Internal Revenue
cumulative
bulletin

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Department of the Treasury
Internal Revenue Service

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Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

These principles of tax administration were previously published in the Internal Revenue Bulletin as Revenue Procedure 64-22, 1964-1 (Part I) C.B. 689. They are restated here to emphasize their importance to all employees of the Internal Revenue Service.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, tax conventions, legislation, court decisions, and other items of general interest.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, industry regulations appearing in internal management documents and statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to service field offices, identifying details and confidential information are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements, such as 18 U.S.C. 1905 and 26 U.S.C. 7213 concerning disclosure of information obtained from members of the public.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

Cumulative Bulletin 1974-1 is a consolidation of all items of a permanent nature published in the weekly Bulletins 1974-1 through 1974-25 for the period of January 1 through June 30, 1974. It includes a cumulative list of announcements relating to decisions of the Tax Court published in the Internal Revenue Bulletins.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: 1—Income Tax, 2—Estate and Gift Taxes, 3—Employment Taxes, and 4—Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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

Foreword

The Internal Revenue Cumulative Bulletin is prepared in five parts as follows:

Part I.—1954 Code. This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954 other than those pertaining to alcohol, tobacco, and firearms. Arrangement is sequential according to Code and regulations sections. The Code section is shown at the top of each page.

Part II.—1939 Code. No rulings or decisions based on provisions of the Internal Revenue Code of 1939 and other laws were published during the period January-June 1974.

Part III.—Reserved. (This part contained all matters pertaining to alcohol, tobacco, firearms, and explosives prior to the transfer of the Alcohol, Tobacco and Firearms Division from the Internal Revenue Service to the Bureau of Alcohol, Tobacco and Firearms, Department of the Treasury, effective July 1, 1972, Treasury Department Order No. 221, 1972-2 C.B. 899.)

Part IV.—Treaties and Tax Legislation. This part is divided into three subparts as follows: Subpart A, Revenue Ruling related to Tax Conventions; Subpart B, Legislation; Subpart C, Committee Reports. House, Senate, and Conference Committee Reports printed in the Bulletin do not include the portion entitled "Changes in Existing Law."

Part V.—Administrative, Procedural, and Miscellaneous. To the extent practicable, pertinent cross-references to these subjects are contained in the other Parts and Subparts. Included in this Part is a list of persons disbarred or suspended from practice before the Internal Revenue Service.

The synopses preceding Revenue Rulings, Revenue Procedures, and Court Decisions are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

Abbreviations

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

***A, B, C,* etc.** The names of individuals.
A.R.R. Committee on Appeals and Review recommendation.
A.T. Alcohol and tobacco tax ruling.
B.T.A. Board of Tax Appeals.
C.B. Cumulative Bulletin.
CFR Code of Federal Regulations.
C.T. Carriers Taxing Act of 1937.
Ct. D. Court Decision.
Del. Order Delegation Order.
D.C. Treasury Department circular.
DISC Domestic International Sales Corporations.
E.O. Executive Order.
E.T. Estate and gift tax ruling.
Em. T. Employment tax ruling.
F.A.A.A. Federal Alcohol Administration Act.
FICA Federal Insurance Contributions Act.
F.R. Federal Register.
FUTA Federal Unemployment Tax Act.
G.C.M. Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B. Internal Revenue Bulletin.
IR-Mim. Published IR-Mimeograph.
I.T. Income tax ruling.
***M, N, X, Y, Z,* etc.** The names of corporations, places or businesses, according to context.
M.T. Miscellaneous tax ruling.
Mim. Published mimeograph.
O.D. Office Decision.
P.L. Public Law.
PS Pension, profit-sharing, stock bonus or annuity plan ruling.
Rev. Proc. Revenue Procedure.
Rev. Rul. Revenue Ruling.
R.S. Revised Statute.
S.M. Solicitor's Memorandum.
Sol. Op. Solicitor's Opinion.
S.P.R. Statement of Procedural Rules.
S.R. Solicitor's Recommendation.
S.S.T. Social Security Tax.
S.T. Sales tax ruling.
Stat. Statutes at Large.
T.C. The Tax Court of the United States.
T.D. Treasury Decision.
T.I.R. Technical Information Release.
U.S.C. United States Code.

x and *y* are used to represent certain numbers and when used with the word "dollars" represent sums of money.

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Finding List of Obsolete Published Rulings[1]

(Rev. Proc. 67-6, 1967-1 C.B. 576)

The following is a complete list of rulings that have been declared obsolete during the period January-June 1974 in accordance with the program announced in Revenue Procedure 67-6 for the review of rulings published prior to 1953. (See 1967-2 C.B. (X), 1968-2 C.B. (XIII), 1969-2 C.B. (VII), 1970-2 C.B. XI, 1971-2 C.B. (XII), 1972-2 C.B. XII, and 1973-2 C.B. X for a listing of rulings declared obsolete in 1967, 1968, 1969, 1970, 1971, 1972, and 1973 respectively.) The rulings are arranged by series in numerical order. Citations are to Cumulative Bulletins.

Cumulative Bulletin No. 1 contains rulings relating to income and profits taxes issued between April 1, 1919, and December 31, 1919. Similar rulings issued from January 1920 through December 1921 are contained in semiannual Cumulative Bulletin Nos. 2, 3, 4, and 5. Other rulings issued during that period are contained in separate Sales Tax Rulings Bulletins.

All rulings published after 1921 are contained in the Internal Revenue Bulletin rather than in separate Income Tax and Sales Tax Bulletins. Cumulative Bulletin I-1 covers the first six months of 1922, and each subsequent semiannual Cumulative Bulletin through the last six months of 1936 is similarly identified by a Roman numeral prefix and an Arabic numeral which denoted the first or the second half of the calendar year. Cumulative Bulletin 1937-1 inaugurated a new numbering system in which the year covered is identified by an Arabic numeral.

[1] Declared obsolete by Rev. Rul. 74-12, page 366, and Rev. Rul. 74-268, page 367.

Appeals and Review Memorandum (A.R.M.) Ruling Series

A.R.M. No.	*C.B. Citation*
151	I-1, 214 (1922)

Appeals and Review Recommendation (A.R.R.) Ruling Series

A.R.R. No.	*C.B. Citation*
156	2, 39 (1920)
252	3, 46 (1920)
521	4, 221 (1921)

General (or Chief) Counsel's Memorandum (G.C.M.) Ruling Series

G.C.M. No.	*C.B. Citation*
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222	V-2, 110 (1926)
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2519	VI-2, 231 (1927)
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1462	I-2, 160 (1922)
1522	I-2, 199 (1922)
1594	II-1, 91 (1923)
1622	II-1, 135 (1923)
1650	II-1, 48 (1923)
1803	II-2, 36 (1923)
2129	IV-1, 29 (1925)
2646	XI-2, 59 (1932)
2841	XIII-2, 584 (1934)
3066	1937-1, 113
3082	1937-1, 77
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3093	1937-2, 80

Income Tax (I.T.) Ruling Series (Cont'd)

I.T. No.	*C.B. Citation*
3094	1937-2, 80
3227	1938-2, 70
3257	1939-1, (Part I) 402
3259	1939-1, (Part I) 127
3275	1939-1, (Part I) 403
3278	1939-1, (Part I) 76
3282	1939-1, (Part I) 406
3284	1939-1, (Part I) 407
3289	1939-1, (Part I) 409
3308	1939-2, 404
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3398	1940-2, 396
3400	1940-2, 415
3514	1941-2, 91
3601	1943, 412
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Mimeograph (Mim.) Ruling Series

Mim No.	*C.B. Citation*
3886	X-2, 164 (1931)
6340	1949-1, 261
6366	1949-1, 270

Office Decision (O.D.) Ruling Series

O.D. No.	*C.B. Citation*
14	1, 67 (1919)
554	2, 108 (1920)
632	3, 204 (1920)
1082	5, 175 (1921)

Treasury Decisions (T.D.) Ruling Series

T.D. No.	*C.B. Citation*
4013	VI-1, 59 (1927)
4098	VI-2, 58 (1927)
4227	VII-2, 125 (1928)
4269	VIII-2, 146 (1929)

Cumulative List of Announcements Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1974 to June 30, 1974

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Adam, Robert L.	4192-71 8092-71	60	996
American Foundry, a corporation	3600-71 6479-71	59	231
Auburn Packing Co. [1]	7347-70	60	794
Austin State Bank	755-69 2387-69	57	180
Barrett, Herbert R. [2]	970-71	58	284
Bradford, James C.	6364-70	60	253
Chase, George E.	1546-70	57	546
Cohen, Morris [3]	87709	39	886
Cohen, Stanley L. [3]	88256		
Cook, Arnold [3]	88258		
Cook, Harold [3]	88264		
Cook, Louis [3]	88261		
Donaldson, J. Glenn [3]	88260		
Enoch, Herbert [4]	511-67 1834-67 5216-68	57	781
Goldstein, Abe H. [3]	88253	39	886
Goldstein, David [3]	88255		
Goldstein, Gilbert [3]	88262		
Goldstein, Paul [3]	88251		
Goldstein, Sam [3]	88252		
Goldstein, William J. [3]	88254		
Hambleton, Sallie B. [2,5]	7260-71	60	558
Hardin, Allen S.	1596-70	57	546
Hectare, Inc.	1597-70		

Taxpayer	Docket No.	Report Volume	Report Page
Heidrich, Doris M. [5]	2423-69	55	746
Heidrich, Francis X. [5]	2424-69		
Heidrich, Herman J. [5]	2425-69		
Heidrich, Martha J. [5]	2409-69		
Heidrich, Paul D. [5]	2410-69		
Heidrich, Sarah F. [5]	2459-69		
Hoffman, Abe L. [3]	88259	39	886
Howell, William B.	1538-70	57	546
Imel, Robert E.	5799-70	61	318
Jaecker, Harry C., Manufacturers Hanover Trust Co., Harry C. Jaecker, Jr. & Katie Jaecker Dexter, executors [6]	824-69	58	166
Jordan, James M.	7323-71	60	770
Linkow, Edward W. [3]	88263	39	886
Mauldin, William H., and Natalie E. Mauldin, deceased, William H. Mauldin, executor	314-71	60	749
Nash, William I.	921-71	60	503
R.R.R., Inc. [4]	1835-67	57	781
Rainier Companies, Inc. (formerly Sicks' Rainier Brewing Co.)	6870-71	61	68
Ross, Carl [7]	3848-71	60	569
	3849-71		
Ross Glove Co. [7]	3837-71		
	3838-71		
	7486-70		
Sachter, Lewis [3]	88257	39	886
Schwartz, Henry, individually, and as surviving spouse & executor of the estate of Sydell Schwartz	3845-70	60	728
	429-72		
Schwartz Corp., Henry	3839-70		
	428-72		
Title & Trust Company of Florida [2]	749-68	58	900

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report Volume	Report Page
Cohen, Morris [8]	87709	39	886
Cohen, Stanley S. [8]	88256		
Cook, Arnold [8]	88258		
Cook, Harold [8]	88264		
Cook, Louis [8]	88261		
Donaldson, J. Glenn [8]	88260		
Enoch, Herbert [4]	511-67	57	781
	1834-67		
	5216-68		
Goldstein, Abe H. [8]	88253	39	886
Goldstein, David [8]	88255		
Goldstein, Gilbert [8]	88262		
Goldstein, Paul [8]	88251		
Goldstein, Sam [8]	88252		
Goldstein, William J. [8]	88254		

Taxpayer	Docket No.	Report Volume	Report Page
Heaberlin, John W. [9]	84559	34	58
Hoffman, Abe L. [8]	88259	39	886
Linkow, Edward W. [8]	88263	39	886
R.R.R., Inc. [4]	1835-67	57	781
Sachter, Lewis [8]	88257	39	886
Stuart, Charles R. [10]	[a]89096	38	1147

[a] United States Board of Tax Appeals.

[1] Acquiescence in the issue relating to whether taxpayer was a livestock raiser eligible to use unit-livestock-price method of valuing inventory of cattle. Acquiescence in result (see footnote 2) in the issue whether Commissioner can require change from the unit-livestock-price method as not properly reflecting income.

[2] Acquiescence in result. Acquiescence "in result" means acceptance of the Court but disagreement with some or all the reasons assigned for the decision.

[3] Acquiescence in the issues relating to (1) nonbusiness bad debt deductions for the year 1956, (2) gain from the sale of real estate. and (3) correct computation of installment payments received during the years 1956 and 1957.

[4] Acquiescence in all issues except nonacquiescence in issue No. 7, relating to whether the term "capital account" includes only amounts received for capital stock.

[5] Gift Tax decision.

[6] Estate Tax decision.

[7] Acquiescence in all issues except acquiescence in result (see footnote 2) in issue No. 2, relating to advances to a sister corporation constituting constructive dividends.

[8] Nonacquiescence in the issue relating to gain from the sale of capital stock.

[9] Acquiescence published in 1960-2 C.B. 5, is withdrawn and nonacquiescence is substituted therefor.

[10] See Rev. Rul. 74-240, page 52.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954, Except Those Pertaining to Alcohol, Tobacco, and Firearms

Subtitle A.—Income Taxes
Chapter 1.—Normal Taxes and Surtaxes
Subchapter A.—Determination of Tax Liability
Part I.—Tax on Individuals

Section 1.—Tax Imposed

26 CFR 1.1-1: Income tax on individuals.

Whether all the world-wide income of a nonresident alien for part of the taxable year is subjected to Federal income tax. See Rev. Rul. 74-239, page 372.

Section 2.—Definitions and Special Rules

26 CFR 1.2-2: Definitions and special rules.

Whether the nondiscrimination clause of Paragraph 11 of the Protocol to the United States-Canada Income Tax Convention prevents the United States from denying a Canadian citizen who is both a resident and a nonresident of the United States during the taxable year the benefit of using the head of household tax rate schedules. See Rev. Rul. 74-239, page 372.

Section 4.—Rules for Optional Tax

26 CFR 1.4-1: Number of exemptions.

Whether the nondiscrimination clause of Paragraph 11 of the Protocol to the United States-Canada Income Tax Convention prevents the United States from denying, a Canadian citizen who is both a resident and a nonresident of the United States during the taxable year the benefit of using the optional tax tables. See Rev. Rul. 74-239, page 372.

