

In *Courand* v. *Vollmer* (31 Tex., 397) it was said:

"A bond is what binds. Therefore, any instrument in writing that legally binds a party to do a certain thing may be called a bond."

An examination of the above instrument will disclose the following obligations:

First, the first party acknowledges that he is indebted to the second party in the sum of $——.

Second, the first party assigns as collateral security for the said loan certificate No. ——, evidencing his ownership of shares of stock in the association.

Third, the first party agrees to pay to the second party the sum of $—— as monthly dues on his shares of stock, together with interest payable monthly.

Fourth, the first party agrees to pay all taxes and assessments on the premises *mentioned in the mortgage accompanying the bond* and to keep such premises insured in favor of the second party to the extent of the mortgage interest of the second party therein.

Fifth, in case of default by the first party the second party shall have the right to declare the shares of stock forfeited and the entire amount of the loan due and the second party shall have the right to bring foreclosure proceedings at the cost of the first party.

The instrument is required to be executed under seal.

In the light of these obligations, the court feels that the instrument comes clearly within the class of documents described and that it is not only a bond, obligating the borrower to do certain things, but to do them under the penalty of forfeiture and foreclosure, and is a taxable instrument. The mere fact that it is labeled a "contract" does not take it outside the provisions of the statute. The instrument speakes for itself, and whether it is taxable or not must be determined from its face. (*United States* v. *Isham*, 17 Wall., 496, 21 L. Ed. 728; *Malley* v. *Bowditch*, 259 Fed., 809; *Merchants Warehouse Co.* v. *McClain*, 112 Fed., 787; *Home Title Ins. Co. of New York* v. *Keith*, 230 Fed., 905.)

It is claimed by plaintiff that it is not a certificate of indebtedness within the meaning of Article XI, Schedule A, paragraph 1, because it is nonnegotiable and nonassignable and that it has none of the attributes of an investment security such as a certificate of indebtedness. The statute and the regulations prescribed by authority thereof provide no such exceptions.

It is claimed that the document in question is not a bond of indebtedness because it calls for no surety, it indemnifies nobody and has no penalty for its breach; and although it is under seal, the seal is not essential to its validity. It was not the theory of the collector that this is an indemnity or surety bond. In determining the question of liability for the tax we look to its form and substance and not particularly to its operation. (*United States* v. *Isham, supra.*)

The fact that the seal was unnecessary would not alter the situation any more than it would if the writing itself was unnecessary. *In re; Capitol*

Trading Co. Ins. (229 Fed., 806). It is sufficient, that it is conditioned for the repayment of money, to be taxed.

It is also contended, by way of justification for its conception, that Exhibit A was provided to take out of the mortgage a number of provisions that made it expensive to have the mortgage recorded according to the recording laws of the State of Illinois. The reasons for the execution of the instrument are also immaterial. Judged by its face and form, which is the only way courts may pass upon the taxability of such a document, the instrument is clearly a bond of indebtedness within the meaning of paragraph 1 of Schedule A. It is a bond conditioned for the repayment of money such as is referred to in the second provision of paragraph 1. It is exactly the kind of an instrument that is referred to in article 3 of Regulations 55, as a "bond accompanying a mortgage." That it is such a bond, and subject to the stamp tax provision of Title XI of the Revenue Act of 1918, this court has no doubt.

The demurrer to the declaration will be sustained.

SCHEDULE A–3. CAPITAL STOCK, SALES AND TRANSFERS.

REGULATIONS 40 (1922), ARTICLE 15: Memorandum for sales. II–18–1039 T. D. 3503

Memoranda for sales not required to show price per share at which stock is sold. Article 15 of Regulations 40 (1922 edition) amended.

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

To collectors of internal revenue and others concerned:

Article 15 of Regulations 40 (1922 edition) is hereby amended to read as follows:

ART. 15. *Memoranda for sales.*—Every person who makes an agreement to sell or transfer title to shares of stock by delivery of certificates assigned in blank, shall as a part of such transaction promptly make and deliver to the buyer a bill or memorandum of such sale or agreement to sell, duly signed by the seller or his agent, to which the requisite stamps shall be affixed and canceled, which bill or memorandum shall show the date of the transaction, the names of the seller and buyer, and the name and number of shares of stock, and the tax paid thereon, and in the case of a transaction made on an exchange shall bear a number upon the face thereof and have printed and written in ink thereon the words "Subject to the Revenue Act of 1921 and regulations made in accordance therewith." No more than one such bill or memorandum made by the seller on any given date shall bear the same number: *Provided, however,* That no single transaction or purchase or sale that is made upon an exchange by one member to another member shall require to be evidenced by more than one stamped memorandum of sale or agreement to sell.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved August 2, 1923.

S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

REGULATIONS 40 (1922), ARTICLE 17: Returns by persons making sales. II–30–1166 T. D. 3526

STAMP TAX ON TRANSFER OF STOCK.

Returns by persons engaged in the business of buying, selling, or transferring shares of stock. Article 17 of Regulations No. 40 (1922 edition) amended.

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

To collectors of internal revenue and others concerned:

Article 17 of Regulations No. 40 (1922 edition) is hereby amended to read as follows:

ART. 17. *Returns by persons making sales.*—(*a*) All persons who are wholly or partly engaged in the business of buying, selling, or transferring shares of stock, whether such sales, purchases or transfers shall be made, cleared, settled, or adjusted through a clearing house, or otherwise, shall on or before the 15th day of each month, and at any other time designated by the Commissioner, render under oath a true return (Form 838, revised 1923) for the preceding month or for any other period designated by the Commissioner. This return should be made to the collector of internal revenue for the district in which such person or persons are located, and should contain in detail the following data and information:

(1) The month for which the return is made.

(2) The name and address of the person, partnership, corporation, or association making the return.

(3) The value of stamps on hand on the 1st day of the month.

(4) The value of stamps purchased during the month.

(5) The value of stamps used during the month.

(6) Balance of stamps on hand at end of month.

(*b*) This return is required to be filed for each month even though no transactions occurred during the month.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 23, 1923.

A. W. MELLON,
Secretary of the Treasury.

SECTIONS 64–a AND 64–b, BANKRUPTCY ACT.

SECTIONS 64–a AND 64–b. II–17–1030
T. D. 3501

FEDERAL TAXES—BANKRUPTCY—DECISION OF COURT.

1. BANKRUPTCY—FEDERAL TAX—PRIORITY—LABOR CLAIMS.

Under the provisions of sections 64–a and 64–b of the Bankruptcy Act a claim for Federal taxes takes priority over payment of labor wage claims, where the assets of the estate are insufficient to pay all claims in full.

2. CASES DISTINGUISHED AND FOLLOWED:

Richmond v. *Bird* (249 U. S., 174), distinguished; *Guarantee Company* v. *Title Guaranty Co.* (224 U. S., 152); In re Weissman (178 Fed., 115) and In re Kittenplan (285 Fed., 62) followed.

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

To collectors of internal revenue and others concerned:

The attached decision of the United States Circuit Court of Appeals for the Ninth Circuit in the case of *West Coast Rubber Corporation, Inc., Bankrupt, et al.*, v. *A. J. Oliver, Trustee, et al.*,

is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 23, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

—

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

[In the matter of West Coast Rubber Corporation, Inc., a Corporation, bankrupt.]

The United States of America and The City and County of San Francisco, a Municipal Corporation, petitioners, v. *A. J. Oliver, as Trustee, and Oscar Courtin, Dorothy E. Knight, C. S. Sanford, D. C. Tuhey, H. Black, and Hugh V. Casserly, respondents.*

[July 2, 1923.]

Before GILBERT, HUNT, and RUDKIN, Circuit Judges.

GILBERT, Circuit Judge:

This case, on petition for revision, presents the question of the relative order of priority between tax claims and labor claims in the distribution of an estate in bankruptcy, the assets being insufficient to pay all such claims in full. It involves the construction of sections 64–a and 64–b of the Bankruptcy Act. 64–a directs the court to order the payment of "all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in the advance of the payment of dividends to creditors." 64–b provides: "The debts to have priority except as herein provided and to be paid in full out of bankrupt's estates shall be (after payment of costs of preserving the estate, filing fees and costs of administrations) (4) Wages of workmen, etc. Wages due to workmen, clerks, traveling or city salesmen or servants which have been earned within three months before the date of the commencement of proceedings, not to exceed $300 to each claimant." The court below held that the claim for wages was prior in rank to taxes owing by the bankrupt. In support of that ruling, reference is made to the language of section 64–a in which the taxes are directed to be paid before the payment of dividends to creditors, and it is said that as "dividends to creditors" means partial payments to general creditors, and payment of taxes is directed to be paid prior to the payment of such dividends only, the intention was to give priority to all the preferred claims mentioned in 64–b. It is true that the term "dividends to creditors" ordinarily refers to dividends to general creditors. But it does not necessarily have that meaning. A dividend is that which is to be divided. In bankruptcy it is the sum of money which is to be divided among two or more creditors. It is not necessarily a partial payment. It is obvious that it may at times be a payment in full even as to general creditors. We think it is the intention of 64–a to provide that taxes shall be paid before any payment is made to creditors, whether they be general creditors or preferred creditors. The power to levy and collect taxes is not only an indispensible attribute of sovereignty but it is absolutely necessary to the support of government, the maintenance of law and order, and the protection of life and property. It is not to be supposed that the power to tax would be subordinated to the claim of any creditor, however meritorious that claim may be. In the Bankruptcy Act of 1867 this was not left to doubt. The law made it clear that after the payment of costs, fees, and expenses, all debts due the United States, and all taxes and assessments under both the laws of the United States and the States, should be paid, and thereafter wages for services performed within a stated period prior to bankruptcy.

The court below found authority for its ruling in *Richmond* v. *Bird* (249 U. S., 174), in which the court said: "Section 64–a directs that taxes be paid in advance of dividends to creditors; and 'dividends' as commonly used throughout the Act means partial payment to general creditors." We do not find that the court was there dealing with the question which is involved

in this case. That was a case in which the city of Richmond sought to have taxes declared payable out of the bankrupt's assets in preference to the claim of a landlord which was secured by a specific lien arising upon distraint. The court held that the city had no such superior right, since neither the laws of the United States nor those of the State accorded it such priority. In *Richmond* v. *Bird* no reference was made to *Guarantee Company* v. *Title Guaranty Co.* (224 U. S., 152). In the latter case, the court had said: "Labor claims are given priority and it is provided that debts having priority shall be paid in full. The only exception is taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality." It is objected that what was thus said was obiter, but conceding that it may have been unnecessary to the decision of the question then pending before the court, it should nevertheless be taken as the expression of the view of the court upon the question of the relative rank of taxes and labor claims, and we do not find that it is inconsistent with or that it is met or answered by anything that was held or said in *Richmond* v. *Bird*. In harmony with the conclusion which we reach are In re Weissman (178 Fed., 115) and In re Kittenplan (285 Fed., 62).

The petitioner discusses also the question whether penalties are allowable as part of the taxes, but that question is not properly before us, the court below not having ruled upon it, and it appearing that the referee in bankruptcy, on a hearing had before him later than the hearing which is herein sought to be revised, had fixed the amount of taxes and that no review has been taken of his order.

That order is reversed.

SECTION 29, ACT OF JUNE 13, 1898.

SECTION 29, ACT OF JUNE 13, 1898. II–20–1049
T. D. 3506

LEGACY TAX—ACT OF 1898—DECISION OF COURT.

1. TAXES—IMPOSITION—ASSESSMENT.

The Act of April 12, 1902, repealing section 29 of the Act of June 13, 1898, saved all taxes "imposed" by the Act of 1898 prior to July 1, 1902.

Held: That the taxes levied by section 29 of the Act of June 13, 1898, were "imposed" prior to July 1, 1902, even though no assessment was made before that date, assessment not being a prerequisite to the "imposition" of a tax.

2. LEGACY TAX—VESTED INTERESTS—CONTINGENT INTERESTS.

The interest of residuary legatees in property transferred to them prior to July 1, 1902, in part payment of their legacies, is an interest vested in possession or enjoyment, and is not a contingent beneficial interest exempt from tax under the provisions of section 3 of the Act of June 27, 1902.

3. SAME—UNDISTRIBUTED LEGACIES.

Where residuary legatees were entitled to demand and collect legacies prior to July 1, 1902, the legacies were on that date vested in possession and enjoyment, and not exempt under section 3 of the Act of June 27, 1902, even though, on account of unpaid taxes, attorneys' fees, and administration expenses, the executors did not fully distribute the legacies until after July 1, 1902.

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

To collectors of internal revenue and others concerned:

The following decision of the Court of Claims of the United States in the case of *Anna Woerishoffer and Lewis Cass Ledyard, as*

executrix and executor of the last will and testament of Oswald Ottendorfer, deceased, v. *The United States*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved August 6, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

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COURT OF CLAIMS OF THE UNITED STATES. No. 33182.

[Decided June 4, 1923.]

Anna Woerishoffer and Lewis Cass Ledyard, as executrix and executor of the last will and testament of Oswald Ottendorfer, deceased, v. *The United States.*

This case having been heard by the Court of Claims, the court, upon the evidence, makes the following

FINDINGS OF FACT.

I.

On December 14, 1900, Oswald Ottendorfer, a citizen of the United States and of the State of New York, and a resident of the city of New York, in said State, died, leaving a valid last will and testament, dated May 22, 1891, and codicils thereto of dates May 25, 1892, November 29, 1897, and October 30, 1900, all of which were thereafter, on March 28, 1901, duly admitted to probate and record by the surrogate's court in and for the county of New York, in said State, and letters testamentary duly issued to Anna Woerishoffer and Lewis Cass Ledyard, plaintiffs herein, and to Julius W. Brunn, who were therein named as executrix and executors, they having accepted said trust. Said executrix and executors duly qualified and entered upon their duties as such. Said Julius W. Brunn has since deceased, leaving the plaintiffs as surviving executrix and executor of the will.

II.

Said last will and testament provided, among other things, as follows:

"Second. I give and bequeath unto my stepdaughter, Emma Schalk, for her sole and separate estate, the sum of $100,000.

"Third. I give and bequeath unto my stepdaughter, Mathilde Riedl von Riedenstein, for her sole and separate estate, the sum of $100,000.

"Fourth. I give and bequeath unto my stepdaughter, Anna Woerishoffer, for her sole and separate estate, the sum of $100,000."

"Twelfth. I give and bequeath unto my stepdaughter, Anna Woerishoffer, one share of the capital stock of the New Yorker Staats Zeitung.

"Thirteenth. I give and bequeath all other shares of the capital stock of the said New Yorker Staats Zeitung which may belong to me at the time of my death, and all my right, title, and interest in and to a certain contract with Herman Ridder for the sale to the said Ridder of shares of the capital stock of the said New Yorker Staats Zeitung, and all my right, title, and interest in the consideration which at the time of my death may remain to be paid by the said Herman Ridder, unto my said three stepdaughters Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer, or such of them as shall survive me, share and share alike."

"Twenty-sixth. I give and bequeath unto my housekeeper, Eleanora Stabler, the sum of $10,000."

In the codicil of May 25, 1892, it was provided:

"First. I hereby revoke the first article of my said will, whereby I disposed of all my household furniture, both useful and ornamental, china, glass, silver, books, paintings, pictures, engravings, wearing apparel, jewelry, horses, carriages, harnesses, and articles of stable equipment or furniture; and I do hereby give and bequeath all the above enumerated articles and property unto

my stepchildren, Edward Uhl, Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer."

And in the codicil of November 29, 1897, it was provided:

"Sixth. I give and bequeath unto Eleanora Stabler, mentioned in the twenty-sixth article of my said will, an additional sum of $10,000, thus increasing her legacy to the total sum of $20,000."

"Ninth. I give and bequeath unto Annibel, Baroness von Leitenberger, daughter of my stepdaughter, Mathilde Riedl von Riedenstein, the sum of $30,000."

"I give and bequeath unto Antoinette Woerishoffer, daughter of my stepdaughter, Anna Woerishoffer, the sum of $30,000."

"I give and bequeath unto Emma Carola Woerishoffer, daughter of my stepdaughter, Anna Woerishoffer, the sum of $80,000."

"Twelfth. I give, devise, and bequeath all the rest, residue, and remainder of my estate, mentioned in the said thirty-first article of my will, that is to say, all the residue thereof which shall remain after carrying out the provisions of my said will as modified by this codicil and my former codicil, share and share alike unto such of my stepdaughters, Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer, as shall survive me, and the issue me surviving of any of them who may have died before me, such issue of any deceased stepdaughter to take per stirpes and not per capita the share which the parent so dying would have taken had she survived me."

Said will and codicils also provided that all succession, legacy, or inheritance taxes that should be due or payable by law on any legacy passing under said will or codicils should be deducted from and paid out of the residuary estate, so that all legatees should receive their legacies free of all such taxes.

III.