Part IV.—Credits Against Tax
Subpart A.—Credits Allowable

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.
(Also Section 48; 1.48-2, 1.48-3, 1.48-4.)

Investment credit; leased section 38 property subsequently purchased from lessor. The lessee who leased new section 38 property from a lessor that properly elected to pass through the investment credit is not entitled to an additional investment credit upon the subsequent purchase of the property from the lessor.

Rev. Rul. 74-1

Advice has been requested whether, under the circumstances described below, the taxpayer is entitled to an additional investment credit in the taxable year 1968.

On June 19, 1967, the taxpayer by means of a valid lease, leased new equipment for use in his business from a corporation that properly elected under section 48(d) of the Internal Revenue Code of 1954 to pass through the investment credit to the taxpayer. The taxpayer claimed an investment credit of 1,120x dollars based on the lessor's statement filed pursuant to section 1.48–4 of the Income Tax Regulations. The statement indicated that the equipment had a fair market value of 48,000x dollars and a useful life in the hands of the lessor of four to five years.

On February 1, 1968, the taxpayer purchased this equipment from the lessor for 45,000x dollars. On February 1, 1968 the taxpayer determined the equipment had an estimated useful life in his hands of 10 years. The taxpayer claimed an additional investment credit on the equipment in connection with this purchase. He calculated the additional credit in such a way that when it was added to the original credit he had claimed as lessee, the total was less than seven percent of 48,000x dollars. The taxpayer would have been entitled to an investment credit equal to seven percent of 48,000x dollars if he had originally purchased the equipment on June 19,1967, instead of first leasing it.

Section 38 of the Code allows taxpayers a credit against the Federal income tax in an amount permitted by section 46 for a qualified investment in depreciable property described in section 48 of the Code. Pursuant to section 46(a)(1), the amount of the credit for a given taxable year (subject to limitations not here relevant) is equal to seven percent of a taxpayer's qualified investment.

The issue in this case is whether taxpayer's purchase of the equipment generated any qualified investment upon which a credit would be computed. Under section 46(c)(1) of the Code, qualified investment is generated only when "new" or "used section 38 property", as defined in sections 48(b) and (c) and the regulations thereunder, is placed in service during the taxable year.

Section 1.48-2 of the regulations provides, in part, that "new section 38 property" is section 38 property that is acquired by the taxpayer after December 31, 1961, provided that the original use of such property commences with the taxpayer and commences after such date.

Section 1.48-3(a)(2)(i) of the regulations provides, in part, that property shall not qualify as "used section 38 property" when a lessee has been using the leased property and subsequently purchases and continues to use it.

In the instant case, the original use of the property commences with the lessor corporation in its leasing operations.

Therefore, since the original use did not commence with the taxpayer the property was not "new section 38 property" when purchased and placed in service by the taxpayer. For purposes other than the credit pass-through, discussed below, this is a general rule.

Section 1.48-4(b) of the regulations states, in part, that both the lessor and the lessee may be considered as the original users of an item of leased property for purposes of the election under section 48(d) of the Code. This

concept is adopted solely to permit a pass-through of the credit to the lessee pursuant to section 48(d). Since the taxpayer claims his additional credit under a provision other than section 48(d), the general rule applies in this case. The taxpayer is not the original user of the purchased property, and, therefore, such property is not "new section 38 property" to him.

Since the taxpayer has placed neither "new" nor "used section 38 property" in service as the result of purchasing the equipment, his purchase has not generated any qualified investment.

Accordingly, in the instant case, the taxpayer is not entitled to an additional investment credit as a result of purchasing the equipment he had been using as a lessee. This result would remain the same whether the taxpayer purchased the equipment in the same taxable year in which he claimed the original credit or in a subsequent taxable year.

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26 CFR 1.38-1: Investment in certain depreciable property.

Proper method for determining the taxable income of a cooperative to be used in computing qualified investment for purposes of the investment credit. See Rev. Rul. 74-288, below.

Subpart B. Rules for Computing Credit for Investment in Certain Depreciable Property

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Section 46.—Amount of Credit

26 CFR 1.46-4: Limitations with respect to certain persons.
(Also Sections 38, 1381, 1382; 1.38-1, 1.1381-1, 1.1382-1.)

Investment credit computation by cooperatives. An example illustrates that in the computation of the amount of a qualified investment for purposes of the investment credit a cooperative's "taxable income" for purposes of the ratio provided by section 46(d)(2)(C) of the Code must reflect deductions allowed under section 1382(b) and special deductions allowed under section 243.

Rev. Rul. 74-288

Advice has been requested regarding the proper method for determining the taxable income of a cooperative to be used in computing qualified investment, under the circumstances described below, for the purpose of the investment credit allowed under section 38 of the Internal Revenue Code of 1954.

The taxpayer is a cooperative organization described in section 1381 of the Code that files its Federal income tax return on a calendar year basis. On January 1, 1973, the taxpayer acquired a storage facility which qualifies as "section 38 property." The basis of the property was $30,000, and it has a useful life of 35 years.

The taxpayer placed the section 38 property in service on January 10, 1973. The taxpayer's taxable income for 1973 was $95,000 after taking into account deductions allowed under chapter 1 of the Code except for deductions of $75,000 allowed under section 1382(b) of the Code, relating to patronage dividends and $5,000 of special deductions allowed under section 243, relating to certain dividend distributions.

Section 46(d) of the Code provides limitations with respect to certain persons in determining the amount of investment credit allowed.

Section 46(d)(1)(C) of the Code and section 1.46-4(c)(1) of the Income Tax Regulations provide, in part, that in the case of a cooperative organization described in section 1381(a), the qualified investment with respect to each section 38 property otherwise determined under section 1.46-3 of the regulations, and the $25,000 limitation specified in section 1.46-1(b)(1) of the regulations, relating to limitation based on amount of tax, shall be reduced to such cooperative's ratable share of each such amount. Under section 46(d)(2)(C) a cooperative's ratable share of the amount described above is the ratio which "taxable income" for the taxable year bears to "taxable income" for the taxable year plus amounts to which section 1382(b) applies and similar amounts the tax treatment of which is determined without regard to subchapter T (section 1381 and following).

Section 1.1382-2(a)(1) of the regulations provides that "* * * in determining the taxable income of any cooperative organization to which part I, subchapter T, chapter 1 of the Code applies, there shall be allowed as deductions from gross income, in addition to other deductions allowable under chapter 1 of the Code, the deductions with respect to patronage dividends provided in section 1382(b) and paragraphs (b) and (c) of this section * * *" relating to deduction for patronage dividends and deductions for amounts paid in redemption of certain nonqualified written notices of allocation.

In the instant case the taxpayer's taxable income is determined by deducting from the $95,000 the $75,000 allowable under section 1382(b) of the Code, and the $5,000 allowable under section 243.

Thus, the computation of qualified investment is as follows:

$$\$30{,}000 \text{ (Investment in section 38 property)} \times \frac{\text{taxable income after deductions allowed under section 1382(b) of the Code and special deductions allowed under section 243}}{\text{taxable income plus the sum of the deductions allowed under section 1382(b)}} = \frac{\$15{,}000}{\$90{,}000} = \$5{,}000$$

Accordingly, in the instant case the taxpayer's qualified investment for the taxable year 1973 is $5,000 as computed above.

Section 47.—Certain Dispositions, etc., of Section 38 Property

26 CFR 1.47-1: Recomputation of credit allowed by section 38.

Investment credit recapture; bankruptcy. Section 38 property, acquired in 1971 by a taxpayer who was adjudicated bankrupt in 1972, and sold in 1973 by the trustee who did not continue the taxpayer's business, was transferred in 1972 within the meaning of section 1.47-1(c)(1)(ii) of the regulations and a recapture determination must be made for that year.

Rev. Rul. 74-26

Advice has been requested whether the transfer of section 38 property, under the circumstances below, constitutes a disposition requiring the recapture of the investment credit.

In 1972, the taxpayer, an individual engaged in the excavating business, was adjudged a bankrupt by the court. During the year, the trustee in bankruptcy took possession of the taxpayer's property for the purpose of liquidating the assets and making distributions to the creditors. The trustee did not continue the taxpayer's business. Included in the property taken by the trustee was section 38 property that had been the basis for an investment credit in 1971. The property was sold by the trustee in 1973.

Section 47(a)(1) of the Internal Revenue Code of 1954 provides that if during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

Section 1.47-1(a)(1)(ii)(b) of the Income Tax Regulations provides that the term "recapture year" means the taxable year in which section 38 property the basis (or cost) of which was taken into account in computing a taxpayer's qualified investment is disposed of, or otherwise ceases to be section 38 property, before the close of the estimated useful life which was taken into account in computing such qualified investment. Section 1.47-1(c)(1)(ii) of the regulations states that if during the taxable year property ceases to be section 38 property with respect to the taxpayer as a result of the occurrence of an event on a specific date (for example, a sale, transfer, retirement or other disposition), such cessation shall be treated as having occurred on the actual date of such event.

Section 1.47-2(a)(2)(i) of the regulations states that a determination as to whether section 38 property ceases to be section 38 property with respect to the taxpayer must be made for each taxable year subsequent to the credit year. Thus, in each such taxable year the taxpayer must determine, as if such property were placed in service in such taxable year, whether such property would qualify as section 38 property in the hands of the taxpayer for such taxable year.

In this case the property was transferred to the trustee for purposes of liquidating the assets, without continuing the taxpayer's business, and making a distribution to the creditors. Thus, a transfer within the meaning of section 1.47-1(c)(1)(ii) of the regulations did in fact occur in 1972 and the property ceased to be section 38 property at that time.

Accordingly, it is held, in the instant case, a recapture determination must be made for 1972 in accordance with section 1.47-1 of the regulations.

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26 CFR 1.47-1: Recomputation of credit allowed by section 38.
(Also Sections 354, 355, 381; 1.354-1, 1.355-1, 1.381(a)-1.)

Investment credit recapture; "section 38 property" transferred in spin-off. Recapture of investment credit due to early disposition of "section 38 property" is required under section 47(a)(1) of the Code where a corporation, engaged in the same business in three States, transfers its business activities in two States, and all related assets including "section 38 property," to two newly formed corporations solely in exchange for all their stock, and immediately thereafter transfers such stock to its sole shareholder in a divisive section 368(a)(1)(D) reorganization.

Rev. Rul. 74-101

Advice has been requested whether the provisions of section 47 of the Internal Revenue Code of 1954 result in a recapture of previously allowed investment credit under the circumstances described below.

X is a domestic corporation which, since 1964, has been engaged in the active conduct of three business activities: (1) the manufacturing and selling of ice cream in State A; (2) the manufacturing and selling of ice cream in State B; and (3) the manufacturing and selling of ice cream in State C. In 1970, pursuant to a plan of reorganization, *X* formed two new corporations, *Y* and *Z*. Immediately after formation of *Y* and *Z*, *X* transferred all of the assets of the State B business to *Y* in exchange solely for all of the stock of *Y*, and all of the assets of its State C business to *Z* in

exchange solely for all of the stock of *Z*. For good business reasons, immediately upon receiving the *Y* and *Z* stock, *X* distributed all of the shares of such stock to *X*'s sole shareholder. In each instance, the transfer by *X* of the respective assets to *Y* and *Z* solely for *Y* and *Z* stock, followed immediately by the distribution of the *Y* and *Z* stock to *X*'s sole shareholder, constituted a divisive reorganization within the meaning of section 368(a)(1)(D) of the Code and met the requirements for non-recognition of gain or loss to *X*'s sole shareholder pursuant to section 355(a), including the requirement of section 355(b)(1)(A) that *X*, *Y*, and *Z* be engaged immediately after the distribution of stock in the active conduct of a trade or business. A portion of the assets transferred to *Y* and *Z* in this transaction consisted of section 38 property having a useful life of 8 years or more on which in prior years *X* had been allowed an investment credit computed in accordance with the provisions of section 46.

The question is whether the investment credit previously computed on the section 38 property transferred by *X* to *Y* and *Z*, respectively, must be adjusted in the year of transfer to reflect the early disposition of such property pursuant to section 47(a)(1) of the Code.

Section 47(a)(1) of the Code provides, in part, that if any property is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer before the close of the useful life on which the credit under section 38 was computed, the Federal income tax shall be adjusted accordingly for the taxable year in which the "cessation" took place.

Section 47(b)(2) of the Code provides for exceptions to the "recapture" provisions of section 47(a) insofar as is pertinent here, (1) if the transaction is one to which section 381(a) applies or (2) if the transaction involves a mere change in form of conducting the trade or business so long as the property transferred is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

Section 381(a)(2) of the Code provides, in effect, that a transaction involving an exchange of assets for stock meeting the requirements of section 368(a)(1)(D) is subject to the provisions of section 381 only if the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets and otherwise meets the requirements of section 354(b)(1). Section 381 is not applicable to transactions qualifying as reorganizations under section 368(a)(1)(D) which so qualify only because they meet the requirements of section 355 as divisive reorganizations. Section 1.381(a)-1(b)(3) of the regulations provides that section 381 does not apply to divisive reorganizations. Therefore, section 381 was not applicable to the foregoing transactions. Thus, the exception to the application of the recapture of investment credit provisions of section 47(a)(1) for a transaction in which section 381(a) applies is not applicable in the instant case.

Regarding the exception to recapture of the investment credit under section 47(b)(2) of the Code relating to a mere change in form of conducting the trade or business (provided the section 38 property is retained as section 38 property in the same trade or business), section 1.47-3(f) of the regulations provides, in effect, that this exception to recapture investment credit will not apply unless certain conditions are met including the condition that the transferor of the section 38 property retain a "substantial interest" in such trade or business.

In the instant case, *X*, immediately after the transfer of a portion of *X*'s property to *Y* and *Z*, respectively, in lieu of retaining a substantial interest therein, distributed the *Y* and *Z* stock received in the exchange to *X*'s sole shareholder. Thus, *X*, after the reorganizations was not the owner of a substantial interest in either the State B business or the State C business transferred to *Y* and *Z*, respectively.

Accordingly, since the transaction in the instant case is not a mere change of form within the meaning of section 47(b)(2) of the Code, the exception to recapture of the investment credit is not applicable. Accordingly, the investment credit allowed to *X* in prior years with respect to the section 38 property transferred to *Y* and *Z* must be adjusted in the year of transfer to reflect the early disposition of such section 38 property by *X* (prior to the close of the useful life of such property) pursuant to the provisions of section 47(a)(1).

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26 CFR 1.47-2: "Disposition" and "cessation."
(Also Sections 108, 1017; 1.108(a)-1, 1.1017-1.)

Investment credit recapture; gain from discharge of indebtedness. Investment credit must be recomputed to reflect the reduction in the basis of section 38 property resulting from the taxpayer's election to exclude gain arising from discharge of an indebtedness even though the indebtedness was incurred before the enactment of section 38 of the Code and the proceeds were not used to acquire the property; income tax liability will increase for the year of the basis reduction; Rev. Rul. 72-248 amplified.

Rev. Rul. 74-184

Advice has been requested concerning the "recapture" of investment credit allowed to a taxpayer on "property" defined in section 38 of the Internal Revenue Code of 1954 where such taxpayer adjusted the basis of such property under section 1017 as a result of excluding from gross income, gain arising from dis-

charge of indebtedness, pursuant to section 108 of the Code.

The taxpayer, a domestic corporation, incurred bond indebtedness before the enactment of section 38 of the Code. The bond indebtedness was incurred for purposes other than the acquisition of section 38 property. Later, the taxpayer reacquired the bond indebtedness at a gain. The taxpayer excluded the gain from its gross income and decreased the basis of section 38 property pursuant to the election provided for under sections 108(a) and 1017. The decrease in basis occurred before the end of the useful life of section 38 property.

The specific question is whether the investment credit allowed to the taxpayer on section 38 property must be recomputed where the basis of such property is adjusted pursuant to sections 1017 and 108 of the Code, if the bond indebtedness reacquired at a gain was incurred before the enactment of section 38 or the bond proceeds were used for purposes other than the purchase of section 38 property.

Section 108(a) of the Code provides, in part, that no amount shall be included in gross income by reason of the discharge in whole or in part within the taxable year of any indebtedness for which the taxpayer is liable or subject to which the taxpayer holds property, if such taxpayer makes and files a consent in accordance with the Income Tax Regulations prescribed under section 1017.

Section 1017 of the Code provides, in part, that where an amount is excluded from gross income under section 108(a) the whole, or any part excluded, shall be applied in reduction of the basis of any property held.

Section 1.1017-1(a) of the regulations provides, with respect to indebtedness incurred to purchase specific property (which includes section 38 property), that the cost or other basis of such specific property shall be decreased by an amount equal to the amount excluded from gross income under section 108(a) of the Code by reason of the discharge of such indebtedness. Section 1.1017-1(a) of the regulations also provides, in effect, that the basis of other property of the taxpayer at the time of discharge of the indebtedness shall be reduced by the excess of gain excluded from gross income under section 108(a) over and above the basis of the specific property purchased. If, however, the indebtedness is not incurred to purchase specific property, the basis of any property of the taxpayer may be adjusted in the manner and order prescribed by section 1.1017-1(a) of the regulations.

Section 47(a)(1) of the Code provides, in part, that if any property is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer before the close of the useful life on which the credit under section 38 was computed, the Federal income tax shall be adjusted accordingly for the taxable year in which the "cessation" took place.

Section 1.47-2(c) of the regulations provides, in part, that if the basis of section 38 property is reduced, then such section 38 property shall be treated as having ceased to be section 38 property with respect to the taxpayer to the extent of the amount of such reduction in basis.

In Rev. Rul. 72-248, 1972-1 C.B. 16, the taxpayer incurred indebtedness to acquire section 38 property. It was held that the investment credit previously computed on such property must be recomputed under section 1017 of the Code to reflect the reduction in basis of the section 38 property as a result of excluding from gross income gain from discharge of the indebtedness, pursuant to section 108. Further, the entire amount of the reduction in the investment credit was held to increase the taxpayer's Federal income tax liability for the taxable year for which the basis of the section 38 property was reduced. The principle set out in Rev. Rul. 72-248, that investment credit on section 38 property must be recomputed to reflect a reduction in the basis of the property as a result of excluding gain from the discharge of indebtedness incurred to acquire section 38 property, before the close of the useful life of the property, is equally applicable to a situation where the indebtedness discharged was incurred prior to the enactment of section 38 of the Code and the bond proceeds were used for purposes other than the purchase of section 38 property.

Since the effect of reducing the basis of section 38 property in the instant case is to reduce the amount of section 38 property with respect to the taxpayer before the close of its useful life which was taken into account in computing the investment credit allowed, such investment credit must be recomputed in order to make the adjustments in taxable income required by section 47(a) of the Code. The fact that the proceeds of the indebtedness were not used to purchase section 38 property does not affect the requirement that the investment credit be recomputed.

Accordingly, it is held that the investment credit previously computed must be recomputed to reflect the reduction in the basis (cost) of the section 38 property. The entire amount of the reduction of the investment credit previously allowed to the taxpayer will increase the taxpayer's Federal income tax liability for the taxable year for which the basis of section 38 property was reduced under section 1017 of the Code.

Rev. Rul. 72-248 is hereby amplified.

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26 CFR 1.47-6: Partnerships.

Whether an unrelated taxpayer acquiring an interest in an oil lease and related equipment from a member of a joint venture acquires "used section 38 property." See Rev. Rul. 74-64, page 12.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.

Investment credit; canopies over loading or storage docks. Canopies of concrete slab or steel frame construction that are integral parts of the walls of the building over loading or storage docks do not qualify as "section 38 property."

Rev. Rul. 74-2

Advice has been requested whether canopies attached to buildings qualify as "section 38 property" for investment credit purposes.

The taxpayer is engaged in manufacturing and has canopies that are attached to buildings to protect inventoried parts, used in the manufactured product, from the elements. The canopies are overhanging shelters attached permanently to the walls of buildings and they ordinarily extend from the walls over loading or storage docks. The canopies are either concrete slab or steel frame construction and are integral parts of the walls of the buildings.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what property qualifies as "section 38 property" is made in accordance with rules provided in section 48 of the Code.

Section 48(a)(1) of the Code provides, in part, that the term "section 38 property" means tangible personal property, or other tangible property (not including a building and its structural components), but only if such other tangible property is used as an integral part of specified activities including manufacturing.

Section 1.48-1(e)(1) of the Income Tax Regulations defines the term "building" to mean any structure or edifice enclosing a space within its walls and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway and bus stations, and stores.

Section 1.48-1(e)(2) of the regulations, in pertinent part, defines the term "structural components" to mean such parts of a building as walls, partitions, floors, as well as any permanent coverings therefor such as paneling or tiling; windows and doors; and other components relating to the operation or maintenance of a building.

The canopies in the instant case are appendages of the building that relate to the ordinary function and operation of the building. They are therefore "structural components" of the building within the meaning of section 1.48-1(e)(2) of the regulations.

Accordingly, the canopies in the instant case do not qualify as "section 38 property" for investment credit purposes.

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; storage enclosures within building. Enclosures constructed as structural components for the purpose of warehousing inventoried parts and assembly elements that are not fungible in character do not qualify as "section 38 property."

Rev. Rul. 74-3

Advice has been requested whether, under the circumstances described below, certain enclosures qualify as "section 38 property" for investment credit purposes.

The enclosures are portions of the inside of a building partitioned off to form areas devoted to the warehousing of inventoried parts and assembly elements such as radios and air conditioners, essential to the completed manufactured product. The stored items are individually identified and are not fungible in character. The material used in constructing the enclosures generally consists of metal or wooden walls and ceilings. The enclosures are depreciable and have useful lives of three years or more.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what property qualifies as "section 38 property" is made in accordance with rules provided in section 48 of the Code.

Section 48(a)(1) of the Code provides, in part, that the term "section 38 property" means tangible personal property, or other tangible property (not including a building and its structural components), but only if such property is used as an integral part of specified activities including manufacturing.

Section 1.48-1(a) of the Income Tax Regulations states, in part, that the term "section 38 property" means property (1) with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the taxpayer, (2) which has an estimated useful life of 3 years or more, and (3) which is either tangible personal property or other tangible property (not including a building and its structural components), but only if such other property is used as an integral part of specified activities including manufacturing.

Section 1.48-1(d)(1) of the regulations states, in part, that in addition to tangible personal property, any other tangible property (but not including a building and its structural components) used as an integral part of manufacturing may qualify as "section 38 property."

Section 1.48-1(d)(5)(ii) of the regulations states, in part, that property will constitute a storage facility only if the facility is used principally for the

bulk storage of fungible commodities. Bulk storage means the storage of a commodity in a large mass prior to its consumption or utilization.

Section 1.48-1(e)(1) of the regulations defines the term "building" to mean any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores.

Section 1.48-1(e)(2) of the regulations defines the term "structural components" to mean such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor, such as paneling or tiling, and windows and doors.

The enclosures in the instant case relate to the ordinary function and operation of a building by providing for the warehousing of inventoried parts and assembly elements, such as radios and air conditioners. They are not facilities used principally for the bulk storage of fungible commodities.

Accordingly, it is held that the enclosures constructed by the taxpayer in this case are "structural components" of a building within the meaning of section 1.48-1(e)(2) of the regulations, and are not "section 38 property" for investment credit purposes.

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; gasoline station storage tanks. Gasoline storage tanks and related piping, located above or below ground, used by a retail service station in connection with gasoline sales do not qualify as "section 38 property."

Rev. Rul. 74-152

Advice has been requested whether tanks which are used for the storage of gasoline at retail gasoline stations are "section 38 property" for investment credit purposes.

The taxpayer owns and operates several retail gasoline stations. Tanks of approximately 8,000-gallon capacity are installed at the stations. Usually the tanks are below ground but some are placed on supports above ground. Gasoline is stored in these tanks and piping is attached to connect them with the retail pumps to permit supplying of the pumps and to allow venting. The tanks are generally not moved in or from the station site during their useful lives.

The gasoline storage tanks were constructed and placed in service after August 15, 1971, and are depreciable property having a useful life of three years or more.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what property qualifies as "section 38 property" is made in accordance with the rules provided in section 48 of the 1954 Code.

Section 48(a)(1) of the Code provides, in part, that the term "section 38 property" means tangible personal property, or other tangible property (not including a building and its structural components) but only if the other tangible property is used as an integral part of manufacturing, production, or extraction, or furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or constitutes a research or storage facility used in connection with any of the foregoing activities. To qualify as "section 38 property," the property must also be property with respect to which depreciation is allowable and must have a useful life of three years or more.

Section 1.48-1(c) of the Income Tax Regulations provides, in part, that the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures including their structural components.

Rev. Rul. 65-308, 1965-2 C.B. 74, provides that gas mains laid under public streets do not qualify as "tangible personal property" because they are improvements added to land in the form of inherently permanent structures.

Rev. Rul. 68-345, 1968-2 C.B. 30, provides that canopies erected over the pump islands of gasoline stations are "other tangible property" but do not qualify as "section 38 property" since they are not used in one of the qualifying activities specified in section 48(a)(1) of the Code.

The facts in this case indicate that the sole function of the tanks is to store gasoline from which the retail pumps are supplied by piping. The gasoline storage tanks in the instant case, whether located above or below ground at a retail service station, are not "tangible personal property" but rather are storage facilities that can only function as such as an improvement to land and hence are "other tangible property." Such storage tanks are used in connection with the retail sales of gasoline and therefore not in connection with one of the qualifying activities described in section 48(a) of the Code.

Accordingly, the gasoline storage tanks and associated piping of the taxpayer's retail gasoline service stations in the instant case, whether located above or below ground, do not qualify as "section 38 property."

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; oil storage terminal property. A fuel oil blending operation at an oil storage terminal facility is "manufacturing or production" as defined in section 1.48-1(d)(2) of the regulations, and oil storage tanks, load-

ing and unloading docks, racks and pumps, and a paved yard that are integral parts of the operation qualify as "section 38 property."

Rev. Rul. 74-204

Advice has been requested whether certain property at an oil storage terminal used in a blending operation qualifies as "section 38 property" for investment credit purposes, under the circumstances described below.

The taxpayer is engaged in providing marine oil terminal services to its customers on a thruput basis. The taxpayer receives its customers' fuel oil, either No. 2 light oil or No. 6 residual oil, from oceangoing tankers coming from refineries which are generally located overseas. The oils are specially treated as required to meet certain specifications, such as sulphur content and viscosity.

Portions of the No. 2 and No. 6 oil are blended in above-ground bulk storage tanks. The components of the blend are pumped through line heaters and the flow of each grade is registered by meters to maintain sulphur and viscosity specifications. These components are mixed in a homogenizer and deposited into a finished product tank which is equipped with special piping that effects circulation within the tank to insure a uniform blend. This blended mixture is No. 4 heating oil.

The blended No. 4 heating oil is then reshipped from the storage terminal facility by barge or by truck to other destinations. To provide this service, the terminal facility includes docks, racks and pumps for filling trucks, and a paved yard.

The oil storage tanks used in the blending operation and the other tangible property described above used directly in and essential to the completeness of the taxpayer's activity, including the loading and unloading docks and the paved yard used in the transportation of the blended oil (but not including any buildings or structural components thereof), are integral parts of that activity.

All of the above described property is depreciable property having a useful life of three years or more.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "section 38 property." The determination of what qualifies as "section 38 property" is made in accordance with the rules provided in section 48 of the Code.

Section 48(a)(1) of the Code provides, in pertinent part, that the term "section 38 property" means tangible personal property, or other tangible property (not including a building and its structural components) but only if such property is used as an integral part of manufacturing, or production, or constitutes a storage facility used in connection with any of the foregoing activities for the bulk storage of fungible commodities. In order to qualify as "section 38 property," the property must also be depreciable property and must have a useful life of three years or more.

To qualify as "section 38 property," section 1.48-1(d)(1) of the Income Tax Regulations provides, in part, that "other tangible property" must be used as an integral part of specified activities (including manufacturing and production) by a person engaged in such activity.