Sections 1819, 2718, 2721, 2722, and 2723 of the Code of Civil Procedure of the State of New York were in force at the time of the decease of the said Oswald Ottendorfer, and thereafter until July 1, 1902, and for a considerable period after said date, and the said sections, with the omission of a portion of section 2718 that is not material to this case, are as follows:

"SEC. 1819. If, after the expiration of one year from the granting of letters testamentary or letters of administration, an executor or administrator refuses, upon demand, to pay a legacy, or distributive share, the person entitled thereto may maintain such an action against him as the case requires. But for the purpose of computing the time within which such an action must be commenced the cause of action is deemed to accrue when the executor's or administrator's account is judicially settled, and not before."

"SEC. 2718. The executor or administrator at any time after the granting of his letters may insert a notice once in each week for six months in such newspaper or newspapers printed in the county as the surrogate directs requiring all persons having claims against the deceased to exhibit the same, with the vouchers therefor, to him, at a place to be specified in the notice, at or before a day therein named, which must be at least six months from the day of the first publication of the notice. * * * If a suit be brought on a claim which is not presented to the executor or administrator within six months from the first publication of such notice, the executor or administrator shall not be chargeable for any assets or moneys that he may have paid in satisfaction of any lawful claims, or of any legacies, or in making distribution to the next of kin before such suit was commenced."

"SEC. 2721. No legacy shall be paid by any executor or administrator until after the expiration of one year from the time of granting letters testamentary or of administration, unless directed by the will to be sooner paid. If directed to be sooner paid, the executor or administrator may require a bond, with two sufficient sureties, conditioned, that if debts against the deceased duly appear, and there are not assets to pay the same, and no other assets sufficient to pay other legacies, then the legatees will refund the legacy so paid, or such ratable portion thereof with the other legatees, as may be necessary for the payment of such debts, and the proportional parts of such other legacies, if there be any, and the costs and charges incurred by reason of the payment to such legatee, and that if the probate of the will, under which such legacy is paid, be revoked, or the will declared void, that such legatee will refund the whole of such legacy,

with interest, to the executor or administrator entitled thereto. After the expiration of one year, the executors or administrators must discharge the specific legacies bequeathed by the will and pay the general legacies; if there be assets. If there are not sufficient assets, then an abatement of the general legacies must be made in equal proportions. Such payment shall be enforced by the surrogate in the same manner as the return of an inventory, and by a suit on the bond of such executor or administrator whenever directed by the surrogate."

"SEC. 2722. In either of the following cases a petition may be presented to the surrogate's court praying for a decree directing an executor or administrator to pay the petitioner's claim, and that he be cited to show cause why such a decree should not be made:

"1. By a creditor for the payment of a debt, or of its just proportional part, at any time after six months have expired since letters were granted.

"2. By a person entitled to a legacy or any other pecuniary provision under the will, or a distributive share, for the payment or satisfaction thereof, or of its just proportional part, at any time after one year has expired since letters were granted.

"On the presentation of such a petition, the surrogate must issue a citation accordingly, and on the return thereof he must make such a decree in the premises as justice requires. But in either of the following cases the decree must dismiss the petition without prejudice to an action or an accounting in behalf of the petitioner:

"1. When an executor or administrator files a written answer, duly verified, setting forth facts which show that it is doubtful whether the petitioner's claim is valid and legal, and denying its validity and legality absolutely, or on information and belief.

"2. Where it is not proved to the satisfaction of the surrogate that there is money or other personal property of the estate applicable to the payment or satisfaction of the petitioner's claim and which may be so applied without injuriously affecting the rights of others entitled to priority or equality of payment or satisfaction."

"SEC. 2723. In a case specified in subdivision second of the last section, the surrogate may, in his discretion, entertain the petition at any time after letters are granted, although a year has not expired. In such a case, if it appears on the return of the citation that a decree for payment may be made, as prescribed in the last section, and that the amount of money and the value of the other property in the hands of the executor or administrator applicable to the payment of debts, legacies, and expenses exceed by at least one-third the amount of all known debts and claims against the estate, of all legacies which are entitled to priority over the petitioner's claim and of all legacies and distributive shares of the same class, and that the payment or satisfaction of the legacy, pecuniary provision, or distributive share, or some part thereof, is necessary for the support or education of the petitioner, the surrogate may, in his discretion, make a decree directing payment or satisfaction accordingly, on the filing of a bond, approved by the surrogate, conditioned as prescribed by law, with respect to a bond which an executor or an administrator with the will annexed may require from a legatee, on payment or satisfaction of a legacy, before the expiration of one year from the time when letters were issued, pursuant to a direction to that effect contained in the will."

IV.

Of the persons named as legatees in the portions of his said last will and testament and codicils set forth in Finding II, the said Oswald Ottendorfer left surviving him the following: Annibel, Baroness von Leitenberger; Edward Uhl, Antoinette Woerishoffer, Emma Carola Woerishoffer, Eleanora Stabler, Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer, all of which legatees were strangers in blood to him.

V.

Pursuant to an order of the surrogate's court entered on May 8, 1901, the executors published the statutory six-month notice to all creditors of the estate requiring them to file their claims with the executors on or before November 16, 1901.

All specific legacies and the greater portion of the residuary legacies provided for in said will and codicils were distributed by the executors before July 1, 1902, each of the three residuary legatees, Emma Schalk, Mathilde Riedl von

Riedenstein, and Anna Woerishoffer, receiving, on or about December 28, 1901, cash and securities amounting in value to $910,000, after which there remained in the hands of the executors of the residuary estate upward of $500,000 in cash, together with a large amount of securities.

No further or complete distribution of the residuary estate was made by the executors until after July 1, 1902, because they anticipated that the estate would be liable for payment of a New York estate transfer tax and the Federal inheritance tax, together with attorneys' fees and other expenses of administration of the estate, and the exact amount of the residuary estate that would be left for distribution, therefore, could not be definitely determined prior to July 1, 1902.

VI.

On March 7, 1902, the plaintiff, Lewis Cass Ledyard, as executor, filed an affidavit in the surrogate's court to which were attached schedules containing a description of all the property owned by the testator at his death which had come to the knowledge of said executor, together with the estimated value of the personal property at that time, and also the range of quotations of decedent's stocks and bonds for a period of three months preceding his death; also statements of the decedent's debts, payments for administration expenses, the estimated commissions of the executors and future administration expenses, and the names and addresses of the legatees, with descriptions of their respective legacies. On June 5, 1902, the appraiser appointed by the surrogate's court filed his report appraising the property of the decedent, and on July 16, 1902, the surrogate entered his order assessing the New York State inheritance tax on the property of the decedent.

VII.

The personal property constituting part of the assets of the estate, which passed to the executors, included a large number of bonds and shares of the capital stock of railroad and other corporations the aggregate par or face value of which amounted to approximately $3,260,748.89. The said bonds were obligations or promises to pay secured upon the property of many different corporations, and the said shares of capital stock represented the ownership and the equitable ownership of many different properties.

VIII.

The actual or clear value of each of said bonds and shares of capital stock was variable and subject to wide fluctuations, and in the case of most of them it was different from the par or face value thereof. The actual or clear value of said bonds and shares of stock and of other assets of said estate could not be determined except by inquiry and investigation and the consideration of evidence thereon.

IX.

The "capital stock of the New Yorker Staats Zeitung," bequeathed by the twelfth and thirteenth paragraphs of said will, and the "certain contract with Herman Ridder," bequeathed by the said thirteenth paragraph, were, respectively, shares in a corporation owning the New Yorker Staats Zeitung and a contract with one Herman Ridder to purchase some of the shares of the same corporation. The New Yorker Staats Zeitung is a daily newspaper published in the German language in the city of New York; Herman Ridder was financially embarrassed when this contract was made; the value of this contract was problematical on December 14, 1900, and at all times thereafter until July 1, 1902; it was necessary to revise this contract repeatedly on account of Herman Ridder's financial difficulties, and the value of this contract depended at all times upon the ability of the said Herman Ridder to make the Staats Zeitung earn a profit above its necessary expenses. Oswald Ottendorfer at the time of his decease owned only one of the shares of the capital stock of said corporation, and therefore none of the shares thereof passed under the said thirteenth paragraph of the will.

The bequests to the residuary legatees of equal interests in said contract were specific bequests and did not form part of the residuary estate.

X.

In the distribution of the estate by the executors, the said residuary legatees, Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer, on December 28, 1901, received distributions, on account of specific and residuary bequests, as follows:

Emma Schalk received the sum of $12,380 in cash and certain securities of a par value of $828,000, which were valued and charged to her by the executors at New York Stock Exchange market values in the sum of $897,620. And subsequently to July 1, 1902, during the years 1902, 1903, 1905, and 1908, she received, on account of the residuary estate, additional cash distributions amounting to $210,953.66.

Mathilde Riedl von Riedenstein received the sum of $751,600 in cash, and securities of a par value of $157,500, which were valued and charged to her by the executors at New York Stock Exchange market values, in the sum of $158,400. And subsequently to July 1, 1902, during the years 1902, 1903, 1905, and 1908, she received additional cash distributions, amounting to $210,953.66, on account of the residuary estate.

Anna Woerishoffer received $6,898 in cash, and securities of a par value of $832,000, which were valued and charged to her by the executors at New York Stock Exchange market values, in the sum of $903,102. And subsequently to July 1, 1902, during the years 1902, 1903, 1905, and 1908, she received additional cash distributions amounting to $210,953.65, on account of the residuary estate.

Almost all of the said securities distributed to said residuary legatees were allotted by the executors and accepted by the legatees at values differing from their par, or face, values.

XI.

No order was entered or requirement made by any court or officer of probate, nor by any other court, prior to or on July 1, 1902, requiring the payment or distribution by the executors of any further portion or portions of the residuary estate in addition to the distribution made to said residuary legatees on December 28, 1901, shown by Finding X.

XII.

Pursuant to the War Revenue Act of June 13, 1898 (30 Stat., 448), and amendments thereto, the executors of said estate prepared and executed a schedule or return of legacies arising from said estate, which was filed by the executors with the Commissioner of Internal Revenue on November 7, 1902. In this return the taxable legacies, with the rates and amounts of tax thereon, were given as follows, all of the legatees being strangers, in blood, to the testator:

Annibel, Countess von Leitenberger: Legacy, $30,000; rate, $7.50 per $100; tax	$2,250.00
Antoinette, Countess Seilern: Legacy, $30,000; rate, $7.50 per $100; tax	2,250.00
Emma Carola Woerishoffer: Legacy, $80,000; rate, $7.50 per $100; tax	6,000.00
Eleanora Stabler: Legacy, $20,000; rate, $5 per $100; tax	1,000.00
Emma Schalk: Legacy, $1,176,869.80; rate, $15 per $100; tax	176,530.47
Mathilde Riedl von Riedenstein: Legacy, $1,226,730.99; rate, $15 per $100; tax	184,009.65
Anna Woerishoffer: Legacy, $1,229,700.99; rate, $15 per $100; tax	184,455.15

In said return the total appraised value of the personal property of the estate was given as $4,371,947.90 and the total amount of legal debts and expenses for which the personal property was liable as $298,646.12.

Said legacy return was examined and approved and an assessment made thereon by the collector of internal revenue on or about December 10, 1902; and on the same day the amount of tax indicated in said return as being due, $556,495.27, was paid by the executors without protest. No legacy tax was assessed by the Commissioner of Internal Revenue prior to July 1, 1902, on any of the legacies passing under said will and codicils.

XIII.

The values assigned by the Commissioner of Internal Revenue, for the purpose of legacy-tax assessment, to the various stocks and bonds distributed by the executors to the residuary legatees were the same values assigned thereto by the executors in their said legacy-tax return to the Commissioner of November 7, 1902, which values for the most part were arithmetical averages of New York Stock Exchange prices or quotations on similar stocks and bonds during the three-month period immediately preceding the testator's decease. These values were in most instances different from the par or face values of such stocks and bonds and were also in most instances different from the values assigned thereto by the executors in their distribution of them to the residuary legatees as a part of the residuary estate.

XIV.

On the basis of the values assigned by the Commissioner of Internal Revenue to the stocks, bonds, and other securities of the estate distributed by the executors to the residuary legatees, the totals of the distributions received by said legatees prior to July 1, 1902, were as follows: Emma Schalk, $979,268.22; Mathilde Riedl von Riedenstein, $991,655.40; Anna Woerishoffer, $969,572.30.

XV.

On December 11, 1913, an affidavit executed by one H. T. Newcomb, as attorney for said Lewis Cass Ledyard, one of said executors, was filed with and received by the collector of internal revenue for the third district of New York, in which affidavit a refund for the whole tax paid, as aforesaid, was demanded on the ground that it had been illegally and wrongfully collected.

Said affidavit and claim for refund were on January 20, 1914, examined by the Chief of Claims Division, Office of Internal Revenue, and by him submitted for allowance for the sum of $12,786.83, and for rejection of the remaining $543,708.44, the sum of $12,786.83 being recommended for allowance to correct an error due to an overvaluation, in the return and assessment, of certain railroad stock belonging to the estate. The claim was on January 21, 1914, examined by the Committee on Claims, Office of Internal Revenue, and the allowance of $12,786.83 and rejection of $543,708.44 approved. On the latter date, January 21, 1914, said claim was by the Commissioner of Internal Revenue recommended for allowance of $12,786.83 and for rejection for $543,708.44, and this recommendation was on said date approved by the Secretary of the Treasury and the $12,786.83 allowed was paid to the executors of the estate.

XVI.

At the time of the partial distribution of the residuary estate on December 28, 1901, all the debts of the estate had been paid, except the costs and expenses of administration and the State and Federal legacy taxes.

At the time the plaintiffs' petition was filed in this court assets still remained which were subject to administration, and the executors had not filed a final account. Up to the time when the evidence was taken in this case the residuary estate had not been fully administered; additional cash to the amount of $48,000 and other assets still remained subject to administration in accordance with the will and codicils, and no final accounting had yet been made or could have been made by the executors.

CONCLUSION OF LAW.

Upon the foregoing findings of fact the court decides as a conclusion of law that the plaintiffs are not entitled to recover. It is therefore adjudged and ordered that the petition be, and the same is hereby, dismissed. Judgment is rendered against the plaintiffs in favor of the United States for the cost of printing the record in this cause, the amount thereof to be entered by the clerk and collected by him according to law.

OPINION.

GRAHAM, Judge, delivered the opinion of the court:

This is an action to recover a legacy tax alleged to have been erroneously assessed and collected under the provisions of section 29 of the Act approved

June 13, 1898 (30 Stat., 448), and certain acts amendatory thereof. The petition was filed January 26, 1916, nearly 15 years after the commencement of the administration of the estate and about as long after the time for presenting claims against it.

Defendant demurred to the plaintiffs' petition, and the court entered the following order on March 12, 1917:

"The within demurrer is overruled without prejudice; but it is ordered that no testimony be taken herein except upon the question of the amount of the residuary legacies not distributed until after July 1, 1902."

Thereafter evidence was taken.

The plaintiffs' requests for findings of fact and brief were filed on January 17, 1918. On March 20, 1918, proceedings in the case were suspended upon a showing to the court that one of the plaintiffs, Anna Woerishoffer, was held to be a German subject and an alien enemy, and the case was remanded to the general docket. On November 14, 1921, a treaty of peace having been ratified between the German Government and the Government of the United States, the President of the United States issued a proclamation declaring that the war between the two countries terminated on July 2, 1921. Thereupon, the case came on to be heard in regular course.

The testator, Oswald Ottendorfer, died on December 14, 1900, being at the time a resident of the State of New York, leaving a last will and testament, dated May 22, 1891, and codicils dated May 25, 1892, November 29, 1897, and October 30, 1900, all of which were admitted to probate and record on March 24, 1901, on which date letters testamentary were granted to Anna Woerishoffer, Lewis Cass Ledyard, and Julius W. Brunn (since deceased), by the surrogate's court in and for the county of New York, in said State. By said last will and codicils the testator made various specific bequests and left all of the residue of his estate share and share alike to three stepdaughters, Emma Schalk, Mathilde Riedel von Riedenstein, and Anna Woerishoffer. So much of the said will and codicils as is material in the present question is set out in the margin.[1]

Annibel, Baroness von Leitenberger, Edward Uhl, Antoinette Woerishoffer, Emma Carola Woerishoffer, Eleanora Stabler, Emma Schalk, Mathilde Riedl

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[1] Said last will and testament provided, among other things, as follows:

"Second. I give and bequeath unto my stepdaughter, Emma Schalk, for her sole and separate estate, the sum of $100,000.

"Third. I give and bequeath unto my stepdaughter, Mathilde Riedl von Riedenstein, for her sole and separate estate, the sum of $100,000.

"Fourth. I give and bequeath unto my stepdaughter, Anna Woerishoffer, for her sole and separate estate, the sum of $100,000.

"Twelfth. I give and bequeath unto my stepdaughter, Anna Woerishoffer, one share of the capital stock of the New Yorker Staats Zeitung.

"Thirteenth. I give and bequeath all other shares of the capital stock of the said New Yorker Staats Zeitung which may belong to me at the time of my death, and all my right, title, and interest in and to a certain contract with Herman Ridder for the sale to the said Ridder of shares of the capital stock of the said New Yorker Staats Zeitung, and all my right, title, and interest in the consideration which at the time of my death may remain to be paid by the said Herman Ridder, unto my said three stepdaughters Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer, or such of them as shall survive me, share and share alike."