Section 1.48-1(d)(2) of the regulations provides, in part, that the terms "manufacturing" and "production" include the making of property by changing the form of an article or by combining or assembling two or more articles.

The blending of No. 2 oil and No. 6 oil, to obtain No. 4 oil, a product whose characteristics and uses are different from the other two, is "the making of property by changing the form of an article, or by combining or assembling two or more articles." See *Northville Dock Corporation*, 52 T.C. 68(1969), *aff'd per curiam*, 427 F. 2d 164 (2d Cir. 1970), which reached the same conclusion on this issue. Therefore, the blending operation comes within the scope of "manufacturing or production" as defined in section 1.48-1(d)(2) of the regulations.

Accordingly, the taxpayer, in the instant case, is engaged in the business of "manufacturing or production" as defined in section 1.48-1(d)(2) of the regulations. The oil storage tanks, loading and unloading docks, racks and pumps, and paved yard used in the manufacturing and production activity described above qualify as "section 38 property" for investment credit purposes.

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26 CFR 1.48-2: New section 38 property.

Whether the taxpayer, in the instant case, is entitled to an additional investment credit as a result of purchasing the equipment he had been using as a lessee. See Rev. Rul. 74-1, page 5.

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26 CFR 1.48-3: Used section 38 property. (Also Section 47; 1.47-6.)

Investment credit; used property; acquisition of joint venturer's interest. The interest in equipment acquired by an unrelated individual upon purchasing a 25 percent working interest in an oil and gas lease joint venture from the individual who owned a 50 percent working interest in the joint venture, which had acquired the equipment as new "section 38 property," does not qualify as "used section 38 property" for investment credit purposes under section 1.48-3(a)(2) of the regulations. Further, the selling joint venturer is subject to the investment credit recapture rules.

Rev. Rul. 74-64

Advice has been requested whether, under the circumstances described below, certain oil lease equipment acquired by a taxpayer in connection with the purchase of a percentage of

the working interest in an oil lease qualifies as "used section 38 property" for investment credit purposes.

Taxpayers *A* and *B* entered into a joint venture that purchased an oil lease, acquired new equipment, and elected not to be treated as a partnership. Each had a 50 percent interest in the joint venture, held title to his percentage working interest in the oil lease and equipment in his own name, and had the right to sell his interest in whole or in part to anyone he so desired. Each claimed his aliquot share of the section 38 property for investment credit purposes. The equipment was used to drill several wells on the leased property.

Subsequently, taxpayer *A* sold one-half of his 50 percent interest in the joint venture to unrelated taxpayer *C*. Upon completing the purchase, *C* secured title in his name to both his 25 percent working interest in the oil lease and the equipment.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in "new section 38 property" and "used section 38 property." The determination of what property qualifies as new or used section 38 property is made in accordance with the rules provided in section 48.

Section 48(c) of the Code defines the term "used section 38 property" to mean "section 38 property" acquired by purchase after December 31, 1961, that is not new "section 38 property." Section 48(c) also provides that property shall not be treated as "used section 38 property" if, after its acquisition by the taxpayer, the property is used by a person who used the property before such acquisition.

Section 1.48-3(a)(2)(i) of the Income Tax Regulations states, in part, that property shall not qualify as "used section 38 property" if, after acquisition by the taxpayer, it is used by a person who used such property before such acquisition.

Section 1.48-3(a)(2)(ii) of the regulations provides, for purposes of applying subdivision (i) of that section, (a) property used by a partnership shall be considered as used by each partner, and (b) property shall not be considered as used by a person before its acquisition if such property was used only on a casual basis.

Rev. Rul. 65-118, 1965-1 C.B. 30, holds that a joint venture electing not to be treated as a partnership for purposes of subchapter K, chapter 1, subtitle A of the Code, is a partnership for investment credit purposes and accordingly is a partnership for the purpose of determining the amount of its qualified investment in section 38 property.

The Internal Revenue Service will continue to apply section 1.48-3(a)(2)(ii) of the regulations and treat partnership property as being used by each partner notwithstanding the decision of the United States Tax Court in *Edward A. Moradian,* 53 T.C. 207 (1970), *nonacq.*, 1973-1 C.B. 2.

The oil lease equipment in the instant case was used by the joint venture (*A* and *B*) prior to the sale of the 25 percent working interest by *A* to *C*, and continued to be used by the joint venture (*A*, *B*, and *C*) after *C* became a member of the joint venture.

Accordingly, pursuant to section 1.48-3(a)(2) of the regulations, C's 25 percent working interest in the oil lease equipment purchased does not qualify as "used section 38 property" for investment credit purposes.

Section 47(a) of the Code provides for the "recapture" of previously allowed investment credit where property ceases to be "section 38 property."

Section 1.47-6(a)(2) of the regulations states, with regard to the disposition of a partner's interest in property, that the basis (or cost) of partnership section 38 property is to be taken into account by a partner in computing his qualified investment and that, if after the date on which such property was placed in service by the partnership and before the close of the estimated useful life of the property, a partner's proportionate interest in the particular property is reduced by sale below 66⅔ percent of his interest in the property for the year in which such property was placed in service, recapture of investment credit must be made for the property.

Since *A* reduced his interest in the equipment to 50 percent of his interest in the property for the year in which such property was placed in service, it ceases to be section 38 property (with respect to him) to the extent his interest in the partnership's general profits, or in the particular property, is reduced. Therefore, *A* is subject to the recapture rules.

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26 CFR 1.48-3: Used section 38 property.

Whether in the instant case the taxpayer is entitled to an additional investment credit as a result of purchasing the equipment he had been using as a lessee. See Rev. Rul. 74-1, page 5.

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26 CFR 1.48-4: Election of lessor of new section 38 property to treat lessee as purchaser.

Whether in the instant case the taxpayer is entitled to an additional investment credit as a result of purchasing the equipment he had been using as a lessee. See Rev. Rul. 74-1, page 5.

Part V.—Tax Surcharge

Section 51.—Tax Surcharge

26 CFR 1.51-1: Imposition of surcharge. (Also Section 531; 1.531-1.)

Surcharge imposed on accumulated earnings tax. The tax surcharge imposed on the "adjusted tax" of corporations by section 51 (a) of the Code is applicable to the accumulated earnings tax imposed by section 531; Rev. Rul. 72-324 distinguished.

Rev. Rul. 74-93

Advice has been requested whether the tax surcharge imposed by section

51(a) of the Internal Revenue Code of 1954 may be imposed on the accumulated earnings tax imposed by section 531.

For the period beginning January 1, 1968, and ending June 30, 1970, section 51(a) of the Code imposes a surtax on corporations equal to a specified percentage of the "adjusted tax" for the taxable year.

For the purposes of section 51(a) of the Code, section 51(b) provides that the term "adjusted tax" means, with respect to any taxable year, the tax imposed by chapter 1, with certain adjustments not here involved.

Section 531 of the Code imposes an accumulated earnings tax upon certain corporations formed or availed of to avoid or prevent the imposition of the income tax on its shareholders. This is in addition to the other taxes imposed on corporations under subtitle A, chapter 1. Section 531 comes within the ambit of subchapter G of chapter 1.

Accordingly, since section 531 of the Code is part of chapter 1 and the tax surcharge is imposed upon the "adjusted tax" determined under chapter 1, it is held that the tax surcharge on corporations under section 51(a) is applicable to the tax imposed on corporations by section 531.

The instant case is distinguishable from Rev. Rul. 72-324, 1972-1 C.B. 399. That Revenue Ruling concerns the computation of interest on the accumulated earnings tax imposed by section 531 of the Code, and holds that if the tax is not paid within 10 days from the date of notice and demand, the interest is computed under the provisions of section 6601 (f)(3) from the date of the notice and demand to the date of payment. Rev. Rul. 72-324 does not concern the relationship between the accumulated earnings tax and the surtax, and should not be considered as implying that the accumulated earnings tax is not a chapter 1 tax.

Rev. Rul. 72-324 is distinguished.

Subchapter B. Computation of Taxable Income

Part I. Definition of Gross Income, Adjusted Gross Income, and Taxable Income

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Indians; income from trusteed lands. The Revenue Service will follow the decision in **Stevens** that income derived directly from restricted land purchased by the Secretary of the Interior on behalf of individual Indians and held in trust by the U.S. solely for their benefit under statutes construed to provide tax exemption for Indian property is exempt from Federal income tax regardless of source of the funds used to purchase the land; Rev. Ruls. 62-16 and 67-284 modified.

Rev. Rul. 74-13

The Internal Revenue Service will follow the holding in *Stevens v. Commissioner*, 452 F. 2d 741 (9th Cir. 1971), that income derived directly from restricted land purchased by the Secretary of the Interior on behalf of individual Indians under section 5 of the Indian Reorganization Act of 1934, 48 Stat. 985, 25 U.S.C. section 465 (1970), and held in trust by the United States solely for the benefit of such individual Indians under statutes that have been construed to provide tax exemption for Indian property, such as the General Allotment Act of 1887, 24 Stat. 388, 25 U.S.C. section 331 et seq., (1970), is exempt from the Federal income tax regardless of the source of the funds used to purchase the land.

Rev. Rul. 62-16, 1962-1 C.B. 7, held, in effect, that the exemption described above is not applicable where the Indian obtained his interest in the land through an arm's length purchase. This position was reconsidered in Rev. Rul. 67-284, 1967-2 C.B. 55, in view of transactions by noncompetent Indians to make intrafamily transfers of allotments or to assist needy Indians in acquiring small amounts of land with restricted funds. Rev. Rul. 67-284 holds that income will retain its exempt status where restriced allotted land is acquired for the above purposes by Deed Form 5-183b, thereby modifying Rev. Rul. 62-16.

Rev. Rul. 62-16 and Rev. Rul. 67-284 are modified to eliminate the holdings that income derived directly from purchased allotted land held in trust by the United States for the benefit of the Indians is not exempt from income tax.

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26 CFR 1.61-1: Gross income.
(Also Sections 162, 7805; 1.162-1, 301.7805-1.)

Political campaign funds; committee controlled. An unincorporated organization established and operated exclusively for political purposes is not exempt from Federal income tax and is required to file returns, Forms 1120, beginning with 1972. Interest, dividends, and net gains from the sales of securities are includible in gross income and expenses directly attributable to interest and dividend income are deductible. Under the provisions of section 7805(b) of the Code, the organization is not required to file a return for 1971 or prior years. It need not include in its gross income gain from contributed securities sold before October 3, 1972. Penalty will not be assessed for 1972 provided the return for that year is filed and the tax paid on or before April 15, 1974 and an extension of time may be granted for the filing of the return and payment of tax for 1973.

Rev. Rul. 74-21

The Internal Revenue Service has been asked as to the proper treatment, for Federal income tax purposes, of an organization under the circumstances described below.

An organization was established and operated for the exclusive purpose of

engaging in activities to influence the nomination and election of individuals to public office. It performs its purpose in part by conducting fund raising affairs and disbursing political contributions for campaign purposes. The organization maintains books and records, including substantiating data of receipts and expenditures.

During 1972, the organization received political contributions in the form of money and securities. The securities were held by the organization, in its name, until it, in its own discretion, decided to sell the securities to obtain funds for campaign purposes. Capital gains were realized during 1972 on the sale of the securities, a portion of the gains being realized before October 3, 1972, and the balance of such gains being realized on and after October 3, 1972. It also received interest earned on bank deposits and dividends from contributed stock.

Expenditures were made by the organization for campaign purposes; for fund raising activities relating thereto; for activities undertaken for the production of interest and dividend income; and for expenses paid upon the sale of the securities. No funds of the organization were used for other than campaign purposes. Available documents indicate that the organization was organized as an unincorporated committee. The organization has associates and an objective to carry on jointly, activities in furtherance of the purposes for which the organization was organized. Its officers have continuing exclusive authority to make management decisions. Also it has a continuing identity unaffected by changes in persons associated with the organization. The organization will terminate upon conclusion of all of its campaign activities.

The specific questions asked are:

(1) whether the organization is exempt from Federal income tax; if not exempt, the type of a Federal income tax return to be filed and the due date thereof;

(2) which of the foregoing amounts received are includible in gross income; and

(3) to what extent are expenditures of the organization deductible.

Section 61 of the Internal Revenue Code of 1954 defines gross income as all income, from whatever source derived, except as otherwise provided by law.

Section 162 of the Code provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 6012(a)(2) of the Code provides that returns with respect to income taxes under subtitle A shall be made by every corporation.

Section 6072(b) of the Code provides, in part, that returns of corporations under section 6012 made on the basis of the calendar year shall be filed on or before the fifteenth day of March following the close of the calendar year, and such returns made on the basis of a fiscal year shall be filed on or before the fifteenth day of the third month following the close of the fiscal year. Extensions of time for filing returns are provided by section 6081 of the Code and extensions of time for paying tax by section 6161 of the Code.

Section 162(e)(2) of the Code and section 1.162-20 of the Income Tax Regulations provides, in relevant part, that all expenditures for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) relating to any of the foregoing purposes, are not deductible from gross income.

Section 501 of the Code provides rules under which certain organizations may be exempt from the Federal income tax imposed by the Internal Revenue Code. That section describes with particularity the purposes for which an organization must be organized and operated in order to be exempt from Federal income tax thereunder. An organization that is organized and operated exclusively to engage in activities the purpose of which is to influence the nomination or election of individuals to public office is not one of the organizations that may be exempt from the Federal income tax for purposes described in section 501. Nor is such an organization one covered by any other provision of the Code as exempt from the Federal income tax. There is no judicial decision holding that such an organization is exempt from such tax.

Section 7701(a)(2) of the Code provides:

"The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation. . . ."

Section 7701(a)(3) of the Code provides that the term "corporation" includes associations, joint stock companies, and insurance companies.

Not all activities conducted jointly by individuals are treated as separate entities for tax purposes. Regulations under section 7701 set forth criteria for determining whether individuals engaging in common activities are entities for tax purposes and for distinguishing between organizations which are taxable as trusts, partnerships or corporations. However, those criteria were developed without reference to, and do not definitively cover, unincorporated organizations (other than trusts) which are engaged in not-for-profit activities. Based upon all the circumstances of the instant case, it is held that the organization is a separate entity for tax purposes, that it more nearly resembles a corporation than a trust or partnership, and that the tax rules for corporations apply.

Accordingly, it is held, in the instant case:

(1) that the organization is not exempt from Federal income tax;

(2) a return, Form 1120, U.S. Corporation Income Tax Return, is required to be filed by the organization as an association taxable as a corporation;

(3) the due date for the filing of the return is March 15, (subject to the granting of appropriate extensions of time) following the close of the taxable year (calendar year);

(4) income of the organization includible in gross income to be reported in its return is interest, dividends, and the net gains from the sale of securities (computed in accordance with the applicable provisions of the Code such as those relating to basis, holding period and amount realized);

(5) campaign contributions are not includible in the gross income of the organizations;

(6) expenditures for campaign purposes are not deductible;

(7) expenses directly attributable to activities undertaken for the production of the interest and dividend income are deductible. Expenses attributable to the sale of the securities are to be taken into account in determining the gain or loss realized on the sale of the securities. Expenses incurred for fund-raising activities are part of the costs of obtaining political contributions and are not deductible in determining taxable income.

However, under the provisions of section 7805(b) of the Code, this Revenue Ruling shall not be applied so as to:

(1) require the filing by the organization of a Federal income tax return for 1971 or prior years,

(2) require the inclusion in gross income of the gain realized on any sale or exchange of the securities made by the organization before October 3, 1972, and,

(3) assert the delinquency penalty or the failure to pay penalty under section 6651 of the Code for 1972 provided the return for such year is filed and the tax paid on or before April 15, 1974. Moreover, in view of the circumstances, extensions of time for not more than six months will be granted for the filing of returns and payment of tax for 1973 under sections 6081 and 6161 of the Code.

Having in mind the possibility of hardship which might result from a requirement of immediate payment in full, the Internal Revenue Service will, in hardship cases, enter into appropriate arrangements for deferred payment of tax.

The conclusions of this Revenue Ruling are equally applicable to incorporated organizations. Further, in order to promote administrative efficiency in the processing of returns, an entity which files a return in accordance with this Revenue Ruling, should attach a statement to the face of such return stating that the return is filed in accordance with Rev. Rul. 74-21.

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26 CFR 1.61-1: Gross income.
(Also Section 170; 1.170A-1.)

Political campaign funds; unexpended portion transferred to U.S. Government. The transfer to the U.S. Government of unexpended political funds impractical to be returned to the contributors, by a campaign committee organized and operated to influence the election of an individual to a Federal public office, is an expenditure to carry out the purpose of the committee and not a diversion for the personal benefit of the candidate or other person. Such transfer does not give rise to gross income to the candidate, committee, or any of its members; is not subject to the gift tax; and does not entitle the candidate, committee or any of its members, or any contributor to a charitable contribution deduction. Rev. Rul. 71-449 clarified.

Rev. Rul. 74-22

Advice has been requested concerning the Federal income tax consequences of a disposition of political campaign contributions under the circumstances described below.

During 1972 a committee was organized and operated for the purpose of influencing the election of *B* to a Federal public office. The committee received cash political campaign contributions from numerous contributors in varying amounts totaling 800*x* dollars. Following the conclusion of the political campaign and the payment by the committee of the expenditures incurred to further *B*'s candidacy, there remained an unexpended balance of political campaign contributions in the amount of 100*x* dollars. Because there were numerous contributors and varying amounts contributed by each, it was impractical to make refunds to each of the contributors.

In 1973, in lieu of making refunds to the contributors, *B* directed the committee to transfer the unexpended balance of the political campaign contributions to the United States Government. The committee did so and the cash gift of 100*x* dollars was accepted by the Department of the Treasury.

Rev. Rul. 71-449, 1971-2 C.B. 77, states the general rule that political funds are not taxable to the political candidate by or for whom they are received if they are used for the expenses of a political campaign or some similar purpose. However, political funds diverted from the channel of campaign activity and used by the candidate for any personal purpose are includible in the candidate's gross income for the year of the diversion. Unexpended balances of political campaign contributions that are repaid to contributors are neither expended nor diverted and are not includible in the candidate's gross income.

Since it was impractical to return the unexpended amounts to the contributors, the transfer of such amounts to the United States Government for general purposes is considered to be an

expenditure to carry out the purpose of the committee. Such a transfer is not a diversion for the personal benefit of the candidate or other person within the meaning of Rev. Rul. 71-449.

Accordingly, under the circumstances presented in the instant case, the transfer of the unexpended political campaign contributions to the United States Government does not give rise to gross income to *B*, *B*'s campaign committee, or any member of *B*'s campaign committee.

Further, since the transfer in the instant case is considered to be an expenditure to carry out the purpose of the committee, the transfer is not subject to the gift tax, and neither *B*, the committee, any member of the committee, nor any contributor is entitled to a charitable contribution deduction under section 170 of the Internal Revenue Code of 1954.

Rev. Rul. 71-449 is hereby clarified.

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26 CFR 1.61-1: Gross income.
(Also Sections 162, 7805; 1.162-20, 301.7805-1.)

Political campaign funds; candidate controlled. Political campaign contributions received in 1972 by a candidate, who maintained personal control of such funds and who expended them solely for campaign purposes, are not includible in gross income. However, interest, dividends on contributed securities, and net gains on the sales of contributed securities are includible in gross income and must be reported on Form 1041. Under the provisions of section 7805(b) of the Code, the gain from contributed securities sold before October 3, 1972 is not required to be included in gross income. No penalty will be assessed for 1972 provided the return for that year is filed and the tax paid on or before April 15, 1974 and extensions of time may be granted for filing the return and payment of tax for 1973.

Rev. Rul. 74-23

Advice has been requested concerning the Federal income tax treatment of funds received and disbursed by a political candidate under the circumstances described below.

During 1972, an individual who was a candidate for an elective public office received political contributions for use in his campaign. The candidate maintained a complete and separate set of books and records, including detailed substantiating records of all receipts and disbursements of political campaign funds, to insure that his political campaign funds were separate and distinct from his private funds. The political campaign funds at all times were under the personal and exclusive control of the candidate.

The candidate received political contributions consisting of cash and securities from individuals solely for use in his campaign. In addition to such contributions, the candidate received income from interest earned on cash contributions deposited in a savings account in a commercial bank and cash dividends paid on the contributed securities. Gain on the sale of the contributed securities was realized before and after October 3, 1972. The interest, cash dividends, and gains on sales of the securities were received and accounted for by the candidate as political campaign funds in accordance with the above-described procedure.

The candidate expended his political campaign funds for radio and television spot announcements and billboard advertising in connection with his campaign. The candidate also expended funds for the production of interest and dividend income and for commissions paid to brokerage firms on sales of contributed securities.

No part of the candidate's political campaign contributions or the earnings thereon, including gains realized on sales of contributed securities, were used by the candidate for other than campaign purposes.

The questions raised are:

(1) What part of the candidate's political campaign funds are taxable for Federal income tax purposes?

(2) What type of return should the candidate file to report income from political campaign funds and when is such a return due?

(3) What expenditures are deductible in computing taxable income?

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

Rev. Rul. 71-449, 1971-2 C.B. 77, states that political funds are not taxable to a political candidate by or for whom they are collected if they are used for expenses of a political campaign or some similar purpose. However, any amount diverted from the channel of campaign activity and used by a political candidate for any personal purpose is income taxable to such candidate for the year in which the funds are so diverted.

Section 6012(a)(1)(A) of the Code provides, with certain limitations not here pertinent, for the filing of returns with respect to income taxes under subtitle A of the Code. Extensions of time for filing returns are provided by Section 6081 of the Code and extensions of time for paying tax by Section 6161 of the Code.

Section 162(e)(2) of the Code and section 1.162-20 of the Income Tax Regulations provide, in relevant part, that all expenditures for political campaign purposes (including the support of or opposition to any candidate for public office), or for carrying on propaganda (including advertising) relating to any of the foregoing purposes, are not deductible from gross income. See also *McDonald v. Commissioner*, 323 U.S. 57 (1944), 1944 C.B. 94.

Accordingly, it is held that because none of the political campaign contributions were used for other than campaign purposes, the political campaign contributions of cash and securities

donated to the candidate solely for use in his campaign for elective public office are not includible in gross income. It is further held that the interest earned on bank deposits, the cash dividends received on contributed securities, and the gains realized on sales of contributed securities, net of any losses on such sales, are includible in gross income. The candidate must report such income on a U.S. Fiduciary Income Tax Return, Form 1041, and pay any tax (plus interest, if any) shown by such return to be payable.

The net gain realized by the candidate on sales of contributed securities is to be computed in accordance with the applicable provisions of the Code relating to basis, holding period, and amount realized. Expenses incurred upon the sales of contributed securities are to be taken into account in determining gain realized on such sales.

Allowable deductions in computing taxable income are limited to the $100 exemption and expenses directly attributable to the income reported on Form 1041. Thus, the candidate may claim a deduction for expenses directly attributable to the production of interest and dividend income. However, expenditures for political campaign purposes are not deductible and the candidate may not claim a deduction for expenditures for radio, television, and billboard advertising in connection with his campaign.

The due date for the filing of the Form 1041 is the fifteenth day of the fourth month following the close of each taxable year (calendar year) during which the candidate holds political campaign funds.

Pursuant to the authority contained in section 7805(b) of the Code, gain realized from contributed securities sold before October 3, 1972, is not required to be included in gross income reported on Form 1041. Further, the delinquency penalty or the failure to pay penalty under section 6651 of the Code will not be asserted for 1972 provided the return for such year is filed and the tax paid on or before April 15, 1974. Moreover, in view of the circumstances, extensions of time for not more than six months will be granted for the filing of returns and payment of tax for 1973 under sections 6081 and 6161 of the Code.

Having in mind the possibility of hardship which might result from a requirement of immediate payment in full, the Internal Revenue Service will, in hardship cases, enter into appropriate arrangements for deferred payment of tax.

If a return for 1972 has previously been filed, an amended return should be filed under this Revenue Ruling to include gains realized on the sale on or after October 3, 1972, of appreciated securities. Further, in order to promote administrative efficiency in the processing of returns, a return or amended return filed in accordance with this Revenue Ruling should be accompanied by a statement that such return is filed in accordance with Rev. Rul. 74-23.

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26 CFR 1.61-1: Gross income.
(Also Section 213; 1.213-1.)

Payments by Crime Victims Compensation Board. Awards made by the Crime Victims Compensation Board of the State of New York to victims of crime or to their surviving spouses or dependents are not includible in the gross income of the recipients. Medical expenses incurred by a recipient that are compensated for by such award are not deductible; further, an award for medical expenses previously deducted must be included in income in the taxable year of receipt to the extent that the expenses resulted in a tax benefit in the prior taxable year.

Rev. Rul. 74-74

Advice has been requested whether awards made by the Crime Victims Compensation Board of the State of New York to victims of crime or their surviving dependents are includible in the gross incomes of the recipients for Federal income tax purposes.

The New York State Crime Victims Compensation Board was created pursuant to Article 22 of the Executive Law of the State of New York to provide financial assistance to victims of crime or their surviving dependents. McKinney's Consolidated Laws of New York Annotated, Book 18, Executive Law, Sections 620-635.

Persons eligible for such assistance are: (1) a victim of a crime; (2) a surviving spouse, parent, or child of a victim of a crime who died as a direct result of such crime; and (3) any other person dependent for his principal support upon a victim of a crime who dies as a direct result of such crime. Awards are made to such persons by the Board for their "out-of-pocket" expenses and loss of earnings or support resulting from the injury.

The statute provides that the term "crime" means an act committed in New York State which would, if committed by a mentally competent criminally responsible adult, who has no legal exemption or defense, constitute a crime as defined in and proscribed by the penal law, provided, however, that no act involving the operation of a motor vehicle which results in injury shall constitute a crime for the purposes of this article unless the injuries were intentionally inflicted through the use of a vehicle.

The term "victim" is defined as a person who suffers personal physical injury as a direct result of a crime.

No award is made unless the claimant has incurred a minimum "out-of-pocket" loss of one hundred dollars or has lost at least two continuous weeks' earnings or support. Out-of-pocket loss is defined as unreimbursed and unreimbursable expenses or indebtedness reasonably incurred for medical care or other services necessary as a result of the injury.

An award for loss of earnings or support is to be in an amount equal to the actual loss sustained. However, such award is not to exceed one hundred dollars for each week of lost earnings or support or an aggregate of fifteen thousand dollars.

Any award is to be reduced by payments received from other sources with respect to the injury. An award is to be denied to any claimant who would not suffer serious financial hardship as a result of the "out-of-pocket" expenses incurred or loss of earnings or support. In such determination all the financial resources of the claimant are to be considered.

A claimant may apply to the Board for review by the full Board of one Board member's determination of a claim. The State Attorney General or Comptroller may commence a proceeding in the Appellate Division of the Supreme Court of New York, Third Department, to review the Board's final decision if in his judgment the award is improper or excessive. There is no other judicial review with respect to a claim.

Section 61(a)(1) of the Internal Revenue Code of 1954 provides that, except as otherwise provided, gross income means all income from whatever source derived. However, disbursements from a general welfare fund in the interest of the general public which are not made for services rendered are not includible in gross income. See Rev. Rul. 63-136, 1963-2 C.B. 19, and rulings cited therein.

The awards made under Article 22 of the Executive Law of the State of New York by the Crime Victims Compensation Board to victims of crime or their surviving dependents are in the nature of welfare payments. Accordingly, such awards are not includible in the gross incomes of the recipients for Federal income tax purposes.

Section 213 of the Code allows as a deduction those amounts not compensated for by insurance or otherwise, which are paid during the taxable year for medical care of the taxpayer, his spouse, and dependents subject to certain limitations.

Accordingly, when an individual receives an award from the Crime Victims Compensation Board, any medical expenses incurred by him that are compensated for by such award are not deductible under section 213 of the Code.

If a taxpayer deducted a medical expense, and in a subsequent taxable year receives an award from the Crime Victims Compensation Board to compensate him for such medical expense, he does not recompute the tax for the taxable year in which the deduction was taken, but includes an amount of the award equal to the amount of the deduction in his gross income for the taxable year in which received, subject to the provisions of section 1.213-1(g) of the Income Tax Regulations relating to reimbursements for expenses paid in prior years.