"Twenty-sixth. I give and bequeath unto my housekeeper, Eleanora Stabler, the sum of $10,000."

In the codicil of May 25, 1892, it was provided:

"First. I hereby revoke the first article of my said will, whereby I disposed of all my household furniture, both useful and ornamental, china, glass, silver, books, paintings, pictures, engravings, wearing apparel, jewelry, horses, carriages, harnesses, and articles of stable equipment or furniture; and I do hereby give and bequeath all the above enumerated articles and property unto my stepchildren, Edward Uhl, Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer."

And in the codicil of November 29, 1897, it was provided:

"Sixth. I give and bequeath unto Eleanora Stabler, mentioned in the twenty-sixth article of my said will, an additional sum of $10,000, thus increasing her legacy to the total sum of $20,000."

"Ninth. I give and bequeath unto Annibel, Baroness von Leitenberger, daughter of my stepdaughter, Mathilde Riedl von Riedenstein, the sum of $30,000."

"I give and bequeath unto Antoinette Woerishoffer, daughter of my stepdaughter, Anna Woerishoffer, the sum of $30,000."

"I give and bequeath unto Emma Carola Woerishoffer, daughter of my stepdaughter, Anna Woerishoffer, the sum of $80,000."

"Twelfth. I give, devise, and bequeath all the rest, residue, and remainder of my estate, mentioned in the said thirty-first article of my will, that is to say, all the residue thereof which shall remain after carrying out the provisions of my said will as modified by this codicil and my former codicil, share and share alike unto such of my stepdaughters, Emma Schalk, Mathilde Riedl von Riedenstein, and Anna Woerishoffer, as shall survive me, and the issue me surviving of any of them who may have died before me, such issue of any deceased stepdaughter to take per stirpes and not per capita the share which the parent so dying would have taken had she survived me."

von Riedenstein, and Anna Woerishoffer, legatees named in said will, survived the testator and were strangers in blood to him.

Said will and codicils also provided that all succession, legacy, or inheritance taxes that should be due or payable by law on any legacy passing under said will or codicils should be deducted from and paid out of the residuary estate, so that all legatees should receive their legacies free of all such taxes.

By an order of the surrogate's court entered on May 8, 1901, the executors published the statutory six-month notice to creditors of the estate requiring them to file their claims with the executors on or before November 16, 1901.

The plaintiffs alleged in their petition that due to the character of the assets of the estate and circumstances of necessity controlling the administration and proceedings in the surrogate's court regarding the basis for determining the value of certain of the assets, it was impossible on or before July 1, 1902, to determine the clear actual net value of said assets or of the residuary estate, or the actual or clear value of the legacies to be derived from the latter.

A part of the assets consisted of personal property which included a large number of bonds and shares of the capital stock of railroads and other corporations, the total par or face value of which bonds and shares of stock amounted to $3,260,748.89, while the actual clear value of most of these bonds and shares of stock was not the same as the par or face value, and this actual clear value could not be determined except by inquiry and investigation and the consideration of evidence thereon. Among the assets were certain capital stock of the New Yorker Staats Zeitung, a daily newspaper published in the city of New York, and a certain contract with Herman Ridder, who was financially embarrassed when this contract was made. The value of this contract was uncertain and problematical on December 14, 1900, and at all times thereafter until July 1, 1902. The value of the contract depended at all times upon the ability of Ridder to make said newspaper earn a profit above its necessary expenses. The contract was a specific bequest to the residuary legatees of equal interest in said contract and did not form part of the residuary estate.

Prior to July 1, 1902, the executors paid all of the legacies except those springing from the residuary estate and each of the residuary legatees prior to that date received securities which the legatees accepted at certain values, and these added to the cash paid each legatee made a total payment to each legatee of $910,000.

No further or complete distribution of the residuary estate was made by executors until after July 1, 1902, for the alleged reason that the estate would be liable for payment of a New York State transfer tax and Federal inheritance tax, together with other expenses and fees of administration of the estate, and that the exact amount of the residuary estate which would be left for distribution for this reason could not be determined prior to July 1, 1902.

On March 7, 1902, the plaintiff, Lewis Cass Ledyard, as executor, filed an affidavit in the surrogate's court to which were attached schedules containing a description of all the property owned by the testator at his death which had come to the knowledge of said executor, together with the estimated value of the personal property at that time, and also the range of quotations of decedent's stocks and bonds for a period of three months preceding his death; also statements of the decedent's debts, payments for administration expenses, the estimated commissions of the executors and future administration expenses, and the names and addresses of the legatees, with descriptions of their respective legacies. On June 5, 1902, the appraiser appointed by the surrogate's court filed his report appraising the property of the decedent, and on July 16, 1902, the surrogate entered his order assessing the New York State inheritance tax on the property of the decedent.

Pursuant to the Act of June 13, 1898 (30 Stat., 448), and amendments thereto, the executors of said estate prepared and executed a schedule or return of legacies arising from said estate, which was filed by them with the Commissioner of Internal Revenue on November 7, 1902, stating taxable legacies with rates of tax thereon. In said return the total appraised value of the personal property of the estate was given as $4,371,947.90 and the total amount of debts and expenses for which the personal estate was liable at $298,446.12. This return was examined and approved and assessment made thereunder by the collector of internal revenue on the 10th day of December, 1902. On the same day the amount of tax indicated in said return as being due, namely, $556,495.27, was paid by the executors without protest. No legacy tax was assessed by the collector of internal revenue prior to July 1, 1902, on any of the legacies arising under said will and codicils. The values assigned

by the Commissioner of Internal Revenue for the proposed legacy-tax assessment to the various stocks and bonds distributed by the executors to the residuary legatees were the same values assigned thereto by the executors in their said legacy-tax return of November 7, 1902.

The issues involved here are:

Was the tax here collected imposed under section 29 of the Act of June 13, 1898, and amendments thereof prior to the taking effect of the Act of April 12, 1902, though no assessment was made until after July 1, 1902, at which date the former Act took effect? [1]

If the tax was "imposed," there arises a further question whether the assets paid to the residuary legatees prior to July 1, 1902, in part satisfaction of the residuary legacies vested in said legatees in possession or enjoyment prior to July 1, 1902, under the provisions of section 3 of the Act of June 27, 1902.

There is the further question, where the required time has elapsed to give the legatees and distributees a right to demand payment of their legacies and where the assets within the hands of the executors are amply sufficient to pay all known liabilities, including expenses of administration, State and Federal taxes, attorneys' fees, etc., whether the fact that these liabilities were not definitely and finally determined on July 1, 1902, and that other liabilities might arise subsequently to that date is of itself sufficient to convert the legatees' right to the property in the hands of the executors into a contingent interest, though

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[1] THE STATUTES INVOLVED.

The statutes of the United States applicable to this case, or so much thereof as are material, are as follows:

1. Section 29 of the Act of June 13, 1898, which provides in part—

"That any person or persons having in charge or trust, as administrators, executors, or trustees, any legacies or distributive shares arising from personal property, where the whole amount of such personal property as aforesaid shall exceed the sum of $10,000 in actual value, passing after the passage of this Act from any person possessed of such property, either by will or by the intestate laws of any State or Territory, or any personal property or interest therein transferred by deed, grant, bargain, sale, or gift, made or intended to take effect in possession or enjoyment after the death of the grantor or bargainer, to any person or persons, or to any body or bodies, politic or corporate, in trust or otherwise, shall be, and hereby are, made subject to a duty or tax, to be paid to the United States, as follows—that is to say: * * *

"Fifth. Where the person or persons entitled to any beneficial interest in such property shall be * * * a stranger in blood to the person who died possessed, as aforesaid, * * * at the rate of $5 for each and every hundred dollars of the clear value of such interest; * * *

"Where the amount or value of said property shall exceed the sum of $25,000, but shall not exceed the sum or value of $100,000, the rates of duty or tax above set forth shall be multiplied by 1½; and where the amount or value of said property shall exceed the sum of $100,000, but shall not exceed the sum of $500,000, such rates of duty shall be multiplied by 2; and where the amount or value of said property shall exceed the sum of $500,000, but shall not exceed the sum of $1,000,000, such rates of duty shall be multiplied by 2½; and where the amount or value of said property shall exceed the sum of $1,000,000, such rates of duty shall be multiplied by 3: * * *."

2. Section 30 of the Act of June 13, 1898, as amended by section 11 of the Act of March 2, 1901 (31 Stat., 948, ch. 806), which provides in part—

"That the tax or duty aforesaid shall be due and payable in one year after the death of the testator and shall be a lien and charge upon the property of every person who may die as aforesaid for 20 years, or until the same shall, within that period, be duly paid to and discharged by the United States; and every executor, administrator, or trustee having in charge or trust any legacy or distributive shares, as aforesaid, shall give notice thereof, in writing, to the collector or deputy collector of the district where the deceased grantor or bargainer last resided within 30 days after he shall have taken charge of such trust, and every executor, administrator, or trustee, before payment and distribution to the legatees, or any parties entitled to beneficial interest therein, shall pay to the collector or deputy collector of the district of which the deceased person was a resident, or in which the property was located in case of nonresidents, the amount of the duty or tax assessed upon such legacy or distributive share, and shall also make and render to the said collector or deputy collector a schedule, list, or statement, in duplicate, of the amount of such legacy or distributive share."

3. Sections 7, 8, and 11 of the repealing Act of April 12, 1902:

"SEC. 7. That section 4 of said Act of March 2, 1901, and sections 6, 12, 18, 20, 21, 22, 23, 24, 25, Schedule A, Schedule B, sections 27, 28, and 29 of the Act of June 13, 1898, and all amendments of said sections and schedules be, and the same are hereby, repealed.

"SEC. 8. That all taxes or duties imposed by section 29 of the Act of June 13, 1898, and amendments thereof, prior to the taking effect of this Act shall be subject, as to lien, charge, collection, and otherwise, to the provisions of section 30 of said Act of June 13, 1898, and amendments thereof, which are hereby continued in force, as follows. * * *

"SEC. 11. That this Act, except as otherwise specially provided for in the preceding section, shall take effect July 1, 1902." (32 Stat., pt. 1, pp. 97, 98, 99, ch. 500.)

4. Section 3 of the Act of June 27, 1902:

"That in all cases where an executor, administrator, or trustee shall have paid, or shall hereafter pay, any tax upon any legacy or distributive share of personal property

otherwise it would be an interest vested in enjoyment and possession, and subject, therefore, to tax under section 29 of the Act of June 13, 1898.

The one year within which executors were allowed by the statute of New York for settling said estate before the right to demand payment of legacies by legatees expired on the 24th day of March, 1902.

The six-month period for presentation of claims expired on November 16, 1901, and the only claims upon the estate so far as was known remaining to be paid on July 1, 1902, were the New York State transfer tax, the Federal inheritance tax, together with attorneys' fees and other expenses of administration.

Subsequent to July 1, 1902, and during the years 1902, 1903, 1905, and 1908 Emma Schalk received on account of the residuary estate cash distributions amounting to $210,953.66, and Mathilde Riedl von Riedenstein received during the same years similar cash distributions to the same amount, and Anna Woerishoffer received cash distributions amounting to $210,953.65, a total of $632,860.97.

This is not a case of resistance to the payment of a tax, but a suit for the recovery of taxes voluntarily paid, and the illegality of them should be shown not only by averment but by proof—not by assertion and speculation.

It is unnecessary to review the provisions of the Act of June 13, 1898 (30 Stat., 448), and the effect thereon of the repealing Act of April 12, 1902. Suffice it to say that where there was a "liability" existing under the former Act at the time of the passage of the repealing Act such liability was not affected by the latter and that a tax imposed prior to the passage of the repealing Act was such a liability. (*Hertz* v. *Woodman*, 218 U. S., 205.)

The latter case also held that a tax is imposed when a legacy vests in possession or enjoyment and that upon the passing by death of a vested right to the immediate possession or enjoyment of the legacy or distributive share there was imposed a tax or duty upon every such right of succession, and that this tax or duty was saved by the saving clause of the repealing Act of April 12, 1902.

It is not disputed that a tax may be imposed without assessment and an assessment is not a prerequisite to the imposition of a tax. While some taxes may require assessment and may not be collected until assessed, this does not prevent Congress from imposing a legacy tax until after it has been assessed. If the Act imposed a tax, an assessment is a matter of routine which does not alter the effect of its imposition. To impose a tax means to levy it. The imposition of the tax and its maturity are distinct and separate things. It is well known that it is not customary to make a tax due and enforceable upon the day of its imposition. (*Cochran* v. *United States*, 254 U. S., 387, 391; *Westus* v. *Union Trust Company*, 164 Fed., 795.)

The tax is on the right of succession, and when by death there passes a vested right to the immediate possession or enjoyment of a legacy or distributive share there is imposed a tax under the Act of June 13, 1898. (*Hertz* v. *Woodman*, *supra.*) So that it follows that the tax collected in this case was imposed under section 29 of the Act of June 13, 1898.

We next approach the question of whether under the terms of this will the property transferred to the residuary legatees prior to July 1, 1902, in partial satisfaction of their residuary legacies vested in possession and enjoyment prior to July 1, 1902, under the terms of section 3 of the Act of June 27, 1902. Said section of that Act provided as follows:

"* * * the Secretary of the Treasury be, and he is hereby, authorized and directed to refund * * * so much of said tax as may have been collected on contingent beneficial interests which shall not have become vested prior to July 1, 1902."

Said Act further prohibits the assessment or imposition of any tax under the Act of June 13, 1898, upon—

"* * * any contingent beneficial interest which shall not become absolutely vested in possession or enjoyment prior to said July 1, 1902."

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under the provisions of the Act approved June 13, 1898, entitled 'An Act to provide ways and means to meet war expenditures, and for other purposes,' and amendments thereof, the Secretary of the Treasury be, and he is hereby, authorized and directed to refund, out of any money in the Treasury not otherwise appropriated, upon proper application being made to the Commissioner of Internal Revenue, under such rules and regulations as may be prescribed, so much of said tax as may have been collected on contingent beneficial interests which shall not have become vested prior to July 1, 1902. And no tax shall hereafter be assessed or imposed under said Act approved June 13, 1898, upon or in respect of any contingent beneficial interest which shall not become absolutely vested in possession or enjoyment prior to said July 1, 1902." (32 Stat., 406, ch. 1160.)

"Vested in possession and enjoyment" has the same meaning as the word "vested." (*United States* v. *Jones*, 236 U. S., 106; *McCoach* v. *Pratt*, 236 U. S., 562, 566.)

A contingent interest is one thing and a vested interest subject to divesture is another. The law uses familiar legal expressions in their familiar legal sense, and the distinction between a contingent interest and an interest subject to be divested is familiar to the law. As to that part of the property transferred by the executors prior to July 1, 1902, to the residuary legatees, there can be no question under the decisions that it vested in possession and enjoyment prior to July 1, 1902. (*Henry* v. *United States*, 251 U. S., 393; *Cochran* v. *United States*, *supra*. See also *Tiffany* v. *United States*, Court of Claims No. 33685.)

We next approach the question of whether the amount of residuary legacies distributed after July 1, 1902, is subject to tax.

It will be seen that the residuary legacies here were vested in possession or enjoyment; that a vested legacy subject to divesture is not a contingent interest. But, aside from this, under the statute of New York if a year had expired from the commencement of the administration—and here it expired March 24, 1902—the legatees have a right to demand and proceed for collection of their legacies. During this period executors have the right to withhold payment, so that prior to July 1, 1902, there is no doubt about the interest being vested and the liability of the executors to pay the legacies, provided there were sufficient funds in hand with which to do it. It is admitted that sufficient funds were in hand, and that all of the known debts except as heretofore stated had been paid and the time for filing claims had expired nearly nine months before, and that the only known debts and liabilities were the State and Federal taxes, attorneys' fees, and certain expenses of administration. The fact that these had not been determined and that the sum necessary to meet them had not been fully and exactly ascertained is not sufficient to turn into a contingent interest an interest which is already vested in enjoyment and possession and therefore subject to tax under the Act of June 13, 1898. The mere fact that the executors concluded to keep a fund on hand to meet certain unknown chances or claims that might arise can not of itself divest this vested interest of the legatees nor turn it into a contingent interest.

This court said in *Carleton* v. *United States* (51 Ct. Cls., 60, 65):

"* * * in order to make a legacy taxable under it, it is only necessary that it should pass out of the hands of the executors into the possession or enjoyment of the legatee or legatees named, subject to no contingency or reservation."

These legacies under the will were subject to no contingencies or reservations.

That there were abundant funds to meet all these unpaid obligations is shown by the fact that after the 1st of July, 1902, the executors distributed to the residuary legatees the sum of $632,860.97. So it is apparent that there were abundant assets in hand to pay these legacies on the 1st of July, 1902, and a mere precautionary state of mind of the executors as to future uncertainties is clearly not enough to turn this vested interest of the legatees into a contingent one. (*Simpson* v. *United States*, 252 U. S., 547.) The illegality of the tax has not been proved.

It follows that the interest of the residuary legatees here was legally assessed and the tax thereon legally collected and that the plaintiffs can not recover. The petition should be dismissed with costs, and it is so ordered.

Hay, Judge; Downey, Judge; Booth, Judge; and Campbell, Chief Justice, concur.

MISCELLANEOUS.

OLEOMARGARINE.

REGULATIONS 9, SECTION 50: Branding. II–39–1274
T. D. 3540

OLEOMARGARINE—BRANDING ORIGINAL PACKAGES.

Regulations No. 9 (revised June, 1923), amended to provide for Government brand being placed on either the sides or tops of original packages.

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

To collectors of internal revenue and others concerned:

The first paragraph of section 50 of Regulations No. 9 (revised June, 1923), relative to branding packages of oleomargarine, is hereby amended to read as follows:

SEC. 50. *Branding.*—Every package of oleomargarine must, before removal from the manufactory, have legibly printed or stenciled on the side or top thereof the word "Oleomargarine"; also the factory number, district and State, and the gross, tare, and net weights; for example:

OLEOMARGARINE
Factory No. 1, First District of Penna.
63–3–60.

D. H. BLAIR, *Commissioner.*

Approved December 17, 1923.
A. W. MELLON,
Secretary of the Treasury.

II–16–1006
MS. 12

Schedule of oleomargarine produced and materials used during the month of April, 1923, as compared with April, 1922.

[Figures do not include sixth California.]

	April, 1923.	April, 1922.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	17,758,183	13,432,177
Ingredient schedule for uncolored oleomargarine:		
Oleo oil	4,022,711	2,937,474
Cocoanut oil	6,002,129	4,299,920
Cottonseed oil	1,732,310	938,173
Peanut oil	449,732	632,381
Oleo stearine	408,962	297,920
Neutral lard	2,399,820	1,896,848
Oleo stock	213,650	109,319
Butter	129,319	75,275
Mustard oil	2,898	.....
Edible tallow	1,970	.....

Schedule of oleomargarine produced and materials used during the month of April, 1923, as compared with April, 1922—Continued.

	April, 1923.	April, 1922.
	Pounds.	*Pounds.*
Ingredient schedule for uncolored oleomargarine—Continued.		
Reclaimed oil	4,265	.....
Miscellaneous	.....	240,770
Total	15,367,766	11,428,080
Total production colored oleomargarine	848,142	497,779
Ingredient schedule for colored oleomargarine:		
Oleo oil	255,970	140,112
Cocoanut oil	194,107	85,430
Cottonseed oil	104,871	52,103
Peanut oil	20,055	20,405
Oleo stearine	2,243	2,227
Neutral lard	142,853	81,686
Oleo stock	10,830	9,013
Butter	.....	225
Mustard oil	90	.....
Glucose	1,200	.....
Miscellaneous	.....	4,377
Total	732,219	395,578

The above figures are subject to revision until published in the Commissioner's annual report.

II–21–1058
MS. 14

Schedule of oleomargarine produced and materials used during the month of May, 1923, as compared with May, 1922.

	May, 1923.	May, 1922.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	16,357,169	13,350,391
Ingredient schedule for uncolored oleomargarine:		
Oleo oil	3,955,649	3,348,576
Cocoanut oil	5,325,265	3,803,508
Cottonseed oil	1,686,455	888,990
Milk	4,792,337	3,850,871
Salt	1,482,118	1,177,202
Peanut oil	351,173	613,900
Oleo stearine	470,215	338,558
Neutral lard	2,330,970	2,055,984
Oleo stock	178,738	128,450
Butter	139,995	81,984
Mustard oil	8,553	.....
Edible tallow	3,208	.....
Palm kernel oil	6,565	.....
Benzoate of soda	3,466	.....
Miscellaneous	.....	287,660
Total	20,734,707	16,555,683
Total production colored oleomargarine	900,385	512,879
Ingredient schedule for colored oleomargarine:		
Oleo oil	240,143	143,377
Cocoanut oil	198,396	88,240
Cottonseed oil	80,105	37,500
Milk	281,483	153,463
Salt	79,873	48,195
Peanut oil	16,546	18,048
Oleo stearine	2,832	3,130
Neutral lard	158,817	89,152
Oleo stock	8,440	6,005
Butter	1,695	20
Mustard oil	60	.....
Glucose	1,700	.....
Palm kernel oil	1,280	.....
Benzoate of soda	6	.....
Color	1,221	732
Miscellaneous	.....	4,901
Total	1,072,597	592,763

The above figures are subject to revision until published in the Commissioner's annual report.

II–23–1090
MS. 15

Schedule of oleomargarine produced and materials used during the month of June, 1923, as compared with June, 1922.

	June, 1923.	June, 1922.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	13,582,314	11,993,816
Ingredient schedule for uncolored oleomargarine:		
Oleo oil	3,283,005	2,971,696
Cocoanut oil	4,269,094	3,280,652
Cottonseed oil	1,209,405	775,594
Peanut oil	296,279	526,052
Oleo stearine	348,513	345,965
Neutral lard	1,854,717	1,781,520
Oleo stock	155,120	126,185
Mustard oil	9,670	.....
Palm kernel oil	9,748	.....
Edible tallow	1,100	.....
Sesame oil	1,040	.....
Butter	116,145	61,182
Milk	3,868,426	3,414,551
Salt	1,216,575	1,041,521
Benzoate of soda	3,522	.....
Miscellaneous	.....	275,657
Total	16,642,359	14,600,575
Total production colored oleomargarine	662,060	418,220
Ingredient schedule for colored oleomargarine:		
Oleo oil	172,687	115,075
Cocoanut oil	166,891	90,595
Cottonseed oil	60,914	35,242
Peanut oil	13,143	17,703
Oleo stearine	2,325	5,156
Neutral lard	111,831	80,454
Oleo stock	18,150	11,308
Palm kernel oil	1,944	.....
Sesame oil	104	.....
Butter	1,271	.....
Milk	215,111	137,733
Salt	59,055	40,239
Benzoate of soda	15	.....
Butter color	918	601
Miscellaneous	.....	1,929
Total	824,359	536,035

II–30–1165
MS. 16

Schedule of oleomargarine produced and materials used during the month of July, 1923, as compared with July, 1922.

	July, 1923.	July, 1922.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	12,632,477	11,865,569
Ingredient schedule for uncolored oleomargarine:		
Oleo oil	3,099,341	2,855,053
Cocoanut oil	3,854,896	3,099,718
Cottonseed oil	1,159,401	778,375
Peanut oil	258,422	509,074
Oleo stearine	378,055	330,004
Neutral lard	1,771,005	1,749,198
Oleo stock	169,725	144,579
Mustard oil	4,478	.....
Palm kernel oil	12,240	.....
Edible tallow	1,800	.....
Sesame oil	570	.....
Corn oil	400	.....
Butter	73,495	79,637
Milk	3,395,138	3,381,667
Salt	1,122,334	1,014,773

Schedule of oleomargarine produced and materials used during the month of July, 1923, as compared with July, 1922—Continued.

	July, 1923.	July, 1922.
	Pounds.	*Pounds.*
Ingredient schedule for uncolored oleomargarine—Continued.		
Benzoate of soda	3,081	
Miscellaneous		227,485
Total	15,304,381	14,169,563
Total production colored oleomargarine	644,256	414,403
Ingredient schedule for colored oleomargarine:		
Oleo oil	191,103	130,787
Cocoanut oil	149,076	59,975
Cottonseed oil	56,100	32,964
Peanut oil	11,882	13,578
Oleo stearine	3,252	2,202
Neutral lard	116,556	79,553
Oleo stock	13,015	8,988
Palm kernel oil	2,704	
Butter	1,520	1,040
Milk	203,420	123,705
Salt	56,352	40,070
Benzoate of soda	14	
Color	1,004	660
Miscellaneous		6,684
Total	805,998	500,206

II–32–1189
MS. 17

Schedule of oleomargarine produced and materials used during the month of August, 1923, as compared with August, 1922.

	August, 1923.	August, 1922.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	15,966,454	12,623,263
Ingredient schedule for uncolored oleomargarine:		
Oleo oil	3,844,499	3,187,859
Cocoanut oil	4,627,039	3,597,729
Cottonseed oil	1,646,664	823,163
Peanut oil	366,138	523,223
Oleo stearine	442,539	388,786
Neutral lard	2,205,443	1,829,797
Oleo stock	223,657	198,713
Mustard oil	10,512	
Palm kernel oil	10,144	
Edible tallow	1,800	
Sesame oil	15,625	
Corn oil	29,965	
Butter	121,781	106,313
Milk	4,498,400	3,644,402
Salt	1,398,986	1,097,710
Benzoate of soda	3,875	
Miscellaneous		182,525
Total	19,447,067	15,580,220
Total production colored oleomargarine	709,522	420,036
Ingredient schedule for colored oleomargarine:		
Oleo oil	205,424	125,001
Cocoanut oil	165,738	67,469
Cottonseed oil	60,247	35,190
Peanut oil	16,264	14,814
Oleo stearine	2,370	2,069
Neutral lard	129,934	77,806
Oleo stock	13,298	10,375
Palm kernel oil	1,344	
Sesame oil	1,180	
Corn oil	350	
Butter	1,470	2,078
Milk	228,484	126,970
Salt	62,758	40,343
Color	983	670
Benzoate of soda	15	
Miscellaneous		3,278
Total	889,859	506,063

II–39–1276
MS. 23

Schedule of oleomargarine produced and materials used during the month of September, 1923, as compared with September, 1922.

	September, 1923.	September, 1922.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	18,258,126	13,684,061
Ingredient schedule for uncolored oleomargarine:		
Oleo oil	4,255,193	3,316,649
Cocoanut oil	6,042,575	3,815,230
Cottonseed oil	1,604,936	1,143,787
Peanut oil	404,039	559,206
Oleo stearine	483,912	389,783
Neutral lard	2,589,247	1,999,451
Oleo stock	227,919	177,142
Mustard oil	3,247	.....
Sesame oil	318	.....
Edible tallow	2,750	.....
Corn oil	50,970	.....
Butter	152,006	90,986
Milk	5,461,845	3,932,822
Salt	1,615,077	1,199,287
Soda	4,796	.....
Miscellaneous	.....	181,403
Total	22,898,830	16,805,746
Total production colored oleomargarine	863,677	547,686
Ingredient schedule for colored oleomargarine:		
Oleo oil	242,766	146,152
Cocoanut oil	181,662	80,718
Cottonseed oil	79,973	44,214
Peanut oil	18,600	17,112
Oleo stearine	2,980	2,600
Neutral lard	152,248	87,148
Oleo stock	13,182	4,621
Corn oil	150	.....
Sesame oil	169	.....
Butter	1,132	741
Milk	256,271	147,045
Salt	76,684	47,681
Soda	15	.....
Color	1,048	760
Miscellaneous	.....	5,443
Total	1,026,880	584,235

PROHIBITION.

REGULATIONS 60, ARTICLE III. II–19–1045
T. D. 3505

PROHIBITION—NOTICE OF PERMIT RENEWAL.

Article III of Regulations 60, amended by Treasury Decision 3398, further amended.

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

To Federal prohibition directors and others concerned:

Article III of Regulations 60, amended by Treasury Decision 3398 [not published in Bulletin service], is hereby amended by substituting the following for section 16(b):

SEC. 16. (b) Renewal applications may be filed on or before July 1 and not later than August 31 preceding the expiration of any permit which will expire

on December 31. Such applications will be made on Form 1404, and the procedure set forth in sections 9 and 15 will be followed. Special attention is called to the provisions of section 9(b) and section 15(a): *Provided, however,* That any permit whose renewal is regularly applied for in provisions identical with the permit then in force may be renewed by sending to the permittee (and director, if renewal is made by the Commissioner) a notice in form substantially as follows:

FORM 7817

To _____ Permit No. _____
_____ Notice of Permit Renewal.

Your permit, renewal of which for the year _____ has been regularly applied for is hereby renewed in terms identical with your present permit except as to date of expiration, which is extended for one year from _____.

_____
Prohibition Commissioner.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved August 6, 1923.
S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

REGULATIONS 60, ARTICLE V: Manufacture of cider and vinegar. II–17–1028 T. D. 3498

PROHIBITION—MANUFACTURE OF CIDER AND VINEGAR.

Article V, Regulations 60, amended.

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

To Federal prohibition directors and others concerned:

Article V of Regulations 60 is hereby amended to read as follows:

SEC. 34. Definitions: As used in this article:

(*a*) The word "cider" shall mean the expressed juice of whole, fresh, sound, ripe apples, exclusive of any extraneous or foreign matter, and without regard to the fermentation or alcoholic content thereof, unless otherwise indicated by the context.

(*b*) "Sweet cider" is the fresh juice obtained by the first pressing of whole, fresh, sound, ripe apples.

(*c*) "Preserved sweet cider" is sweet cider as defined above in which alcoholic fermentation is prevented or materially retarded (1) by the addition, immediately upon pressing, of U. S. P. benzoate of soda in the proportion of not less than 4 to 4½ avoirdupois ounces[1] to each barrel of not exceeding 50 wine gallons capacity, or (2) by pasteurization or sterilization and immediately placing same in small impervious, sterile, sealed containers, such as bottles or jugs.

(*d*) The presence of 4 per cent of acetic acid will be considered as constituting the article "vinegar" and the presence of as much as 1½ per cent of acetic acid will be considered "vinegar stock." Other acetic solutions of similar strength made from malt, etc., shall also be considered to be vinegar or vinegar stock.

SEC. 35. (a) *Home manufacture of nonintoxicating cider and fruit juices.*—Under section 29 of the Act, the penalties against the manufacture of liquor without a permit do not apply "to any person for manufacturing nonintoxicating cider and fruit juices exclusively for use in his home, but such cider and fruit juices shall not be sold or delivered except to persons having permits to

[1] This increase in the minimum requirement of benzoate of soda is intended to provide for variations in temperature, shipping conditions, destination, period of time in which cider is to be kept, etc.

manufacture vinegar." Any person, therefore, for use exclusively in his home, may manufacture cider and fruit juices of other kinds which are nonintoxicating, without obtaining permit or giving bond. Such manufacture need not be done at the home of the producer but such person may take his apples or other fruits to a custom or commercial mill and have the juice expressed, and the juice removed to his home, but such removal must be accomplished immediately after the juice is expressed. Fruit juice may not be lawfully used for beverage purposes after becoming intoxicating.

(b) If the nonintoxicating cider or fruit juice so manufactured is intended for beverage use it must, if intended for other than immediate consumption, be so preserved and put up as to prevent further alcoholic fermentation. The processes by which fruits and vegetables are ordinarily prepared in cans or jars for winter use are familiar to most housewives, and it is expected that the same care will be exercised in sterilizing and bottling cider, grape juice, etc., as is done in the case of the other preserving operations mentioned, so that such cider and fruit juices will not, when consumed for beverage purposes, be found to have "worked" or fermented so as to become intoxicating.

(c) If intended for immediate beverage use or if intended for home use only as vinegar, such cider and fruit juices need not be sterilized and sealed or otherwise preserved, but after becoming intoxicating such cider or fruit juices should not be used for beverage purposes.

(d) A person who makes nonintoxicating fruit juice for bona fide home use exclusively may, if he afterwards finds it desirable, sell a part thereof to a person holding a permit as a manufacturer of vinegar. If such sale is made before the juice has so fermented as to become intoxicating, no permit authorizing the specific transaction is required; but if such juice at the time of sale is intoxicating, the provisions of section 40(d) must be complied with. If the juice has fermented through to vinegar stock or vinegar, such sale to a vinegar manufacturer may be made without presentation of a permit to purchase, but the vinegar manufacturer is required to keep the records required in section 41. A person who makes fruit juices containing one-half of 1 per cent or more of alcohol by volume with the intent of selling same to a vinegar manufacturer must procure permit as provided in sections 39(a) and 39(e).

(e) Sweet cider direct from the press may lawfully be sold by the glass or in other small containers without permit, provided it is not combined with any other ingredient so as to produce an intoxicating liquor and is sold for consumption at the place of sale or in such proximity thereto and in such quantities that it will reasonably be expected to be consumed before becoming intoxicating. One selling unpreserved sweet cider, even though it is not intoxicating at the time of sale, to be consumed after such alcoholic content has developed, is guilty of violating section 18 of the Act making it unlawful to sell any "substance * * * designed or intended for use in the unlawful manufacture of intoxicating liquor."

(f) Dried fruits, dandelions, rhubarb, etc., may not lawfully be used in the production of the "nonintoxicating cider and fruit juices" mentioned herein.

SEC. 36. (a) A head of a family intending to produce in any year not to exceed 200 gallons of such fruit juice, other than cider, any part of which may ferment so as to contain as much as one-half of 1 per cent of alcohol by volume, must, in order to legalize such production under the internal revenue laws as well as to obtain tax exemption, in lieu of the notice provided in T. D. 2765 [not published in Bulletin service] at least five days before commencing operations for any vintage season, file Form 1541, set out in section 37. The notice will be made in triplicate on Form 1541; one copy will be retained by the producer, one copy will be filed with the collector of internal revenue, and one filed with the director. Form 698 will be used by persons intending to produce wine. The nonintoxicating fruit juices thus manufactured tax free may not be commercialized or sold. The notice will be effective for one year from the date thereof. Production hereunder shall not take place on bonded winery premises.