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26 CFR 1.61-1: Gross income.
(Also Sections 162, 3101, 3102, 3121, 3401, 6051, 6413; 1.162-7, 31.3101-1, 31.3102-1, 31.3121(a)(1)-1, 31.3401(a)-1, 31.6051-1, 31.6413(c)-1.)

Payment of employee FICA tax by employer without deduction from wages. Payment by an employer of employee FICA tax without deduction from the employee's wages under an agreement between them constitutes additional compensation to the employee under section 61 of the Code and is deductible by the employer as a business expense under section 162. However, if an employer pays the employee's FICA tax but inadvertently fails to deduct it from the employee's remuneration, and upon discovery of the error the employer is reimbursed by the employee or the tax is deducted from subsequent remuneration paid to him, the tax is not includible in the employee's gross income; I.T. 3154 superseded.

Rev. Rul. 74-75

Advice has been requested as to the Federal income and employment tax consequences when, under the circumstances described below, an employer incurs liability for payment of the employee tax imposed by section 3101 of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) without deducting the amount of the tax from the compensation of the employee.

At the beginning of the calendar year 1972, *X* Company hired *A* to perform certain services for it as an employee at a stated remuneration of $100 per week. In addition, *X* agreed to pay *A*'s employee tax imposed by section 3101 of the Federal Insurance Contributions Act without deducting it from *A*'s pay. For the year 1972, *X* paid *A* $5,000 and, in addition, incurred liability for the taxes imposed on *A* by section 3101 of the Act totalling $260 without deducting those taxes from *A*'s remuneration. (During 1972 the total employee tax imposed by section 3101 was 5.2 percent of "wages.")

For purposes of section 61 of the Code, relating to the definition of gross income, *A*'s gross income for 1972 from the employment described, under the specific agreement and the stated facts, included both his remuneration of $5,000 and the amount of employee tax due with respect to this remuneration, or a total of $5,260. *Old Colony Trust Co. v. Commissioner,* 279 U.S. 716 (1929), VIII-2 C.B. 222 (1929).

The employee tax liability incurred by the employer was also "wages" for purposes of income tax withholding. Section 31.3401(a)-1(b)(6) of the Employment Tax Regulations. However, section 3121(a)(6) of the Federal Insurance Contributions Act provides that the term "wages" for pur-

poses of that Act, does not include "the payment by an employer (without deduction from the remuneration of the employee)—(A) of the tax imposed upon an employee under section 3101 * * *." Therefore, for purposes of the Federal Insurance Contributions Act, no additional tax was applicable to the employee tax liability incurred by the employer for the employee.

In reporting the facts with respect to employee *A* and in presenting him with evidence to present the facts to the Internal Revenue Service, the employer properly indicated on the Form W-2, Wage and Tax Statement, prepared with respect to *A*, that the "wages" paid subject to income tax withholding in 1972 were $5,260, and that the employee tax withheld for purposes of the Federal Insurance Contributions Act was $260. Assuming that it was otherwise appropriate, employer *X* properly deducted $5,260 as ordinary and necessary business expenses under section 162 of the Code.

If the employee tax liability incurred for *A* were part of a total section 3101 tax liability incurred on his behalf for the calendar year, by two or more of his employers, on an amount in excess of the annual limitation on employee's wages subject to the Federal Insurance Contributions Act taxes under section 3121(a)(1) of the Act ($9,000 in 1972), *A* would be entitled to a special refund of the excess tax paid, under section 6413 (c)(1) of the Code. That section indicates that the refund is conditioned upon the tax being deducted from the employee's wages. Since the tax liability incurred on behalf of *A* in this situation was included in his gross income, it was, in effect, deducted from his remuneration.

In the case of an employer who paid the Federal Insurance Contributions Act employee tax, but inadvertently failed to deduct it from the employee's remuneration, the employee's gross income would not include the amount of the employee tax if, upon discovery of the mistake, the employee reimbursed the employer or the employer deducted such employee tax from subsequent remuneration paid to the employee. In addition, for purposes of the special refund of any excess tax under section 6413(c)(1) of the Code, the situation would be treated as though the employer had properly deducted the employee tax from the employee's remuneration.

I.T. 3154, 1938-1 C.B. 113, is superseded.

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26 CFR 1.61-1: Gross income.
(Also Section 152, 1.152-1.)

State payments to adoptive parents. Maryland State Department of Social Services payments to adoptive parents who use the payments for support and maintenance of their adoptive child are not includible in income but must be considered in determining who furnished the child's principal support for purposes of claiming the dependency exemption.

Rev. Rul. 74-153

Advice has been requested whether adoptive parents are required to include in gross income for Federal income tax purposes the adoption payments received by them from the State of Maryland under the circumstances described below.

The taxpayers receive monthly payments for necessary support and maintenance of their adopted child under a program administered by the Maryland State Department of Social Services and use the payments for the care of the adopted child.

Section 67 of Article 16 of the Annotated Code of Maryland, as reenacted with amendments effective July 1, 1969, provides that a court, in passing on a petition for adoption, shall give due consideration to any assurance by the State Department of Social Services that it will provide or contribute funds for necessary support and maintenance of the adoptive child. The program is administered by the State Department of Social Services pursuant to its Rule 500. Rule 500 provides, in effect, that payments may be made for any child in the local department's foster care program upon the placement of that child in an adoptive home that meets all other eligibility tests as an adoptive home except for the ability to provide financially for an adoptive child. The amount and duration of the payments are based upon a written agreement between the adoptive parents and the local Department of Social Services. The payments are disbursed from foster care funds at a maximum rate of three-fourths of the foster care rate for board and clothing.

The adoption payments made by the Maryland State Department of Social Services under these circumstances are disbursements from a general welfare fund in furtherance of the social welfare objectives of the State and are furnished to assist the adoptive parents in the care of the adopted child.

Accordingly, the adoption payments received by the adoptive parents in the instant case are not includible in their gross income for Federal income tax purposes. However, such amounts are to be taken into account in the determination of who furnished the principal support of the adopted child for purposes of claiming the child's dependency exemption. See Rev. Rul. 57-344, 1957-2 C.B. 112, which holds similarly with respect to payments made under the Social Security Act to the child of a deceased individual in the care of the surviving parent, or other person having custody of the child.

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26 CFR 1.61-1: Gross income.
(Also Section 1012, 1.1012-1.)

Replacement housing payments. Replacement housing payments received by individuals under the

Housing and Urban Development Act of 1968 are not includible in gross income. Payments received under that Act, or similar tax-exempt payments received under the Uniform Relocation Assistance and Real Property Acquisitions Policies Act of 1970, used to acquire a new residence are includible in its basis.

Rev. Rul. 74-205[1]

Advice has been requested concerning the treatment for Federal income tax purposes of "replacement housing payments" received by individuals pursuant to the Housing and Urban Development Act of 1968 (1968 Act) Public Law 90-448, 1968-2 C.B. 734, and the Uniform Relocation Assistance and Real Property Acquisitions Policies Act of 1970 (1970 Act), Public Law 91-646, 1971-1 C.B. 540.

In general, replacement housing payments made under the above Acts are for the purpose of aiding individuals and families displaced from their homes, businesses or farms by Federal or federally assisted programs in acquiring decent, safe and sanitary dwellings of modest standards sufficient in size to accommodate the displaced owners, reasonably accessible to public services and places of employment, and available on the open market. As a condition to receiving the payment, a displaced owner must (a) under the 1968 Act, purchase and occupy a replacement dwelling within one year from the date he is required to move; (b) under the 1970 Act, purchase and occupy a replacement dwelling within one year from the date on which he receives from the Federal agency final payment of all costs of the acquired dwelling, or on the date on which he moves from the acquired dwelling, whichever is later. This payment is in addition to any acquisition payment, and cannot exceed $5,000 under the 1968 Act and $15,000 under the 1970 Act.

In House Report No. 1585, Ninetieth Congress, Second Session, page 5, it is noted that the purpose of the 1968 Act is to further implement the national goal of providing "a decent home and a suitable living environment for every American family."

The Internal Revenue Service has consistently held that payments made under legislatively provided social benefit programs for promotion of the general welfare are not includible in a recipient's gross income. See for example, Revenue Ruling 63-136, 1963-2 C.B. 19, concerning payments under the Manpower Development and Training Act; Revenue Ruling 68-38, 1968-1 C.B. 446, involving payments under Title II-A of the Economic Opportunity Act of 1964; and Revenue Ruling 72-340, 1972-2 C.B. 31, concerning stipends paid by a city to unemployed or underemployed probationers.

Accordingly, replacement housing payments made prior to January 2, 1971, pursuant to the 1968 Act are not includible in the gross incomes of the recipients.

As to replacement housing payments made on or after January 2, 1971, such payments are specifically exempted from taxation by section 216 of the Uniform Relocation Assistance and Real Property Acquisitions Policies Act of 1970, which repealed the provisions of the 1968 Act, but provided for substantially the same type of payments.

In determining the basis of a new residence where part of the cost of its acquisition relates to a replacement housing payment, such payment is taken into account as part of the displaced person's cost of the newly acquired property, and is includible in the basis of such property.

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26 CFR 1.61-1: Gross income.

Income received in foreign currency by U.S. citizen; rate of exchange. A U.S. citizen who received payments in a foreign currency for services performed for a foreign corporation in a foreign country must report such payments in terms of U.S. currency to the extent includible in his gross income at the rate of exchange in effect at the time the income was received or, if there is more than one rate of exchange in use, the rate which will properly reflect income; O.D.s 419 and 459 superseded.

Rev. Rul. 74-222[1]

B, a United States citizen and employee of a foreign corporation in foreign country *X* for the taxable year, was paid for his services in the currency of foreign country *X*. *B* was not in a foreign country for at least 510 full days of a period of eighteen consecutive months nor did *B* qualify as a bona fide resident of foreign country *X*.

Held, the amount of income received by *B* for services performed in foreign country *X* in the currency of foreign country *X* is to be reported for the purpose of Federal income taxes in terms of United States currency translated at the exchange rate in effect at the time the income was received. If there is more than one rate of exchange in use, *B* should translate the currency of foreign country *X* into United States dollars using the rate of exchange that will most properly reflect his income; thus, he does not have a free election to use any rate he wishes. See Revenue Ruling 64-307, 1964-2 C.B. 163 and *Marko Durovic v. Commissioner*, 54 T.C. 1364, 1388-90 (1970).

O.D. 419, 2 C.B. 60 (1920), and O.D. 459, 2 C.B. 60 (1920), are hereby superseded, since the positions stated therein are set forth under the current statute and regulations in this Revenue Ruling.

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[1] Also released as Technical Information Release No. 1285, dated April 10, 1974.

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

26 CFR 1.61-1: Gross income.

Whether insurance proceeds recovered by a corporation relating back to income items lost as a result of misappropriation by its officers is a recovery excludable from gross income under section 111 of the Code. See Rev. Rul. 74-34, page 35.

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26 CFR 1.61-1: Gross income.

Whether amounts received by a taxpayer as damages for alienation of affections and as consideration for the surrender of his right to the custody of his minor child are excludable from gross income for Federal income tax purposes. See Rev. Rul. 74-77, page 33.

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26 CFR 1.61-1: Gross income.

Recognition of gain or loss on sale of undivided interest in mortgage pool to Federal Home Loan Mortgage Corporation by insured savings and loan association. See Rev. Rul. 74-221, page 365.

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26 CFR 1.61-1: Gross income.

Whether an amount received in settlement of litigation by a regulated investment company is includible in gross income. See Rev. Rul. 74-248, page 167.

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26 CFR 1.61-1: Gross income.

Whether an amount received in settlement of litigation represents capital gain or ordinary income. See Rev. Rul. 74-251, page 234.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.
(Also 1.61-6.)

Contract for benefit of third party. A taxpayer who stipulated in a sales contract that the amount representing his gain from the sale of his property be paid to a third party must include the gain in his gross income; a cash-method taxpayer who contracted to perform services under an arrangement whereby the remuneration for his services would be paid to a third party must include the compensation in his gross income; Mim. 3040 superseded.

Rev. Rul. 74-32 [1]

The purpose of this Revenue Ruling is to update and restate under the current statute and regulations the position set forth in Mimeograph 3040, II-1 C.B. 48 (1923).

The question presented is whether a taxpayer must include in his income under the circumstances described below: (1) that portion of his compensation paid to a third party; or (2) the gain attributable to the proceeds from the sale of his property paid to a third party.

Taxpayer *A* owned property that he had purchased at a cost of $10,000. He subsequently sold the property for $25,000, stipulating in the contract of sale that $10,000 of the selling price was to be paid to him, and at the same time $15,000 was to be paid to a third party.

Taxpayer *B* who reports his income on the cash receipts and disbursements method of accounting contracted to perform services under an arrangement whereby the remuneration for his services would be paid to a third party.

Section 1.61-6 of the Income Tax Regulations provides that gain realized on the sale or exchange of property is included in gross income, unless excluded by law.

Under section 1.61-2 of the Regulations compensation for services, including fees, commissions, and similar items is includible in gross income.

In the first situation above, the contract has the same effect as would have resulted if the entire proceeds of the sale had been paid directly to taxpayer *A* and $15,000 had been given by him to the third party. Accordingly, the entire gain from the sale is includible in taxpayer *A*'s gross income. See *Lucas v. Earl*, 281 U.S. 111 (1930) and *T. J. Rogers*, 15 B.T.A. 638 (1929). In the second situation, the payment is includible in taxpayer *B*'s gross income at the time it is received by the third party.

Mimeograph 3040 is hereby superseded, since the position stated therein is restated under current statute and regulations in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.
(Also Sections 3231, 3401; 31.3231(e)-1, 31.3401(a)-1.)

Summer employees under State youth opportunity program. Summer employees of a railroad company under a State youth opportunity program who as a condition of their employment are required to consent that a portion of their remuneration be withheld and paid to the State are not required to include these amounts withheld in their gross income. Such amounts are not wages for purposes of income tax withholding or compensation for purposes of the Railroad Retirement Tax Act.

Rev. Rul. 74-50

Advice has been requested as to the amounts includible in the gross income of seasonal employees under the circumstances described below.

In furtherance of a state youth opportunity program, a railroad company agreed to employ young persons during the summer season to improve its track lines. The state agency administering the program agreed to pay the railroad company an initial sum of 600,000x dollars to be used for payment of remuneration to the seasonal employees.

Under existing contracts between the railroad company and the labor unions that represented the company's employees, the company was obligated to compensate its employees at the rate of at least 4x dollars per hour. However, in order to benefit a greater number of young persons, the state agency insisted upon a pay rate of 2.5x dollars per hour for the seasonal

employees. A compromise was reached and it was agreed that the seasonal employees would be paid in accordance with the union contracts, but that the amount of remuneration in excess of 2.5*x* dollars per hour would be withheld and paid to the state agency.

Therefore, as a condition to employment with the railroad company, each seasonal employee was required to execute a payroll deduction authorization in which the employee directed the company to (1) deduct from his remuneration for each payroll period the amount in excess of 2.5*x* dollars multiplied by the number of hours worked during that payroll period and (2) forward such excess amount to the state agency. The excess amounts so collected by the state agency at the end of each payroll period are to be returned to the railroad company during the following payroll period.

Section 61(a) of the Internal Revenue Code of 1954 provides that, unless otherwise excluded by law, gross income means all income from whatever source derived, including compensation for services.

Rev. Rul. 69-274, 1969-1 C.B. 36, holds that Medicare fees collected for a group of university medical school faculty physicians are not includible in their individual gross incomes where the fees were required to be turned over to the university in accordance with its policy of prohibiting faculty members from receiving fees for services rendered in the course of their teaching duties, and no individual physician ever had control of the fees collected for his services.

Accordingly, it is held in the instant case that the remuneration computed at the rate of 2.5*x* dollars per hour is includible in the seasonal employee's gross income. However, the amount withheld and paid to the state agency in excess of the rate of 2.5*x* dollars per hour is not includible in the employee's gross income.

Section 3401(a) of the Code, relating to the withholding of income tax, defines the term "wages," with certain exceptions not material here, as all remuneration for services performed by an employee for his employer.

Section 3231(e)(1) of the Railroad Retirement Tax Act (chapter 22, subtitle C of the Code) provides, in part, that "compensation" for purposes of the Act means any form of money remuneration earned by an individual for services rendered as an employee.

Accordingly, it is further held that the seasonal employee's remuneration computed at the rate of 2.5*x* dollars per hour is "wages" for purposes of the Collection of Income Tax at Source on Wages and "compensation" for purposes of the Railroad Retirement Tax Act. The amount paid to the state agency in excess of the rate of 2.5*x* dollars per hour is neither "wages" nor "compensation" for such purposes.

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

Whether a fellowship grant by the National Endowment for the Humanities for the purpose of enabling junior college professors to increase their understanding and to improve their teaching is excludable from gross income. See Rev. Rul. 74-95, page 39.

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

Commodities dealers; futures contracts. Dealers in cotton and other commodities treated in a similiar manner may, in determining gross income, take into account gains or losses at the end of the taxable year based upon market value of open futures contracts to which they are parties that are hedges against actual spot or cash transactions or against forward sales or purchases. This does not apply to purely speculative transactions in futures, which may not be included or taken into income in any manner until they are actually closed. A.R.M. 135, I.T. 1166, S.R. 5084, and S.M. 5693 superseded.

Rev. Rul. 74-223[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the positions set forth in A.R.M. 135, 5 C.B. 67 (1921), I.T. 1166, I-1 C.B. 52 (1922), S.R. 5084, IV-2 C.B. 120 (1925), and that portion of S.M. 5693, V-2 C.B. 20 (1926) that pertains to the treatment of gains or losses arising from dealings in futures contracts. Rev. Rul. 74-227, page 119, this Bulletin, updates and restates that portion of S.M. 5693 that pertains to the evaluation of commodities at market for inventory purposes.

The question presented is how dealers in cotton and other commodities dealt with in a similar manner may treat futures contracts, entered into under the circumstances described below, for Federal income tax purposes.

The taxpayer, a dealer in commodities, had on his books at the close of the taxable year open futures contracts which are hedges against either forward sales or forward purchases, or against spot or cash transactions made during the taxable year. The taxpayer also had some futures contracts against which there were no concurrent forward sales or forward purchases or spot or cash transactions.

The following statement represents the method of accounting used by dealers in cotton (commodities).

At the close of the taxable year, either fiscal or calendar, the cotton merchant takes an inventory (physical) of the cotton on hand. This cotton consists of bales purchased from the first day of the season to the last day of the season and represents a wide difference in price paid. The universal practice has been to inventory at market, because that tells the

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

real value of his commodity; further, because the identity of the bale and the matter of cost cannot be determined, hence it is impossible to take it other than at the market price.

In the keeping of books in the cotton business, it has been the custom, existing over a period of approximately 100 years, for the cotton merchants to take into consideration at market his forward sales, purchases, and hedges, and if they show a profit, that is added to the season's business. If on the other hand, they show a loss, it is deducted from the season's business. His real profit, or loss, is hereby determined for the year. This system of bookkeeping is the only accurate and correct system that has been devised that truly reflects the net profit or loss of any given year's business, either fiscal or calendar. It is the system in use, approved by auditors who certify to the correctness of his financial statements which are the basis of his credit, and is the system accepted by his bankers for all his financial transactions and the only system which would not be false and misleading.

The term "hedge" means a counterbalancing transaction of a futures contract against an actual purchase or sale of a commodity or against a forward purchase or sale. It is a form of price insurance utilized in order to avoid the risk of changes in the market. The term "futures contracts" means a contract to sell or purchase some fixed amount of the commodity at a future date at a fixed price. The terms "spot" and "cash" mean an actual purchase or sale for the purpose of moving the commodity along from producer to consumer. It is the merchandising of the staple product. The terms "forward sales" and "forward purchases" mean valid and enforceable sales or purchase contracts into which the commodity dealer enters to sell or buy a certain amount of the commodity at a certain price for shipment by him or delivery to him at a specified future time.

Section 446 of the Internal Revenue Code of 1954 provides that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary of the Treasury or his delegate, does clearly reflect income.

Section 61 of the Code provides that gross income means all income from whatever source derived, including among other items, gross income derived from business.

Section 165 of the Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

The practice followed by cotton and grain dealers, of bringing all elements to market price at the end of the taxable year, which has been in use for a long period of years and which conforms to the best accounting practices in the trade, is recognized as the only practical method of arriving at a true and correct result of the operations. See Rev. Rul. 74-227 which holds that dealers in commodities may inventory at market.

Accordingly, cotton dealers and dealers in other commodities dealt with in a similar manner may, in determining gross income, take into account gains or losses at the end of the taxable year based upon the market value of such open futures contracts to which they are parties as are hedges against actual spot or cash transactions or against forward sales or purchases, as the case may be. This does not apply to purely speculative transactions in futures not offset by actual spot or cash transactions or concurrent forward purchases or sales. These speculative transactions may not be included or taken into income in any manner until such futures transactions are actually closed. Further, the value of the commodity covered by such open futures contracts shall not be added to or deducted from the inventory of the taxpayer. See Rev. Rul. 74-227.

In all cases the taxpayer is required to keep such records of all transactions entering into the computation of income as described above as will enable the Commissioner of Internal Revenue to determine the true taxable income.

A.R.M. 135, I.T. 1166, S.R. 5084, and S.M. 5693 are hereby superseded, since the positions stated therein are restated under the current law in this Revenue Ruling.

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26 CFR 1.61-6: Gains derived from dealings in property.

Whether a taxpayer must include in his income that portion of his proceeds from the sale of his property paid to a third party. See Rev. Rul. 74-32, page 22.

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26 CFR 1.61-7: Interest.
(Also Section 103, 1.103-1.)

Income from tax-exempt securities; "purchase and resale" agreements. A bank receiving interest on tax-exempt securities held by it under so-called "purchase and resale" agreements entered into with customers is not entitled to exclude such interest from its gross income under section 103 of the Code but such tax-exempt interest is income of the customers and the bank must report the interest charged such customers as income under section 61; G.C.M. 12355 superseded.

Rev. Rul. 74-27 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in G.C.M. 12355, XII-2 C. B. 100 (1933).

The question presented is whether, under the circumstances described below, certain interest earned by the

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

taxpayer is excludable from its gross income pursuant to the provisions of section 103 of the Internal Revenue Code of 1954, or is includible in its gross income under the provisions of section 61.

During the years 1970 to 1972, inclusive, the taxpayer, a bank, entered into transactions with certain of its customers which, it is purported, resulted in the "purchase and resale" of state or municipal bonds the interest on which is exempt from tax under section 103 of the Code. In such transactions, customers owning the bonds and desiring to secure temporary funds entered into written agreements with the bank providing as follows:

Agreement made the ___ day of _____, 19___, between [the customer] here in after referred to as the party of the first part, and [the bank], here in after referred to as the party of the second part,

WITNESSETH:

1. That the party of the first part, in consideration of the agreements hereinafter contained, to be performed by the party of the second part, agrees to sell and deliver to the said party of the second part on the day and year first above written the following securities: _____

_____

for which in consideration thereof the party of the second part agrees to pay to the party of the first part _____

_____.

2. In consideration of the premises, the party of the first part agrees to repurchase and the party of the second part agrees to sell said securities on or before _____

_____.

3. Upon failure of said party of the first part to accept delivery of said securities as provided for in clause 2 hereof, and to make payment therefor, then the party of the second part may immediately, without further notice to the party of the first part, sell the above-mentioned securities at public or private sale, at any broker's board or otherwise, and apply the proceeds of said sale as far as needed toward the above contract price, and of any or all other obligations or liabilities of the party of the first part to the party of the second part, accounting to the party of the first part for any surplus arising; the party of the first part remaining liable to the party of the second part for any deficiency remaining unpaid after such application.

4. In the event of failure of said party of the second part to deliver said securities and accept payment therefor under this repurchase agreement, then the said party of the first part may, without further notice of the party of the second part, "buy in" the party of the second part under terms and conditions corresponding to those described in the preceding paragraph.

5. Delivery and payment to be made at the office of the party of the _____ part. * * * "

Section 61 of the Code provides, in part, that, except as otherwise provided in subtitle A, gross income includes interest.

From an examination of the agreement quoted herein, it is apparent (1) that the identical securities which are "sold" to the bank are required to be held by it for repurchase by the customer, and that the customer is entitled to demand and receive such identical securities when he performs his agreement to repurchase; (2) that upon the failure of the customer to repurchase the securities and to make payment therefor as stipulated, the bank may sell the securities, apply the proceeds of the sale upon the repurchase price, and either credit the customer with any excess or hold him liable for any deficiency; (3) that the customer is legally bound both to repurchase the securities and to pay any deficiency remaining unpaid after the application of the proceeds of sale (the customer not having a mere option to repurchase); (4) that the customer agrees to pay interest at a stipulated rate upon the amount advanced by the bank; and (5) that the value of the securities may or may not equal the amount advanced by the bank.

In the case of *First American National Bank of Nashville, v. United States*, 467 F. 2d 1098 (6th Cir. 1972), bond dealers orally agreed with a bank that it (bank) would buy tax exempt bonds from issuers and later sell them to the dealers at the price the bank had paid for them and the bank would accrue interest on the bonds until the latter sales occurred. In addition, arrangements were made whereby customers of the bank agreed that the bank would acquire bonds from dealers and later sell the bonds to the customers at the price it (bank) had paid with adjustments for accrued interest. The United States Court of Appeals held that the bank in substance never owned the bonds and was not entitled to tax exemptions for interest that accrued on the tax exempt bonds during the period held by the bank. See also *American National Bank of Austin, v. United States*, 421 F. 2d 442 (5th Cir. 1970), *rev'g rem'g* D. C., *cert. denied*, 400 U.S. 819.

Based on the foregoing, it is concluded that the "purchase and resale" agreements described in the instant case simply effect loans of money by the taxpayer upon collateral security and such agreements are not purchases by the taxpayer of securities for investment.

Accordingly, it is held that the taxpayer must include in its gross income, pursuant to section 61 of the Code, the entire amount of the interest charged on its customers' loans in such transactions. The taxpayer is not entitled to treat as income from tax exempt securities the interest payable by the obligors on such securities during the period they are held by it. Such tax-exempt interest is the income of the customer who submitted the securities to the bank for collateral.

G.C.M. 12355 is hereby superseded, since the position stated therein is restated under the current law in this Revenue Ruling.

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26 CFR 1.61-7: Interest.

Whether interest to be paid on warrants issued by a political subdivision of a State will be exempt from tax. See Rev. Rul. 74-113, page 31.

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26 CFR 1.61-12: Income from discharge of indebtedness.

Whether a parent corporation realizes income under section 61(a)(12) of the Code from the cancellation of an indebtedness, owed by the parent to its subsidiary corporation, in connection with the liquidation of the subsidiary which is subject to the provisions of section 332. See Rev. Rul. 74-54, page 76.

Part II. Items Specifically Included in Gross Income

Section 71.—Alimony and Separate Maintenance Payments

26 CFR 1.71-1: Alimony and separate maintenance payments; income to wife or former wife.
(Also Sections 641, 662, 671, 677, 682; 1.641(a)-0, 1.662(a)-4, 1.671-1, 1.677(a)-1, 1.677(b)-1, 1.682(a)-1.)

Alimony trust. Distributions to a former wife from an irrevocable trust created in contemplation of divorce, payable at the discretion of the trustees but limited to purposes other than for her support, are not includible in her gross income under either section 71(a)(1) or 682(a) of the Code. The former husband will be considered the owner, under sections 671 and 677, of amounts applied or distributed from current income for the support of the parties' minor children but will be considered a beneficiary as to amounts distributed from trust corpus or from income other than current income.

Rev. Rul. 74-94

Advice has been requested concerning the Federal income tax treatment of a trust, its grantor, and its beneficiaries, under the circumstances described below.