(b) The tax exemption mentioned in section 36(a) does not apply to such fruit juices (*a*) made by one person for the use of another, whether consumed on the premises or removed therefrom for the family use of the owner; (*b*) produced by a single person, unless he is the head of a family; (*c*) produced by a married man living apart from his family, and not for the use of that family, as in such case the fruit juices are not made for family use; (*d*) made by a partnership; (*e*) furnished ranch hands or boarders.

SEC. 37. The notice mentioned in section 36(a) should be in form substantially as follows:

Notice of Intention to Produce not in Excess of 200 Gallons of Nonintoxicating Fruit Juices Exclusively for Use in the Home of the Producer.

FORM 1541.
To Collector of Internal Revenue,
_____ District of _____.

SIR:

I, _____, _____, _____,
(Name.) (Street and No.) (City, County, State.)

hereby give notice that on or about _____, 192__, I intend to commence producing nonintoxicating fruit juices exclusively for use in my home, and not to be otherwise removed, consumed, sold, or delivered, and that I do not intend to produce more than 200 gallons of such fruit juices during the year for which this notice is given and is in effect.

I further state that if I produce or have on hand at any one time more than 200 gallons of fruit juices, containing as much as one-half of 1 per cent of alcohol by volume, I will give timely notice thereof on Form 698 and execute bond as required by T. D. 2765, and will further comply with the provisions of the Internal Revenue and Prohibition Laws and Regulations of the United States.

Dated at _____, 192__.

_____
(Signature.)

SEC. 38. For the operation of a custom cider mill no permit is required, if the cider is promptly removed to the home of the owner while sweet, as defined in section 34(b); cider taken as toll may be promptly sold by the mill operator under the same circumstances.

SEC. 39. (a) *Commercial production.*—A person desiring to manufacture preserved sweet cider under section 4 of Title II of the Act, or cider or other liquid or liquor specified in this article for conversion into vinegar, or to use such cider, liquid, or liquor in the manufacture of vinegar, or to sell same to a vinegar manufacturer, should file application on Form 1404 as prescribed in Article III, as amended by T. Ds. 3398 and 3410 [not published in Bulletin service], setting forth in such application the acts for which authorization is desired. If such application is approved, a permit will be issued authorizing the acts stipulated in the permit.

(b) Preserved sweet cider may be manufactured under permit issued as provided above and when manufactured and prepared for the market may be sold without further permit. The process of preservation shall be adequately described in the application. A method of preserving by pasteurization and bottling in closed sterile containers is generally recognized as efficient. Pasteurized cider may not be sold or delivered in bulk containers, such as kegs, barrels, etc. (except to a vinegar maker, pursuant to section 40(d)). The manufacturer of preserved sweet cider is responsible for preparing it in such manner as will insure such cider remaining nonintoxicating; and where such cider is found upon the market containing excessive alcohol the burden of proof shall be upon the manufacturer to show that it was so prepared and that it was not intoxicating at the time it was withdrawn from the place where manufactured. The placing of such responsibility upon the manufacturer shall not, however, be construed to relieve from the penalties provided in the Act such manufacturer or any other person so treating or manipulating such cider as to increase the alcoholic content.

(c) By section 602(b) of the Revenue Act of 1921, a sales tax of 2 cents per gallon is placed "upon all unfermented fruit juices," sweetened or not and intended for consumption as beverages; by section 602(c), pure apple cider, preserved as herein provided, is specifically exempted from such tax.

(d) Intoxicating cider is subject to forfeiture unless manufactured under permit and intended for sale to a vinegar manufacturer and except as provided in section 35(a). If nonintoxicating cider is lawfully acquired and held and such cider later develops sufficient alcohol to render it intoxicating, the person so possessing such cider in good faith may apply for a permit to dispose of it to a vinegar manufacturer.

(e) Cider manufactured by a person holding a permit therefor, may, under proper permit, be used in the manufacture of vinegar or may be sold or furnished to other persons holding permits to use cider in the manufacture of vinegar, pursuant to and upon receipt of permits to purchase, Form 1410A, and may not be otherwise disposed of, except as provided in subsection (f) of this section. Such cider may be sold in bulk containers such as barrels and without payment of tax thereon.

(f) Cider manufactured under permit may, pursuant to and upon receipt of permit to purchase, Form 1410A, be sold by the manufacturer to a manufacturer of food products such as apple butter, as provided in T. D. 3045 [not published in Bulletin service].

(g) In the manufacture of cider, sugar or other fermentable substances should under no circumstances be added to the apple juice for the purpose of increasing the alcoholic content, inasmuch as such practice is held to constitute the production of a mash fit for distillation within the prohibition of R. S. 3282. Preserved sweet cider may, however, be charged with carbonic-acid gas.

SEC. 40. (a) *Vinegar.*—Pursuant to appropriate permits, liquors may be manufactured for conversion into vinegar, and vinegar may be manufactured from such liquors.

(b) Vinegar may be made by the vaporization process pursuant to the provisions of R. S. 3282, as amended, and Regulations 7, pages 225 and 229.

(c) Malt vinegar may be made by the direct oxidation of malt liquor without the use of generators or the vaporization process. Malt liquor for conversion into vinegar may be produced by a person holding permit to produce vinegar under this section.

(d) A person holding permit for such purposes may manufacture vinegar from cider produced by him, or he may procure, for use in the manufacture of vinegar, cider from other persons authorized to manufacture it or tax-paid wine from bonded wineries. To procure either cider or wine containing as much as one-half of 1 per cent of alcohol by volume, a permit to purchase, Form 1410A, is required. If such cider is to be procured from a person who has produced it without permit pursuant to the provisions of section 35(a), the permit to purchase and the application therefor should be modified by using the words "home production" in place of the permit number of the vendor in the space for such number. If the cider procured from a person who has manufactured it exclusively for use in his own home contains less than one-half of 1 per cent of alcohol by volume, it may be sold and transported to the plant of the vinegar manufacturer without permit, or a permit to purchase may be issued on the application of the vinegar manufacturer. Vinegar and vinegar stock as defined in section 34(d) may be sold and transported without obtaining a permit to purchase.

(e) Vinegar may be produced from alcohol lawfully denatured by the oxidation of such denatured alcohol in oxidizing or generating plants, without the necessity of obtaining permits under this article, upon compliance with the provisions of Regulations 61.

(f) Persons operating bonded wineries may convert wines into vinegar upon such premises without obtaining permit for such purpose, provided that upon removal from such premises the product contains 1½ per cent or more of acetic acid and is treated as vinegar stock and not sold or used as wine. Before removing such product from the bonded premises application should be made to the collector on Form 1415 for permission to make such removal, accompanied by a signed copy of the chemical analysis of the material, showing the percentage of acetic acid contained therein. Such vinegar may be removed from the winery free of tax and proper credit taken on the records kept at the winery.

SEC. 41. Persons manufacturing intoxicating liquors under permit must keep a record of the amount manufactured as well as the date of manufacture and must show upon such record the disposition of all liquor manufactured by them.

SEC. 42. Containers of all intoxicating liquor manufactured for sale as such under this article must immediately upon manufacture be labeled in accordance with Article XVIII to show the following:

1. Name of manufacturer,
2. Date of manufacture,
3. Serial number of permit authorizing manufacture,
4. Kind and quantity of contents.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved July 19, 1923.

S. P. GILBERT, Jr.,
Acting Secretary of the Treasury.

II-27-1130
T. D. 3522

INDUSTRIAL ALCOHOL TRANSFER STAMPS.

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

To collectors of internal revenue and others concerned:

On and after October 1, 1923, an engraved industrial alcohol transfer stamp will be used in lieu of transfer certificate, Form 1446, on packages and tank cars of alcohol transferred in bond from one industrial alcohol bonded warehouse to another; from an industrial alcohol bonded warehouse to a denaturing plant on other premises; from an industrial alcohol plant not having a bonded warehouse to a denaturing plant on other premises; and from one denaturing plant to another. Each stamp has been provided with a stub or counterpart to be filled in with the same data as the stamp and they will be bound in books of 400 stamps each.

These stamps will be furnished to collectors of internal revenue, who will issue and forward them to the officer in charge of the warehouse or plant as required. The officer will sign each stamp and affix same to the head of the package for which issued, if the shipment is to be made in barrels or metal drums. If the alcohol is to be shipped in a tank car the stamp must be affixed in a conspicuous place near the marks showing the capacity of the car. The stamps must be securely affixed with the use of good quality, strong glue or paste, and if the alcohol is contained in a wooden barrel a tack must also be driven through each corner of the stamp. The stamp, having been so affixed, must immediately be canceled. For this purpose the officer will use a stencil plate of brass or copper, in which will be cut at least 3 parallel waived lines long enough to extend above and below the stamp on the package or tank car; and the name of the officer will be cut on one end of the plate and his title and district on the other end, perpendicular to the lines. This plate must be imprinted with durable coloring material, over and across the stamp, as indicated, and the stencil set so as to bring the 3 parallel waived lines across the stamp at such points as will least obscure the reading. The stamp will then be covered with a coating of transparent varnish.

Collectors of internal revenue may, when they deem it necessary for the proper conduct of the business, intrust to the officer in charge of an industrial alcohol bonded warehouse, industrial alcohol plant or denaturing plant, one or more books of industrial alcohol transfer stamps. Where books of stamps are so intrusted to an officer, he will be required to keep the same continuously in his immediate possession, and when not in actual use the book must be deposited in a safe and secure place, under lock and key, to which no one shall have access at any time except himself. The place of storage should consist of a built-in locker either in the bonded warehouse or the Government office. The officer will fill out and sign each stamp issued by him and will immediately, upon issuing stamps for a shipment, make full report of same to the collector of internal revenue. At the close of each day he will also make report on Form 118 (re-

vised) of all such stamps issued by him during the day. When all the stamps contained in a book have been used the officer will return the stub book to the collector, who will in turn forward same to the Commissioner of Internal Revenue.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved October 3, 1923.
A. W. MELLON,
Secretary of the Treasury.

II–28–1140
T. D. 3523

PROHIBITION—INSPECTION AND SUPERVISION OF BREWERIES AND OTHER ESTABLISHMENTS.

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

To collectors of internal revenue, Federal prohibition directors, and others concerned:

Breweries, cereal beverage plants, industrial alcohol plants, in so far as cereal beverages are manufactured or dealcoholized therein, and all other establishments engaged in the production of malt, vinous and fermented liquors, shall, under the direction of the Commissioner of Internal Revenue or the Prohibition Commissioner, be subject to inspection and supervision by collectors of internal revenue, their deputies and all revenue agents, prohibition directors and prohibition agents, and all other duly authorized internal revenue officers and prohibition officers.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved October 5, 1923.
MCKENZIE MOSS,
Acting Secretary of the Treasury.

II–30–1164
Mim. 3145

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., October 19, 1923.

Transfer stamps prescribed in T. D. 3582.

To collectors of internal revenue and others concerned:

Owing to the delay in printing a supply of industrial alcohol transfer stamps prescribed in Treasury Decision 3522 [see p. 364], the use of transfer certificates, Form 1446, will be continued until the industrial alcohol stamps are available.

D. H. BLAIR, *Commissioner.*

II–22–1066
T. D. 3509

PROHIBITION—DECISION OF COURT.

1. The Commissioner of Internal Revenue is authorized by the Concentration Act of February 17, 1922, to take whisky from distillery warehouses and transport it to concentration warehouses without the consent of the distillery warehouseman.

2. An order of the Commissioner of Internal Revenue, issued under the Concentration Act, directing the removal of whisky from a distillery to a concentration warehouse, if warranted, will not be disturbed because such action was initiated pursuant to a request of the owner.

3. Removal of whisky pursuant to the order of the Commissioner of Internal Revenue, under the Concentration Act and regulations, terminates the tax liability of distillery warehouseman, on his bond, as to the whisky so moved.

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

To collectors of internal revenue, Federal prohibition directors, and others concerned:

The attached decision of the United States Circuit Court of Appeals, Sixth Circuit, in the case of *Clear Springs Distilling Company* v. *Julian Simon*, is published for the information of internal-revenue and prohibition officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved August 22, 1923.
A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT. No. 3910.

W. O. Stiles, et al., partners, trading and doing business as Clear Springs Distilling Company, appellants, v. *Julian Simon, et al., partners, doing business as J. Simon & Sons, appellees.*

[Decided July 17, 1923.]

Before KNAPPEN, DENISON, and DONOHUE, Circuit Judges.

KNAPPEN, Circuit Judge:

Appellants (whom we shall call defendants) operate a distillery bonded warehouse at Bardstown, Ky. Appellees (whom we shall call plaintiffs) reside at St. Louis, Mo., and own warehouse receipts, issued by defendants' predecessor corporation on December 12, 1916, and on later dates (and acquired by plaintiffs, as asserted, previous to the National Prohibition Act), for 725 barrels of whisky stored in defendants' distillery warehouse. These receipts acknowledge the holding of the whisky subject to the order of the depositor, "deliverable only on return of this warehouse receipt and the written order of the holder thereof, and on payment of the United States Government taxes and all other taxes when due thereon." Storage charges are provided for at the rate of 5 cents per barrel per month from date of original inspection. The receipt further provides that the owner thereof "is to furnish us money to pay all taxes when due and to pay all accrued storage charges at expiration of seven years from date of entry into bond." On February 17, 1922, Congress passed the so-called "Concentration Act," providing "that for purpose of

concentration, upon the initiation of the Commissioner of Internal Revenue, and under regulations prescribed by him, distilled spirits may be removed from any internal-revenue bonded warehouse to any such other warehouse, and may be bottled in bond in any such warehouse before or after payment of the taxes; and the Commissioner shall prescribe the form and penal sums of bond covering distilled spirits in internal-revenue bonded warehouses, and in transit between such warehouses."[1] By section 1 of the regulations adopted by the Commissioner of Internal Revenue on June 16, 1922, with the approval of the Secretary of the Treasury (T. D. 3351 [not published in Bulletin service]), the concentration statute was declared to authorize the Commissioner of Internal Revenue "to concentrate into a small number of warehouses all the distilled spirits at present stored in distillery, special bonded and general bonded warehouses." Section 5 of the regulations provided that "when deemed advisable for purposes of concentration the Commissioner will direct the removal of spirits to the concentration warehouses designated by him. Applications requesting the Commissioner to direct the transfer of spirits to a concentration warehouse, designated by him, will be on Form 236." There was express provision that "such removals or transfers will be subject to the rules prescribed by law and regulations, so far as applicable, relating to removal of spirits from a distillery to a general bonded warehouse," with provision for settlement of accrued charges against the spirits and transportation costs to the concentration warehouse; for example, either by payment of such charges by the owner of the spirits to the distiller or warehouse proprietor from whose warehouse the spirits are to be removed and payment of transportation cost by the owner, or by assumption of such charges and transportation costs by the proprietor of the concentration warehouse to which the spirits are removed. By section 10 of the additional regulations promulgated and approved October 25, 1922 (T. D. 3404 [not published in Bulletin service]), it is provided that all spirits stored in a concentration warehouse under the Act referred to "shall be covered by transportation and warehousing bond Form 1522, given either by the distiller of such spirits, by the owner thereof, or by the proprietor of the concentration warehouse in which they are stored."

The Commissioner of Internal Revenue having designated the warehouse of the Security Warehouse & Investment Company, at St. Louis, as a concentration warehouse under the Act, and plaintiffs having applied to the Commissioner under section 5 of the regulations before referred to for an order for the removal to the St. Louis warehouse named of whisky owned by plaintiffs and stored in various distilleries in Kentucky, including that operated by appellants, the Commissioner issued orders to the defendants directing the removal of plaintiffs' whisky to the St. Louis concentration warehouse, whose owner duly obligated itself to pay all revenue taxes accruing upon the spirits in question. Permits from the proper Federal prohibition officers for the transportation of the whisky in bond, from defendants' warehouse to the concentration warehouse of the St. Louis company, having been obtained, defendant refused, on demand, to deliver the whisky for such transportation, notwithstanding offer to pay all accrued charges of every kind thereon, and all taxes except the United States Government taxes. Thereupon this bill was filed, praying a mandatory injunction requiring defendants to permit and facilitate the transportation of the whisky in question to the concentration warehouse of the St. Louis company. After hearing upon bill and answer (treated as an affidavit), as well as other affidavits submitted by each party, the district court issued a temporary injunction and restraining order as prayed by plaintiffs. From that order this appeal is taken.

Defendants present a variety of objections to the maintenance of this bill. It is alleged that the attempted removal from defendants' distillery warehouse to the Government concentration warehouse was not within the intention of the Concentration Act because made in the interest of the owners and not on the initiation of the Commissioner, and that such removal of whisky in small lots would not accomplish the purpose of concentration.

We can not agree with this contention as applied to the facts of this case. The proceedings for removal of the whisky here involved was not an isolated transaction, but was one of a large number of similar proceedings relating to whisky owned by plaintiffs and stored in many different Kentucky distillery warehouses. There is nothing to indicate that the order before us was not

[1] 42 Stat., ch. 55, p. 375, being a provision of the Act making appropriation for the Treasury Department for the fiscal year ending June 30, 1923; U. S. Comp. Stat., 1923, Cum. Supp., sec. 6059–a.

made in the course of a good-faith effort by the Commissioner to carry out the manifest intention of the Concentration Act by concentrating in a comparatively few Government-controlled warehouses whisky stored in a large number of distillery warehouses, in the interest of economy in guarding and inspecting liquors held in storage, and by way of effective protection against theft and loss of liquor incident to storage in distillery warehouses, thus facilitating the enforcement of the National Prohibition Act.

Nor, in the Commissioner's practice of receiving applications from owners for transfer of liquors to concentration warehouses, as contemplated by section 5 of the regulations, do we see anything inconsistent with the "initiation" by the Commissioner provided for by the Concentration Act.[2] By the regulations, which the Act gave the Commissioner power to adopt, removal is directed by that officer only "when deemed advisable for purposes of concentration," and "subject to the rules prescribed by law and regulations, so far as applicable, relating to removal of spirits from a distillery to a general bonded warehouse." A consulting of the convenience and interest of owners, so long as the general policy of the Act is not contravened, is commendable rather than otherwise. The law plainly does not require the consent of the distiller to the removal, although we assume the Commissioner might receive applications from distillers as well as from owners. The considerations presented by plaintiffs in error in favor of the removal here in question include the fact that St. Louis was the place of plaintiffs' residence and business location, and the asserted greatly lessened storage and handling charges, as well as superior fire and police protection available for whisky stored in the St. Louis Government-controlled warehouse, as compared with defendants' distillery warehouse.

Defendants further urge, against the validity of the attempted transfer, that by the terms of plaintiffs' warehouse receipts the whisky is not to be delivered to the owner except "on payment of the United States Government tax and all other taxes when due": that by statute (R. S., sec. 3293, as amended; U. S. Comp. Stat., sec. 6034) defendants were required to give bond for the payment of the Government tax on the whisky before removal from the distillery warehouse, and within eight years from the time of entry (on none of the whisky in question will the tax be due before December 12, 1924); that plaintiffs have not paid or offered to pay the Government tax, and that the Concentration Act did not empower the Commissioner to discharge defendants' obligation therefor. The asserted conclusion is that defendants would still remain liable for the tax, notwithstanding the removal of the whisky to the concentration warehouse.

We can not agree with this conclusion. Plaintiffs are not asking to withdraw their whisky from bond. As later shown, they could not lawfully do so. The rights of the parties are to be determined under the Concentration Act. That Act not only expressly authorizes the Commissioner to prescribe "regulations" governing its enforcement, but provides that that officer shall prescribe "the form and penal sums of bond covering distilled spirits in internal revenue bonded warehouses and in transit between such warehouses." We are disposed to think (especially in view of the consideration presently to be mentioned) that the statutory provisions above cited were intended to give the Commissioner power to take a new bond as a substitute for the distillery warehouse bond, and to relieve the warehouseman from liability thereon. The Concentration Act is not detailed. The powers conferred on the Commissioner are stated in general terms and manifestly were intended to be comprehensive. But, however this may be, when Congress authorized the Commissioner (as it plainly did) to take whisky from distillery warehouses and transport it to a concentration warehouse, and (as we must construe the statute to mean)[3] without the consent of the distillery warehouseman, the removal thereunder *ipso facto* terminated the liability of the warehouseman upon his bond. (*United States* v. *Ulrici*, 111 U. S., 38, 42.) It may be noted that section 10 of the regulations of October 25, 1922, expressly provides for such *ipso facto* relief from further liability upon the giving of the transportation and warehousing bond provided thereby, and it is held thereunder (T. D. 3404) that notice of such relief given to the distiller shall operate as a release of all the distiller's rights of lien for

[2] We attach no controlling importance to the fact that in the passage of the Act the words "for purpose of concentration, upon the initiation for the Commissioner of Internal Revenue" were substituted for "upon application of the owner or upon the initiation of the Commissioner," as originally used.

[3] The Senate rejected a proposed amendment which would have limited the removal to distillery warehouses.

unpaid internal revenue taxes, and shall constitute official notice to the distiller that his liability for taxes on the spirits is relieved.

Defendants further contend that the Concentration Act (if construed as we have construed it) impairs defendants' contractual rights. The argument is that previous to the Act whisky could be bottled in bond only at the distillery warehouse where it was manufactured, and that the statutory provision therefor was part of defendants' contract, thereby forbidding bottling elsewhere than at defendants' warehouse, *and then only if defendants agreed thereto and upon prices and terms satisfactory to them.*

Passing by other considerations, it should be enough to say that the Concentration Act, in the competent exercise of police power, has, by express provision for bottling in bond in concentration warehouse, taken away whatever right defendants may have had (not assuming, however, that such right had existed) to insist upon themselves doing such bottling.[4] (*Beer Co.* v. *Massachusetts*, 97 U. S., 25; *Mugler* v. *Kansas*, 123 U. S., 623.) Whatever right plaintiffs had to relief in the premises was based upon the Concentration Act and the orders of removal made by the Commissioner.

We see no merit in the proposition that an impairment of defendants' warehouse contract with plaintiffs is effected from the fact that in bottling under the Concentration Act plaintiffs would be compelled, as before that Act, to put defendants' trade name on their bottles. The requirement that the distiller's name appear on the stamp applies wherever the bottling is had. The resulting legal or equitable injury to defendants from such statutory use of the distiller's name is, we think, too shadowy for serious consideration.

Defendants urge that plaintiffs have a complete and adequate remedy at law, and that equity has thus no jurisdiction over the instant suit, and insist that the bill should have been dismissed for this reason. Assuming (but not deciding) that plaintiff had a right of action as for conversion of the whisky for refusal to deliver it on demand, the question is, Would such remedy be adequate? We think this question must be answered in the negative. It is not, and we think plainly could not, be claimed that plaintiffs could by replevin or other process obtain actual possession of their whisky. See *Pattison* v. *Dale* (C. C. A., 6) (196 Fed., 5, 9). Plaintiffs are, however, engaged at St. Louis in the business of selling warehouse receipts to druggists and others for whisky to be used for nonbeverage purposes. Being neither manufacturers nor wholesale druggists, they can not sell the whisky themselves, and so can not themselves withdraw it from bond. *Small Grain Distilling Co.* v. *Hamilton* (C. C. A., 6) (276 Fed., 544). They can only sell the receipts. It seems a reasonable conclusion that the market value of these receipts among plaintiffs' trade at St. Louis would be much greater were the whisky stored in the Government warehouse there, subject to immediate and ready withdrawal, than if stored in Bardstown with defendants, who deny the right of the receipt holder to withdraw it except upon conditions impracticable, if not impossible, of fulfillment. Especially is this so if, as plaintiffs assert, the expenses and risks of storage in defendants' warehouse are of the character claimed. But even if by action in trover plaintiffs might recover the real value of the whisky withheld, there could be no recovery for an injury not unlikely to result to plaintiffs' business from inability to use their receipts therein.

Wholly apart, however, from these considerations, plaintiffs' action is not upon its contract with defendants. They are substantially and equitably interested in the carrying out of the order of transfer made by governmental authority under the Concentration Act; and we think plaintiffs thus entitled to ask and obtain in equity the injunctional relief granted.

We have not discussed in detail all the considerations urged by defendants in support of their defense. We have, however, considered them all and have discussed those which seem reasonably to justify discussion.

We think the decree below was right, and it is accordingly affirmed.

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[4] Regulations No. 10, before referred to, provide that such bottling in bond may be had "at any time without previous payment of tax or consent of surety on any bond. After bottling, such spirits may continue to be stored in such warehouse until removed according to law." (T. D. 3404.)

REGULATIONS 35 (REVISED), ARTICLES 83 AND 88. II–34–1210
T. D. 3532

NARCOTIC LAW—EXPORTS.

Dates and numbers of approved export applications to be reported in monthly returns.—Articles 83 and 88, Regulations No. 35 (revised), amended.

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

To importers, manufacturers, producers, and compounders of and wholesale dealers in narcotics:

The last paragraph of articles 83 and 88, Regulations No. 35 (revised), is hereby amended, each to read as follows:

In the case of exports, the date and exporter's number of the application for permission to export, approved by the secretary of the Federal Narcotics Control Board, will be entered in the first and second columns, respectively. The columns headed "Registry number," "Class," and "District" may be left blank.

This decision shall be effective December 1, 1923, all monthly narcotic returns rendered for November, 1923, and subsequent months to be prepared as required by said articles as hereby amended.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 16, 1923.
A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 35 (REVISED), ARTICLE 109. II–34–1211
T. D. 3531

NARCOTIC LAW—ORDER FORMS.

The effective date of T. D. 3460 deferred to January 1, 1924.

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

To collectors of internal revenue and others concerned:

Treasury Decision 3473, approved May 5, 1923 [C. B. II–1, p. 317], is hereby revoked and the first sentence of paragraph 1 of Treasury Decision 3460, approved April 6, 1923 [not published in Bulletin service], is hereby amended to read as follows:

1. On and after January 1, 1924, only order forms for opium, etc., of the series of 1923 may be filled.

Paragraph 6 of said decision is also amended to read as follows:

6. This decision shall take effect at once, except as to paragraphs 2 and 3, which shall take effect January 1, 1924; provided, however, that forms of the 1923 series which may be made out prior to that date must be prepared in accordance with paragraph 2. Collectors are hereby authorized to fill all requisitions (Form 679) received on and after November 26, 1923, with forms of the 1923 series, which may be used by the purchasers as soon as received. Persons qualified to fill orders (see art. 109½) are hereby authorized to accept forms of either series during the period November 26, 1923, to December 31, 1923, inclusive, if presented for filling.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved November 16, 1923.
A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 60, SECTIONS 20(e) AND 20(p). II–36–1249
T. D. 3533

Prohibition—Bond of manufacturers of preserved sweet cider—Section 20(e) and 20(p) of Regulations 60 amended.

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

To Federal prohibition directors and others concerned:

1. Section 20(e) of Regulations 60, as amended by T. D. 3398 [not published in Bulletin service], is hereby amended by striking out the word " cider " where it appears in subsection (e).

2. Section 20(p) of Regulations 60, as amended by T. D. 3398, is hereby amended to read as follows:

(p) The amount of bond required from the proprietor of a plant for manufacturing yeast, preserved sweet cider or vinegar (not including any using specially denatured alcohol pursuant to Regulations 61) is $2,000. If more than one such plant is operated by the same proprietor, the amount of bond required shall be $2,000 for the first plant and $1,000 for each additional plant. In such case a blanket bond may be executed and filed with the director of the State in which one of the plants is located in such number of copies as will provide two for the commissioner and one for each director in whose State one of the plants is located. After approval by the commissioner, the copies will be distributed as indicated.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 1, 1923.
A. W. MELLON,
Secretary of the Treasury.

MISCELLANEOUS.

MISCELLANEOUS. II–18–1038
D. C. 326

CARDS TO BE FURNISHED ATTORNEYS AND AGENTS PRACTICING BEFORE TREASURY DEPARTMENT AFTER FILING DECLARATIONS REGARDING CONTINGENT FEES.

[1923. Department Circular No. 326.[1] Chief Clerk.]

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, July 17, 1923.

To heads of bureaus and offices, and chiefs of divisions, Secretary's office, Treasury Department, and others concerned:

The following additional regulations are prescribed with respect to practice before the Treasury Department and its several bureaus and offices:

1. All attorneys and agents practicing before the Department who have filed specific declarations or general affidavits in accordance with paragraph 6(e) of Treasury Department Circular No. 230, of April 25, 1922 [C. B. I–1, p. 469], and the order of the Secretary of the Treasury dated March 21, 1923, as amended by order dated April 7, 1923, will be furnished with cards showing that they have done so, and from and after August 15, 1923, officers of the De-

[1] This circular supersedes Treasury Department Circular No. 326, dated June 28, 1923 [not published in Bulletin service], as amended and supplemented.

partment will recognize only those presenting such cards, which will be accepted in lieu of all cards previously issued to them as evidence of their authority to practice before the Department.

These cards are issued on condition that, prior to appearing before the Department in any case handled on the basis of a contingent interest or fee, the said case shall be reported to the Department as provided in the order of the Secretary of the Treasury dated March 21, 1923, as amended by order of April 7, 1923, and as further amended herein. The Treasury Department will make such independent inquiry in regard to the circumstances connected with the employment of attorneys or agents on a contingent basis as it deems advisable.

2. The second paragraph of the order of the Secretary of the Treasury dated March 21, 1923, is hereby amended so that the said paragraph, as amended, shall read as follows:

"The Chief Clerk of the Treasury Department will retain in his confidential files the originals and duplicates or copies of all declarations and affidavits filed hereunder, for use of the Committee on Enrollment and Disbarment and of heads of bureaus and divisions. Attention is called to the fact that, while discouraging contingent fees and requiring their disclosure, the Treasury does not bar contingent fees in practice before the Treasury Department, nor is the information, which is submitted in connection with such cases, used to prejudice the fair consideration of any case, provided the attorney or agent is guilty of no unfair practice or violation of the Treasury's requirements."

S. P. GILBERT, JR.,
Acting Secretary of the Treasury.

MISCELLANEOUS. II-28-1141
D. C. 230 (revised)

LAWS AND REGULATIONS GOVERNING THE RECOGNITION OF ATTORNEYS, AGENTS, AND OTHER PERSONS REPRESENTING CLAIMANTS AND OTHERS BEFORE THE TREASURY DEPARTMENT AND OFFICES THEREOF.

[1923. Department Circular No. 230.[1] Chief Clerk.]

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, August 15, 1923.

The statutes regulating the recognition of attorneys and agents and their practice before the Treasury Department appear at the end of these regulations.

Pursuant to statutory provisions, the following rules and regulations are prescribed:

1. *Practice.*—Any individual taxpayer or member of a firm or officer or authorized regular employee of a corporation may appear for himself or such firm or corporation solely upon adequate identification to the Treasury officials. Where, however, the attorney or agent appears before the Department representing a taxpayer, he must be enrolled, and, to be enrolled, must satisfy the requirements of the statute. The statute requires that applicants for enrollment must "show that they are of good character and in good repute, possessed of the necessary qualifications to enable them to render * * * claimants valuable service, and otherwise competent to advise and assist such claimants in the presentation of their cases." (Act of July 7, 1884.) In order better to protect the taxpayer's interests and to expedite practice before the Department, applicants should clearly establish their right to enrollment by showing that they possess (1) a good character and reputation; (2) a sound education; and (3) a familiarity with the laws and regulations covering taxes or other subjects which they will present to the Department. Practice before the Treasury Department is not restricted to duly licensed attorneys at law and certified public accountants; but an agent who is not an attorney or accountant,

[1] Effective August 15, 1923. This circular supersedes Treasury Department Circular No. 230, dated February 15, 1921, and its several supplements.

and attorneys and accountants licensed in States where, in the opinion of the committee on enrollment and disbarment, the license requirements are not adequate, must show satisfactory educational qualifications and evidence of an ability to understand tax questions or such other matters as will be presented to the Treasury by the applicants. An applicant's character and reputation can only be established by inquiry among those who have had the opportunity of knowing the applicant in the community in which he has lived. A bad reputation as to integrity or any previous conduct of applicant which is unethical, as viewed by the standards of the American Bar Association or the American Institute of Accountants, or such conduct as would be considered unfair in commercial transactions, will be regarded as sufficient to justify the rejection of the application. References as to the applicant's character should be given, and in addition the applicant should furnish the names of those with whom he has come in contact in his business and of whom inquiry may be made. The committee on enrollment and disbarment will endeavor to ascertain all facts deemed necessary by it to pass on any applicant without expense or undue inconvenience to the applicant, but the committee may require, where it is not satisfied with the information received, that the applicant appear in person before the committee or its duly authorized representative.

2. *Applications for enrollment.*—Applicants for enrollment pursuant to these regulations shall submit to the Secretary of the Treasury an application, in duplicate, properly executed on Form 23 attached hereto.[2] Applications in any other form will not be considered, and all statements contained in the application must be verified by the applicant. The application must be accompanied by an affidavit regarding contingent fees, in compliance with the order of the Secretary of the Treasury dated March 21, 1923 [C. B. II–1, p. 344], as amended April 7, 1923 [C. B. II–1, p. 345]. The applicant must also take the oath of allegiance and to support the Constitution of the United States as required by section 3478, Revised Statutes. A person who can not take the oath of allegiance and to support the Constitution of the United States can not be enrolled. Members of the bar of a court of record will apply for enrollment as attorneys; all others will apply for enrollment as agents. Applicants will be notified of the approval or disapproval of their applications. All applications for enrollment must be individual, and individuals who practice as partners should apply for enrollment as individuals and not in the partnership name. An individual who has been enrolled may, however, represent claimants and others before the Treasury Department in the name of a partnership of which he is a member or with which he is otherwise regularly connected. Except as hereinafter provided in paragraph 3, a corporation can not be enrolled and attorneys or agents will not be permitted to practice before the Treasury Department for account of a corporation which represents claimants and others in the prosecution of business before the Treasury Department. Persons applying for enrollment who propose to act for such a corporation in the prosecution of claims and other business before the Treasury Department will be subject to rejection, and enrolled attorneys or agents who act for a corporation in representing claimants and others in the prosecution of claims and other business will be subject to suspension from practice as to such claims or business.

3. *Customhouse brokers.*—The Act of June 10, 1910 (36 Stat., 464, T. D. 30789), provides in part that persons, copartnerships, associations, joint-stock associations, and corporations may be licensed as customhouse brokers by the collector or chief officer of customs at any port of entry or delivery to transact business as such customhouse broker in the collection district in which such license is issued. Customhouse brokers so licensed require no further enrollment under these regulations for the transaction of business within their respective collection districts, but for the representation of a claimant before the Treasury Department in the city of Washington, application for enrollment as attorney or agent must be made in conformity with the requirements of paragraph 2, and otherwise in accordance with these regulations, except that if a customhouse broker, so licensed in a collection district, is a copartnership, association, joint-stock association, or corporation, its claims or other business may be prosecuted in its name before the Department in the city of Washington by an accredited member or representative, who must, however, be first duly enrolled in accordance herewith.

4. *List of attorneys and agents.*—A list of all attorneys and agents who make application for enrollment or who are enrolled or whose applications have been

[2] Not printed.

rejected or who have been suspended or disbarred, will be kept in the office of the chief clerk of the Treasury Department, and a copy of such list will be furnished the bureaus, offices, and divisions of the Treasury Department. Information as to whether or not any person is enrolled as an attorney or agent may be had by application to the chief clerk. All bureaus, offices, and divisions of the Treasury Department are prohibited from recognizing or dealing with any attorney or agent unless enrolled, provided that an attorney or agent, by application to the chief clerk and at the discretion of the committee on enrollment and disbarment, may be recognized temporarily, pending action upon his application for enrollment.

5. *Knowledge through connection with the Treasury Department.*—No attorney or agent shall be permitted to appear before the Treasury Department in connection with any matter to which such attorney or agent gave personal consideration or as to the facts of which he had actual personal knowledge while in the service of the Treasury Department, and likewise no such attorney or agent shall aid or assist another in any such matter and no attorney or agent shall receive assistance from one formerly in the service of the Treasury Department and having such personal knowledge.

6. *Suspension and disbarment proceedings.*—If information is received by the Treasury Department of conduct of any enrolled attorney or agent in violation of any of the statutory provisions or regulations governing practice before the Department, the information shall be referred to the committee on enrollment and disbarment. The committee may, on the basis of any such complaint, upon its own motion, or otherwise upon reasonable cause, institute proceedings for suspension or disbarment against any enrolled attorney or agent. Notice thereof, signed by the Secretary or Undersecretary of the Treasury, shall be sent by mail to such attorney or agent at the address under which he is enrolled, and such notice shall state the charge or charges made, and give the place and time within which the respondent shall file, in duplicate, his verified answer, which time shall be not less than 20 nor more than 30 days from the date of mailing the notice. Such answer shall state specifically every ground of defense relied upon by the respondent to answer the charge or charges against him. The committee may, in its discretion, extend the time for filing such answer. The complainant may, in the discretion of the committee, be furnished with a duplicate copy of such answer. If the respondent fails to file such answer within such time, he shall be declared to be in default and the charge or charges against him shall be deemed to be true without further proof by the complainant. When the answer has been filed, the committee shall pass upon the sufficiency of the same, and in case an issue of fact is raised by said answer, then the committee shall set a time and place for the hearing of such case. Notice of the time and place of such hearing, signed by the chairman of the committee, shall be sent by mail to the respondent, which hearing shall not be less than 20 nor more than 30 days from the date of mailing such notice. The committee may, in its discretion, postpone the date of hearing, or adjourn any hearing from time to time as may be necessary. An enrolled attorney or agent against whom proceedings for suspension or disbarment have been instituted as herein provided may, pending the conclusion of the proceedings and subject to the approval of the Secretary of the Treasury, be suspended for the time being from practice before the Treasury Department.

The committee shall conduct hearings according to such rules of procedure as it shall determine, and may receive evidence in such form as it may deem proper. The respondent may be represented by counsel. The testimony of witnesses may, in the discretion of the committee, be required to be under oath, and may be stenographically reported and transcribed. Depositions for use at a hearing may, with the approval of the committee, be taken by either party upon oral or written interrogatories before any officer duly authorized to administer an oath for general purposes upon 10 days' written notice if the deposition is to be taken within the District of Columbia and upon 20 days' written notice if it is to be taken elsewhere. When a deposition is taken upon written interrogatories, any cross-examination shall be upon written interrogatories. Copies of such written interrogatories shall be served with the notice, and copies of any written cross-interrogatories shall be mailed to the opposing party or his counsel at least 5 days before the time of taking the deposition.

The committee shall, promptly after the conclusion of the hearing, or, if the respondent does not appear in person for the hearing, promptly after the

date set therefor, submit to the Secretary of the Treasury a copy of the notice of hearing, the complaint, answer (if any), the record of the hearing (if any), and any written findings of fact by a majority of the committee, together with a recommendation either that the charges be dismissed or that the respondent be reprimanded, suspended for a given period of time, or disbarred. The findings and recommendation shall be signed by all members of the committee agreeing thereto. Members of the committee dissenting therefrom shall submit statements of their reasons therefor. If any members of the committee were not present at the hearing, the fact shall be stated.

Upon the suspension or disbarment of an attorney or agent, notice thereof shall be given by the committee to the heads of all bureaus, offices, and divisions of the Treasury Department and to the other branches of the Government, and, unless duly reinstated, such person shall not thereafter be recognized as an attorney or agent in any claim or other matter before the Treasury Department or any office thereof.

7. *Causes for rejection, suspension, or disbarment.*—In general, any conduct which would preclude an applicant from enrollment will be sufficient to justify his suspension or disbarment. Specifically, the following matters, among others, will be considered grounds for suspension or disbarment:

(*a*) Violation of the statutes or rules governing practice before the Treasury Department.

(*b*) Conduct contrary to the canons of ethics as adopted by the American Bar Association, or the rules of professional conduct approved by the American Institute of Accountants, or their equivalent.

(*c*) False or misleading statements or promises made by the attorney or agent to a taxpayer or misrepresentation to the Treasury Department.

(*d*) Solicitation of business by the attorney or agent. This includes letters, circulars, and interviews not warranted by previous association; printed matter appearing on the letterheads or cards of the attorney or agent indicating previous connection with the Treasury Department or enrollment as attorney or agent; or representation of acquaintance with Treasury officials or employees. It includes also the use by attorneys and agents of any titles which might imply official status or connection with the Government, such as "Federal tax expert" or "Federal tax consultant." It is not considered a violation of this regulation for Treasury employees, on severing their connection with the Department, to send out announcement cards, briefly stating their former official status and announcing their new association, provided the cards are addressed only to personal or business acquaintances, and provided further that such cards are distributed only at the time of severance of the official connection with the Government. These cards are regarded by the committee not as advertising but as the customary announcement cards issued for the express purpose of identifying the sender with his new association or business.

(*e*) Negligence in furnishing evidence required in matters pending before the Treasury Department, and the use of any means whereby the final settlement of the matter is unjustifiably delayed.

(*f*) The employment by an enrolled attorney or agent as correspondent or subagent in any matter pending before the Treasury Department, or the acceptance by such enrolled attorney or agent of employment as correspondent or subagent of or from any person who has been denied enrollment or who has been suspended or disbarred from practice. It is in violation of the regulations for an enrolled attorney or agent to assist in any way or be assisted by an attorney or agent who has been denied enrollment or has been suspended or disbarred.

(*g*) Any other matter which, in the opinion of the committee on enrollment and disbarment, is unfair to the taxpayer or to the Treasury Department or interferes unduly with the orderly disposition of matters pending before the Department.

8. *Contingent fees.*—(*a*) While contingent fees may be proper in some cases before the Department, they are not generally looked upon with favor and may be made the ground of suspension or disbarment. Both their reasonableness in view of the services rendered and all the attendant circumstances are a proper subject of inquiry by the Department. The Commissioner of Internal Revenue or the head of any other Treasury bureau or division of the Secretary's office may, at any stage of a pending proceeding, require an attorney or agent to make full disclosure as to what inducements, if any, were held out by him to procure his employment and whether the business is being handled on a contingent

basis, and, if so, the arrangement regarding compensation. The Treasury Department will also make such independent inquiry in regard to the circumstances connected with the employment of attorneys or agents on a contingent basis as it deems advisable.

(*b*) All attorneys and agents and others practicing before the Treasury Department or any of its bureaus or offices are required to file with the chief clerk of the Treasury Department an affidavit, in duplicate, stating whether or not the business in which the attorney or agent appears before the Department is being handled on a contingent basis, and, if so, on what basis and under what arrangements regarding compensation. Specific information, giving the names and descriptions of cases handled on a contingent basis, must be filed covering all such cases pending before the Treasury Department; and, whenever an additional case is taken on the basis of a contingent interest or fee, a further affidavit regarding such case must be filed with the Department, provided, however, that any attorney or agent not practicing before the Department on a contingent basis may file with the chief clerk of the Treasury Department, in lieu of these specific affidavits, a general affidavit, in duplicate, stating that he is not handling any business before the Treasury Department on a contingent basis and that he will not handle any business before the Treasury Department on a contingent basis without first giving specific notice to the Department and filing an affidavit, in duplicate, as above required. Every such affidavit must state the Treasury offices before which the attorney or agent proposes to practice.

(*c*) The chief clerk of the Treasury Department will retain in his confidential files the originals and duplicates or copies of all such affidavits regarding contingent fees for use of the committee on enrollment and disbarment and of heads of bureaus and divisions. While discouraging contingent fees and requiring their disclosure, the Treasury does not bar such fees in practice before the Treasury Department; nor is the information, which is submitted in connection with such cases, used to prejudice the fair consideration of any case, provided the attorney or agent is guilty of no unfair practice or violation of the Treasury's requirements.

(*d*) All attorneys and agents practicing before the Treasury Department, who have filed specific or general affidavits regarding contingent fees, will be furnished with cards showing that they have done so, and officers of the Department will recognize only those presenting such cards, which will be accepted in lieu of all cards previously issued to them as evidence of their authority to practice before the Department. These cards are issued on condition that, prior to appearing before the Department in any case handled on the basis of a contingent interest or fee, the said case shall be reported to the Department as hereinbefore provided.

9. *Constitution of committee.*—The committee on enrollment and disbarment shall consist of the chief clerk of the Treasury Department, ex officio, and five other members appointed by the Secretary of the Treasury, of whom two shall be detailed from the office of the Secretary, two from the office of the Commissioner of Internal Revenue, and one from the Division of Customs. The Secretary shall designate the chairman and vice chairman from members detailed from his office. The committee shall make such rules for its own government as it considers advisable. Subject to these regulations, the committee shall have jurisdiction over all matters relating to enrollment, suspension, or disbarment of attorneys and agents practicing before the Treasury Department, and shall submit its recommendations to the Secretary of the Treasury for approval.

10. *Authority to prosecute claims; delivery of checks, drafts, and warrants.*—(*a*) A power of attorney from the principal in proper form may be required of attorneys or agents by heads of bureaus, offices, and divisions, in any case. *In the prosecution of claims involving payments to be made by the United States, proper powers of attorney shall always be filed before an attorney or agent is recognized.* No power of attorney shall be recognized which is filed after settlement made by the accounting officers, even though the settlement certificate may not yet have issued, unless such power of attorney recites that the principal is fully cognizant of such settlement and of the balance found due.

(*b*) In all cases originally filed in the Treasury Department and audited and allowed by the accounting officers, payable from appropriations thereafter to be made by Congress, the drafts, warrants, or checks issued for the proceeds of such claims shall be made to the order of the claimant, and may be delivered to the attorney or agent legally authorized to prosecute the same, upon his filing

in the Department, after the allowance of the claim, the ascertainment of the amount due, and its submission to Congress for an appropriation, written authority executed in proper legal form for delivery of such draft, warrant, or check. The authority so filed shall describe the claim by the number of certificate of settlement, the amount allowed, the title of appropriation from which to be paid, the date when submitted to Congress, and the number of the executive document in which it is contained. Drafts, warrants, or checks issued for the proceeds of other like cases audited and allowed by the accounting officers but which are to be paid from appropriations available at the time of allowance shall also be made to the order of the claimant and may be delivered to the attorney or agent filing written authority, executed in proper legal form, to receive them. The Secretary of the Treasury reserves the right, however, in any case to send any draft, warrant, or check to the claimant direct. (See also paragraph 11 hereof.)

(*c*) Drafts, warrants, or checks issued in payment of amounts allowed by Congress in favor of corporations and individuals and appropriated for in private or special Acts, and for the payment of all other claims presented directly to Congress and prosecuted before its committees, shall be made to the order of claimants and delivered to them in person or mailed to their actual post-office addresses.

(*d*) Drafts, warrants, or checks issued in payment of judgments rendered by the Court of Claims, United States courts, or other courts shall be made to the order of the judgment creditor and delivered to or sent in care of the attorney certified by the court to be the attorney of record upon his filing in the Department written authority, executed in proper legal form, after the date of the rendition of the judgment, for such disposition of such draft, warrant, or check

(*e*) When judgments of the Court of Claims, United States courts, or other courts are paid by the United States, a notice of such payment, giving number, class, and date of the draft, warrant, or check, and amount paid, will be sent by the Treasury Department to the clerk of the court in which the judgment was entered in order that payment may be entered on the docket of the court.

11. *Substitution of attorneys or agents and revocation of authority.*—(*a*) Substitution of attorneys or agents may be effected only on the written consent of the attorney or agent of record, his principal, and the attorney or agent whom it is desired to substitute, and in all cases only with the assent of the head of the bureau, office, or division concerned; provided that where the power of attorney under which an attorney or agent of record is acting expressly confers the power of substitution, such attorney or agent, if in good standing before the Department, may, by a duly executed instrument, substitute another in his stead, such other, however, to be recognized as the attorney or agent only with the assent of the head of the bureau, office, or division concerned.

(*b*) If a firm dissolve, or those associated as attorneys or agents by virtue of a power of attorney contest the right of either to receive a draft, warrant, or check, the principal only shall thereafter be recognized, unless the members or survivors of such firm, or the associates in such power of attorney, file a proper agreement showing which of such members, survivors, or associates may continue to prosecute the matter and may receive a draft, warrant, or check; and in no case shall a final settlement of the matter or action toward the transmission of a draft, warrant, or check to the principal be delayed more than 60 days by reason of the failure to file such agreement.

(*c*) The revocation by a principal or his legal representatives of authority to prosecute a matter will not be effective, so far as the Treasury Department is concerned, without the assent of the head of the bureau, office, or division before which the matter is pending. Where a matter has been suspended pending the furnishing of evidence for which a call has been made on an attorney or agent, failure to take action thereon within three months from the date of suspension may be deemed by the administrative officer before whom the case is pending cause for revocation of the authority of such attorney or agent without further notice to him.

(*d*) In the settlement of claims of officers, soldiers, sailors and marines, or their representatives, and all other like claims for pay and allowances within the jurisdiction of the General Accounting Office, the draft, warrant, or check for the full amount found due shall be delivered to the payee in person or sent to his bona fide post-office address (residence or place of business) in accordance with the provisions of the Act of June 6, 1900 (31 Stat., 637).

12. *Acknowledgment of affidavit.*—A declaration, affidavit, or any paper, requiring execution or acknowledgment in connection with any claim, application for reaudit, or other matter before the Treasury Department, must be executed or acknowledged before an officer duly authorized to administer oaths for general purposes who is not interested in the prosecution of the claim or other matter to which the said declaration, affidavit, or paper pertains.

13. *Application and effective date of circular.*—This circular supersedes the regulations promulgated by Treasury Department Circular No. 230 of February 15, 1921, as heretofore amended and supplemented, relating to the recognition of attorneys, agents, and others. The regulations contained in this circular shall apply to attorneys, agents, and others representing claimants and others before the Treasury Department in the city of Washington or elsewhere, with the exception as to customhouse brokers set forth in paragraph 3, and shall be effective from and after the 15th day of August, 1923. This circular shall apply to all unsettled matters then pending in this Department, or which may hereafter be presented or referred to the Department or offices thereof for adjudication, and shall be applicable to all those now enrolled to practice before the Treasury Department as attorney or agent, provided that nothing herein contained shall be construed to abrogate any rules or orders of the General Accounting Office relating to the fees of attorneys, agents, or others, or to require those now enrolled to apply again to be enrolled.

14. *Circular may be withdrawn or amended.*—The Secretary of the Treasury may withdraw or amend at any time or from time to time all or any of the foregoing rules and regulations, with or without previous notice, and may make such special orders as he may deem proper in any case.

A. W. MELLON,
Secretary of the Treasury.

STATUTES.

The following statutes relate to the recognition of attorneys, agents, and other persons representing claimants and others before the Treasury Department and offices thereof:

That the Secretary of the Treasury may prescribe rules and regulations governing the recognition of agents, attorneys, or other persons representing claimants before his Department, and may require of such persons, agents, and attorneys, before being recognized as representatives of claimants, that they shall show that they are of good character and in good repute, possessed of the necessary qualifications to enable them to render such claimants valuable service, and otherwise competent to advise and assist such claimants in the presentation of their cases. And such Secretary may after due notice and opportunity for hearing suspend, and disbar from further practice before his Department any such person, agent, or attorney shown to be incompetent, disreputable, or who refuses to comply with the said rules and regulations, or who shall with intent to defraud, in any manner willfully and knowingly deceive, mislead, or threaten any claimant or prospective claimant, by word, circular, letter, or by advertisement. (Act of July 7, 1884, 23 Stat., 258.)

Whoever, being an officer of the United States, or a person holding any place of trust or profit, or discharging any official function under, or in connection with, any executive department of the Government of the United States, or under the Senate or House of Representatives of the United States, shall act as an agent or attorney for prosecuting any claim against the United States, or in any manner, or by any means, otherwise than in discharge of his proper official duties, shall aid or assist in the prosecution or support of any such claim, or receive any gratuity, or any share of or interest in any claim from any claimant against the United States, with intent to aid or assist, or in consideration of having aided or assisted, in the prosecution of such claim, shall be fined not more than $5,000, or imprisoned not more than one year, or both. (Act of March 4, 1909, sec. 109, 35 Stat., 1107.)

It shall not be lawful for any person appointed after the 1st day of June, 1872, as an officer, clerk, or employee in any of the departments, to act as counsel, attorney, or agent for prosecuting any claim against the United States which was pending in either of said departments while he was such officer, clerk, or employee, nor in any manner, nor by any means, to aid in the prosecu-

tion of any such claim, within two years next after he shall have ceased to be such officer, clerk, or employee. (Sec. 190, Revised Statutes.)

That it shall be unlawful for any person who, as a commissioned officer of the Army, or officer or employee of the United States, has at any time since April 6, 1917, been employed in any bureau of the Government and in such employment been engaged on behalf of the United States in procuring or assisting to procure supplies for the Military Establishment, or who has been engaged in the settlement or adjustment of contracts or agreements for the procurement of supplies for the Military Establishment, within two years next after his discharge or other separation from the service of the Government, to solicit employment in the presentation or to aid or assist for compensation in the prosecution of claims against the United States arising out of any contracts or agreements for the procurement of supplies for said bureau, which were pending or entered into while the said officer or employee was associated therewith. A violation of this provision of this chapter shall be punished by a fine of not more than $10,000 or imprisonment for not more than one year, or both. (Act of July 11, 1919, 41 Stat., 131.)

That section 558 of the Code of Law for the District of Columbia, relating to notaries public, be amended by adding at the end of said section the following: "*Provided*, That the appointment of any person as such notary public, or the acceptance of his commission as such, or the performance of the duties thereunder, shall not disqualify or prevent such person from representing clients before any of the departments of the United States Government in the District of Columbia or elsewhere, provided such person so appointed as a notary public who appears to practice or represent clients before any such department is not otherwise engaged in Government employ, and shall be admitted by the heads of such departments to practice therein in accordance with the rules and regulations prescribed for other persons or attorneys who are admitted to practice therein: *And provided further*, That no notary public shall be authorized to take acknowledgments, administer oaths, certify papers, or perform any official acts in connection with matters in which he is employed as counsel, attorney, or agent or in which he may be in any way interested before any of the departments aforesaid." (Act of June 29, 1906, 34 Stat., 622. Held by 26 Opinions of Attorney General, 236, to apply to all notaries who may practice before the departments.)

The head of each department is authorized to prescribe regulations, not inconsistent with law, for the government of his department, the conduct of its officers and clerks, the distribution and performance of its business, and the custody, use, and preservation of the records, papers, and property appertaining to it. (Sec. 161, Revised Statutes.)

MISCELLANEOUS. II–37–1253
T. D. 3534

Revised Statutes of the United States as amended or affected by legislation subsequent to May 1, 1920.

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

To collectors of internal revenue and others concerned:

Attention is invited to the following changes in the laws applicable to the internal revenue which have occurred since the publication of the compilation entitled "Internal Revenue Laws in Force May 1, 1920."

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved December 1, 1923.
A. W. MELLON,
Secretary of the Treasury.

Section 236, R. S. Amended by Act June 10, 1921 (ch. 18, sec. 305) (42 Stat., 24), to read as follows:

"SEC. 236. All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office."

Section 1044, R. S. Amended by Act November 17, 1921 (ch. 124) (42 Stat., 220), to read as follows:

"SEC. 1044. No person shall be prosecuted, tried, or punished for any offense, not capital, except as provided in section 1046, unless the indictment is found, or the information is instituted, within three years next after such offense shall have been committed: *Provided, however*, That in offenses involving the defrauding or attempts to defraud the United States or any agency thereof, whether by conspiracy or not, and in any manner, and now indictable under any existing statutes, the period of limitation shall be six years. This Act shall apply to acts, offenses, or transactions where the existing statute of limitations has not yet fully run, but this proviso shall not apply to acts, offenses, or transactions which are already barred by the provisions of existing laws."

SEC. 2. That this Act shall be in force and effect from and after the date of its passage.

Section 2971, R. S. (as referred to in sec. 600(b) of the Revenue Act of 1918). Repealed by Act September 21, 1922 (ch. 356, sec. 642) (42 Stat., 989).

Section 2982, R. S. Repealed by Act September 21, 1922 (ch. 356, sec. 642) (42 Stat., 989).

Section 3142, R. S. Amended by Act March 4, 1923 (ch. 244) (42 Stat., 1444), by adding at the end thereof a new paragraph to read as follows:

"On and after July 1, 1921, the whole number of collection districts for the collection of internal revenue and the whole number of collectors of internal revenue shall not exceed 65."

Sections 3164, 3165, 3167, 3172, 3173, 3176, R. S., as amended. Reenacted without change in Revenue Act of 1921 (sec. 1311), published in T. D. 3258. (42 Stat., 311.)

Section 3182, R. S. Amended by Revenue Act of 1921 (sec. 1322), published in T. D. 3258. (42 Stat., 315.)

Section 3220, R. S., amended. Reenacted without change in Revenue Act of 1921 (sec. 1315), published in T. D. 3258. (42 Stat., 314.)

Section 3225, R. S., as amended. Reenacted without change in Revenue Act of 1921 (sec. 1323), published in T. D. 3258. (42 Stat., 316.)

Section 3226, R. S. Amended by Revenue Act of 1921 (sec. 1318), published in T. D. 3258. (42 Stat., 315.)
Further amended by Act March 4, 1923 (ch. 276, sec. 2), published in T. D. 3457. (42 Stat., 1505.)

Section 3227, R. S. Repealed by Revenue Act of 1921 (sec. 1319), published in T. D. 3258 (42 Stat., 315), but such repeal shall not affect any suit or proceeding instituted prior to the passage of this Act (Revenue Act of 1921).

Section 3228, R. S. Modified by section 252, Revenue Act of 1921, published in T. D. 3258. (42 Stat., 268.)
Amended by section 1316, Revenue Act of 1921, published in T. D. 3258. (42 Stat., 314.)
Amended by Act March 4, 1923 (ch. 276), published in T. D. 3457. (42 Stat., 1504.)

Section 3315, R. S., as amended. Reenacted without change in Revenue Act of 1921 (sec. 1330), published in T. D. 3258. (42 Stat., 319.)

Section 3360, R. S., as amended by section 704 of the Revenue Act of 1918. Reenacted without change in Revenue Act of 1921 (sec. 704), published in T. D. 3258. (42 Stat., 288.)

Section 3362, R. S., as amended by section 701 of the Revenue Act of 1918. Reenacted without change in Revenue Act of 1921 (sec. 701(b)), published in T. D. 3258. (42 Stat., 287.)

Section 3368, R. S. Amended by section 701(a) of the Revenue Act of 1921, published in T. D. 3258. (42 Stat., 287.)

Section 3369, R. S. Last proviso amended by Act October 14, 1921 (ch. 107) (42 Stat., 205), to read as follows:

"*And provided further*, That in case it shall appear that any abandoned, condemned, or forfeited tobacco, snuff, cigars, or cigarettes, when offered for sale, will not bring a price equal to the tax due and payable thereon, such goods shall not be sold for consumption in the United States; and upon application made to the Commissioner of Internal Revenue, he is authorized to order the destruction of such tobacco, snuff, cigars, or cigarettes by the officer in whose custody and control the same may be at the time, and in such manner and under such regulations as the Commissioner of Internal Revenue may prescribe, or he may, under such regulations, order delivery of such tobacco, snuff, cigars, or cigarettes, without payment of any tax, to any hospital maintained by the United States for the use of present or former members of the military or naval forces of the United States."

Section 3392, R. S. Amended by section 700(d) of the Revenue Act of 1921, published in T. D. 3258. (42 Stat., 287.)

Section 3394, R. S. Amended by section 700(a) of the Revenue Act of 1921, published in T. D. 3258. (42 Stat., 286.)

Section 3433, R. S. In connection with this section see section 311 of the Tariff Act of 1922, approved September 21, 1922 (42 Stat., 858, 938).

"SEC. 311. That all articles manufactured in whole or in part of imported materials, or of materials subject to internal-revenue tax, and intended for exportation without being charged with duty, and without having an internal-revenue stamp affixed thereto, shall, under such regulations as the Secretary of the Treasury may prescribe, in order to be so manufactured and exported, be made and manufactured in bonded warehouses similar to those known and designated in Treasury Regulations as bonded warehouses, class 6: *Provided*, That the manufacturer of such articles shall first give satisfactory bonds for the faithful observance of all the provisions of law of such regulations as shall be prescribed by the Secretary of the Treasury: *Provided further*, That the manufacture of distilled spirits from grain, starch, molasses, or sugar, including all dilutions or mixtures of them or either of them, shall not be permitted in such manufacturing warehouses.

"Whenever goods manufactured in any bonded warehouse established under the provisions of the preceding paragraph shall be exported directly therefrom or shall be duly laden for transportation and immediate exportation under the supervision of the proper officer who shall be duly designated for that purpose, such goods shall be exempt from duty and from the requirements relating to revenue stamps.

"Any materials used in the manufacture of such goods, and any packages, coverings, vessels, brands, and labels used in putting up the same may, under the regulations of the Secretary of the Treasury, be conveyed without the payment of revenue tax or duty into any bonded manufacturing warehouse, and imported goods may, under the aforesaid regulations, be transferred without the exaction of duty from any bonded warehouse into any bonded manufacturing warehouse; but this privilege shall not be held to apply to implements, machinery, or apparatus to be used in the construction or repair of any bonded manufacturing warehouse or for the prosecution of the business carried on therein. * * *

"Articles manufactured under these provisions may be withdrawn under such regulations as the Secretary of the Treasury may prescribe for transportation and delivery into any bonded warehouse at an exterior port for the sole purpose of immediate export therefrom: *Provided*, That cigars manufactured in whole of tobacco imported from any one country, made and manufactured in such bonded manufacturing warehouses, may be withdrawn for home consumption upon the payment of the duties on such tobacco in its condition as imported under such regulations as the Secretary of the Treasury may prescribe, and the payment of the internal-revenue tax accruing on such cigars in their condition as withdrawn, and the boxes or packages containing such cigars shall be stamped to indicate their character, origin of tobacco from which made, and place of manufacture.

"The provisions of section 3433 of the Revised Statutes shall, so far as may be practicable, apply to any bonded manufacturing warehouse established under this Act and to the merchandise conveyed therein."

Section 3450, R. S. In connection with this section see section 26 of the National Prohibition Act (41 Stat., 315).

"SEC. 26. When the commissioner, his assistants, inspectors, or any officer of the law shall discover any person in the act of transporting, in violation of the law, intoxicating liquors in any wagon, buggy, automobile, water or air craft, or other vehicle, it shall be his duty to seize any and all intoxicating liquors found therein being transported contrary to law. Whenever intoxicating liquors transported or possessed illegally shall be seized by an officer he shall take possession of the vehicle and team or automobile, boat, air or water craft, or any other conveyance, and shall arrest any person in charge thereof. Such officer shall at once proceed against the person arrested under the provisions of this title in any court having competent jurisdiction; but the said vehicle or conveyance shall be returned to the owner upon execution by him of a good and valid bond, with sufficient sureties, in a sum double the value of the property, which said bond shall be approved by said officer and shall be conditioned to return said property to the custody of said officer on the day of trial to abide the judgment of the court. The court upon conviction of the person so arrested shall order the liquor destroyed, and unless good cause to the contrary is shown by the owner, shall order a sale by public auction of the property seized, and the officer making the sale, after deducting the expense of keeping the property, the fee for the seizure, and the cost of the sale, shall pay all liens, according to their priorities, which are established, by intervention or otherwise at said hearing or in other proceeding brought for said purpose, as being bona fide and as having been created without the lienor having any notice that the carrying vehicle was being used or was to be used for illegal transportation of liquor, and shall pay the balance of the proceeds into the Treasury of the United States as miscellaneous receipts. All liens against property sold under the provisions of this section shall be transferred from the property to the proceeds of the sale of the property. If, however, no one shall be found claiming the team, vehicle, water or air craft, or automobile, the taking of the same, with a description thereof, shall be advertised in some newspaper published in the city or county where taken or if there be no newspaper published in such city or county, in a newspaper having circulation in the county, once a week for two weeks and by handbills posted in three public places near the place of seizure, and if no claimant shall appear within 10 days after the last publication of the advertisement, the property shall be sold and the proceeds after deducting the expenses and costs shall be paid into the Treasury of the United States as miscellaneous receipts."

And also see section 5 of the Act of November 23, 1921, supplemental to the National Prohibition Act, published in T. D. 3257. (42 Stat., 223.)

Section 3648, R. S.

"* * * Section 3648, Revised Statutes, shall not apply to subscriptions for foreign and professional newspapers and periodicals to be paid for from this appropriation: * * *" Act June 30, 1921 (ch. 33) (42 Stat., 73).

"* * * *Provided further*, That not to exceed $25,000 of the total amount appropriated shall be available for advances to be made by special disbursing agents when authorized by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, the provisions of section 3648 of the Revised Statutes to the contrary notwithstanding. * * *" Act January 3, 1923 (ch. 22) (42 Stat., 1097).

"* * * Section 3648, Revised Statutes, shall not apply to subscriptions to foreign and professional newspapers and periodicals to be paid for from this appropriation. * * *" Act March 2, 1923 (ch. 178) (42 Stat., 1379).

Section 3689, R. S. Repealed in part by section 1317 of the Revenue Act of 1921, published in T. D. 3258. (42 Stat., 314.)

Appropriation for refunds under section 3689, Revised Statutes, as amended by Act February 24, 1919. Act January 3, 1923 (ch. 22) (42 Stat., 1098).

Section 5219, R. S. Amended by Act March 4, 1923 (ch. 267) (42 Stat., 1499), to read as follows:

"SEC. 5219. The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares

of national banking associations located within its limits. The several States may tax said shares, or include dividends derived therefrom in the taxable income of an owner or holder thereof, or tax the income of such associations, provided the following conditions are complied with:

"1. (a) The imposition by said State of any one of the above three forms of taxation shall be in lieu of the others.

"(b) In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks: *Provided*, That bonds, notes, or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section.

"(c) In case of a tax on the net income of an association, the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon the net income of mercantile, manufacturing, and business corporations doing business within its limits.

"(d) In case the dividends derived from the said shares are taxed, the tax shall not be at a greater rate than is assessed upon the net income from other moneyed capital.

"2. The shares or the net income as above provided of any national banking association owned by nonresidents of any States, or the dividends on such shares owned by such nonresidents, shall be taxed in the taxing district where the association is located and not elsewhere; and such associations shall make return of such income and pay the tax thereon as agent of such nonresident shareholders.

"3. Nothing herein shall be construed to exempt the real property of associations from taxation in any State or in any subdivision thereof, to the same extent, according to its value, as other real property is taxed.

"4. The provisions of section 5219 of the Revised Statutes of the United States as heretofore in force shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section."

Sections 5292, 5293, R. S. Repealed by Tariff Act of 1922, approved September 21, 1922 (42 Stat., 989).

II–13–967

CHANGES IN BUREAU ORGANIZATION.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., June 21, 1923.

Collectors of internal revenue, internal revenue agents in charge, and others concerned:

The following changes in the organization of the Bureau of Internal Revenue became effective June 16, 1923:

Charles R. Nash appointed Assistant to the Commissioner of Internal Revenue.

Harris F. Mires appointed deputy commissioner in charge of the Accounts and Collections Unit, vice Charles R. Nash, promoted.

The Sales Tax Unit has been abolished by consolidation with the Estate Tax and Capital Stock Tax Unit with Deputy Commissioner Robert M. Estes in charge of the combined work. This will hereafter be known as the Estate Tax, Capital Stock Tax, and Sales Tax Unit.

D. H. BLAIR, *Commissioner.*

II–14–977

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 2, 1923.

Collectors of internal revenue, internal revenue agents in charge, and others concerned:

The following changes in the organization of the Bureau of Internal Revenue became effective July 1, 1923:

James G. Bright appointed deputy commissioner in charge of the Income Tax Unit, vice E. W. Chatterton, resigned.

Charles B. Allen appointed assistant deputy commissioner in charge of the Income Tax Unit, vice James G. Bright, promoted.

C. R. NASH,
Acting Commissioner.

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