A husband, in contemplation of divorce, entered into a written settlement agreement with his wife in order to settle the questions of her alimony and support, and their respective property rights. In full and complete settlement of these rights, the husband agreed to establish a trust and to transfer to it a specified amount of money for the benefit of his wife and their descendants. The settlement agreement was incorporated by an Illinois court in a decree of divorce which held, among other things, that all the rights, claims, and demands of each party to alimony and support from the other party were foreover barred, discharged, ended, and released. Pursuant to the settlement agreement, the trust was established and three trustees were appointed, one of whom was the grantor's wife with the remaining two being independent and unrelated individuals. The trust is irrevocable and no person, including the grantor and the trustees, has the right to revoke, alter, or amend the agreement or the trust. In addition, the grantor does not have any administrative control over the trust.

The trustees are authorized, in their sole discretion, to distribute to the former wife at any time, any part of the net income or corpus of the trust which they deem advisable for her best interest, even though not for her support, or to accumulate the income and add it to the principal of the trust. Since the former wife's personal resources are sufficient for her support, a legally binding agreement was reached by all the parties to the effect that no distribution would be made to her for this purpose. Decisions of the trustees are governed by majority vote, subject to the former wife's approval except for those decisions concerning distributions to herself. During her lifetime, or by her will, the former wife may appoint from the trust estate (including income) any amounts for the support or other benefit of any or all of the descendants of the grantor and of herself. Upon her death the trustees are to distribute the remaining trust estate to the then living descendants of the grantor and his former wife, or, if there are none then living, to her heirs at law.

Under section 71(a)(1) of the Internal Revenue Code of 1954, if a wife is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, the wife's gross income includes periodic payments (whether or not made at regular intervals) received after such decree in discharge of (or attributable to property transferred, in trust or otherwise, in discharge of) a legal obligation which, because of the marital or family relationship, is imposed on or incurred by the husband under the decree or under a written instrument incident to such divorce or separation.

Section 71(c)(1) of the Code provides the general rule that for purposes of subsection (a), installment payments discharging a part of an obligation the principal sum of which is, either in terms of money or property, specified in the decree, instrument, or agreement, shall not be treated as periodic payments.

Under section 71(c)(2) of the Code, if, by the terms of the decree, instrument, or agreement, the principal sum referred to in section 71(c)(1) is to be paid or may be paid over a period ending more than 10 years from the date of such decree, instrument, or agreement, then (notwithstanding section 71(c)(1)) the installment payments shall be treated as periodic payments for purposes of section 71(a), but (in the case of any one taxable year of the wife) only to the extent of 10 percent of the principal sum. For purposes of the preceding sentence, the part of any principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be treated as an installment payment for the taxable year in which it is received.

Section 71(d) of the Code provides that the husband's gross income does not include amounts received which, under section 71(a), are includible in the gross income of the wife, and attributable to transferred property.

Section 1.71-1(b)(4) of the Income Tax Regulations provides, in part, that section 71(a) of the Code applies only to payments made because of the family or marital relationship in recognition of the general obligation to support which is made specific by the decree, instrument or agreement.

Under section 682(a) of the Code there shall be included in the gross

income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance (or who is separated from her husband under a written separation agreement) the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not, despite any other provision of subtitle A, be includible in the gross income of such husband.

Section 682(b) of the Code provides that for purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom section 682(a) or section 71 applies, such wife shall be considered as the beneficiary specified in part I, subchapter J, chapter 1 of the Code (sections 641 through 683). A periodic payment under section 71 to any portion of which this part applies shall be included in the gross income of the beneficiary in the taxable year in which under this part such portion is required to be included.

Section 1.682(a)-1(a)(2) of the regulations provides that section 682 (a) of the Code does not apply in any case to which section 71 applies. Although section 682(a) and section 71 seemingly cover some of the same situations, there are important differences between them. Thus, section 682(a) applies, for example, to a trust created before the divorce or separation and not in contemplation of it, while section 71 applies only if the creation of the trust or payments by a previously created trust are in discharge of an obligation imposed upon or assumed by the husband (or made specific) under the court order or decree divorcing or legally separating the husband and wife, or a written instrument incident to the divorce status or legal separation status, or a written separation agreement. If section 71 applies, it requires inclusion in the wife's income of the full amount of periodic payments received attributable to property in trust (whether or not out of trust income), while, if section 71 does not apply, section 682(a) requires amounts paid, credited, or required to be distributed to her to be included only to the extent they are includible in the taxable income of a trust beneficiary under subparts A through D (sections 641 through 669), part I, subchapter J, chapter 1 of the Code.

Since the trust in the instant case was created in contemplation of divorce, section 682 of the Code is inapplicable and any distributions made to the former wife from the trust are therefore not includible in her gross income under section 682(a). Furthermore, since any distributions from the trust to the former wife are discretionary with the trustees and may not be made for the former wife's support, any distributions to the former wife from the trust are not periodic payments within the meaning of section 71 and, therefore, are not includible in her gross income under section 71(a)(1).

With respect to the taxability of the grantor of a trust, section 671 of the Code provides that where it is specified in subpart E (sections 671 through 678), part I, subchapter J, chapter 1 of the Code, that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person, those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under the Federal income tax law in computing taxable income or credits against the tax of an individual.

Based on the facts of the instant case, a question as to the taxability of the grantor as the owner or beneficiary of the trust arises under section 677 of the Code.

Section 1.677(a)-1(d) of the regulations provides, in part, that under section 677 of the Code a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Section 1.677(b)-1(a) of the regulations provides that under section 677(b) of the Code a grantor is not treated as the owner of a trust merely because its income may in the discretion of any person other than the grantor (except when he is acting as trustee or cotrustee) be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse in the case of income from property transferred in trust after October 9, 1969), such as the child of the grantor, whom the grantor or his spouse is legally obligated to support. If income of the current year of the trust is actually so applied or distributed the grantor may be treated as the owner of any portion of the trust under section 677 to that extent, even though it might have been applied or distributed for other purposes. In the case of property transferred to a trust before October 10, 1969, for the benefit of the grantor's spouse, the grantor may be treated as the owner to the extent income of the current year is actually applied for the support or maintenance of his spouse.

Section 1.677(b)-1(b) of the regulations provides that if any amount applied or distributed for the support of a beneficiary, including the grantor's spouse in the case of property transferred in trust before October 10, 1969, whom the grantor is legally obligated to support is paid out of corpus or out of income other than income of the current year, the grantor is treated as a beneficiary of the trust, and the amount applied or distributed

is considered to be an amount paid within the meaning of section 661(a)(2), taxable to the grantor under section 662.

Whether the legal obligation of a husband to support his wife has been discharged through the creation of a trust under a property settlement depends on local law. *Helvering v. Fuller,* 310 U.S. 69 (1940), 1940-1 C.B. 172. It must be shown by clear and convincing proof that local law and the trust have given the husband a full discharge from his duty to support his divorced wife, leaving no continuing obligation, contingent or otherwise. *Helvering v. Fuller,* above; *Helvering v. Fitch,* 309 U.S. 149 (1940), 1940-1 C.B. 165. Although under Illinois law a decree of periodic alimony is subject to modification, a decree which provides for a property settlement in lieu of periodic alimony constitutes a final property settlement, operates as a discharge and satisfaction of all claims for future support of the wife, and cannot be modified after the decree becomes final. *Canady v. Canady,* 30 Ill. 2d 440, 197 N.E. 2d 42 (1964); *Walters v. Walters,* 409 Ill. 298, 99 N.E. 2d 342 (1951). Furthermore, under Illinois law the obligation of the father to support a minor child is not affected by a decree granting divorce and awarding care and custody of his child to his wife or other suitable person, nor can he be relieved of such obligation by agreement with her. *Leland v. Brower,* 28 Ill. 2d 598, 192 N.E. 2d 831 (1963); *Kelley v. Kelley,* 317 Ill. 104, 147 N.E. 659 (1925).

In the instant case the property settlement agreement incorporated in the divorce decree resulted in a waiver and release of the former wife's rights, claims, and demands for alimony. Also, by agreement, the former husband was relieved of any obligation for the future support of his former wife.

Accordingly, since the former husband's legal obligation to support his former wife, but not their children, has been discharged by the property settlement agreement, he will be considered as the owner of a portion of the trust under section 671 and section 677 of the Code and the regulations thereunder to the extent that trust income of the current year is actually applied or distributed for the support or maintenance of their minor children. But with respect to trust corpus or trust income, other than income of the current year, that is actually applied or distributed for support or maintenance of their children, the former husband will be considered a beneficiary of such portion of the trust under section 662 and section 677 and the regulations thereunder. However, the former husband will not be considered as the owner or beneficiary of any other portion of the trust income under section 677 and will not be taxable on the income therefrom under section 671 or section 662. Thus, the former husband is taxable on income and corpus of the trust pursuant to section 671 and section 662 only as to amounts actually applied or distributed for the support or maintenance of the minor children.

Further, to the extent the former husband is not treated as the owner or beneficiary of any portion of the trust under the provisions of section 677 of the Code and thus is not taxable with respect to trust income under the provisions of section 671 or section 662, the taxation of the trust and its beneficiaries, including the former wife, will be governed by the applicable trust rules contained in sections 641 through 669.

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72-2: Applicability of section. (Also Section 402; 1.402-1.)

Civil Service annuitant reemployed; supplemental benefits. Supplemental retirement benefits a retired Federal employee received after terminating a period of Federal reemployment of three years and one month are treated as being received under a separate annuity contract for purposes of applying section 72 of the Code whether or not he makes a contribution to the U.S. Civil Service Retirement and Disability Fund to cover the reemployment period; Rev. Rul. 70-147 revoked.

Rev. Rul. 74-107

Advice has been requested with regard to the method to be used for computing the excludable portion of the supplemental amount received from the United States Civil Service Retirement and Disability Fund (Fund) under the circumstances described below.

A Federal employee retired for age and length of service and began receiving life annuity payments from the Fund. He was later reemployed as a Federal employee and worked for a period of three years and one month. Upon his separation from this last employment, he elected to make a deposit with interest to the Fund of a certain percentage of his basic pay received during his period of reemployment.

As provided under section 8344 of Title 5 of the United States Code, the salary the employee was paid for work performed after his reemployment was reduced by the annuity payments he received from the Fund and, after his separation from service following his reemployment, he received an additional benefit or supplemental of $425 per year, based upon services performed during the period of reemployment. He was neither required nor permitted to make contributions to the Fund during his reemployment, but his supplemental benefit would have been a lesser amount ($285 per year) if he had not made the specified deposit of $1,400 to cover the reemployment service. See section 8344(a) and

8339(h) of Title 5 of the United States Code.

The Fund is a qualified trust under section 401(a) of the Internal Revenue Code of 1954 and is exempt from Federal income tax under section 501(a). See Rev. Rul. 68-486, 1968-2 C.B. 184.

Section 402(a) of the Code provides that the amounts actually distributed or made available to any distributee by an exempt employees' trust shall be taxable to him in the year in which so distributed or made available under section 72 (relating to annuities).

Section 72(b) of the Code provides that gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). This section does not apply to any amount to which section 72(d) applies. Section 72(d) provides for the taxation of certain employee annuities if the employee will recover his contributions during the three-year period beginning on the date on which an amount is first received under the contract as an annuity.

Section 1.72-2(a)(3) of the Income Tax Regulations provides that, for purposes of applying section 72 of the Code to distributions and payments, each separate program of the employer consisting of interrelated contributions and benefits shall be considered a single contract. Example (4) in such section states that the Fund consists of a compulsory program and a voluntary program each of which is considered a separate program of interrelated contributions and benefits. It also indicates that distributions received from each program constitute distributions from separate contracts for purposes of section 72.

In this case the additional contributions made after the employee's separation from reemployment are not part of either of the two programs mentioned in Example (4) of section 1.72-2(a)(3) of the regulations. Such contributions and the benefits derived therefrom are part of a separate program of the employer consisting of interrelated contributions and benefits. Therefore, the separate program is to be treated as a separate contract for purposes of applying section 72 of the Code.

Since the employee's basis in the contract (resulting from the optional contribution of $1,400) will not be recovered within the three-year period mentioned in section 72(d) of the Code, the excludable portion will be determined under section 72(b).

Furthermore, had the employee not elected to make the optional deposit, the reduced supplemental benefit of $285 per year would be treated as a separate annuity contract from the regular compulsory annuity program. Since the employee would have made no contribution in such a case, he would have had no basis in the contract for the purposes of section 72(b) of the Code.

Rev. Rul. 70-147, 1970-1 C.B. 20 which holds that if no deposit is made for supplemental benefits based on reemployment of over one year, the supplemental benefits are not "received as an annuity" within the meaning of section 72(e) of the Code, is hereby revoked.

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26 CFR 1.72-2: Applicability of section.

Civil Service annuitant reemployed; recomputed benefits. Recomputed retirement benefits a retired Federal employee received after terminating a period of Federal reemployment of five years, electing to have his annuity recomputed, and making the mandatory contribution to the U.S. Civil Service Retirement and Disability Fund required to cover the reemployment period, are treated as being received under a new annuity contract for purposes of applying section 72 of the Code. His basis in the new contract is his contribution added to any unrecovered basis under the original contract.

Rev. Rul. 74-138

Advice has been requested with regard to the method to be used for computing the excludable portion of the supplemental amounts received from the United States Civil Service Retirement and Disability Fund (Fund) under the circumstances described below.

A Federal employee retired for age and length of service and began receiving life annuity payments of $7,308 per year from the Fund. He recovered his investment basis under the contract within the three-year period mentioned in section 72(d) of the Internal Revenue Code of 1954. He was later reemployed as a Federal employee for a five-year period of continuous full-time service. Pursuant to the law in effect during this period of reemployment, the employee was neither required nor permitted to make contributions to the Fund.

As provided under section 8344 of Title 5 of the United States Code, the salary the employee was paid for work performed during the period of his reemployment was reduced by the annuity payments he received from the Fund and, after his final separation from service, he became entitled to a supplemental benefit based upon service performed during the period of reemployment. That section provides that a reemployed employee who had previously been retired for age and length of service, who has completed at least five years of continuous full-time service during the period of reemployment, and who is qualified for a supplemental annuity, may elect, in lieu of such supplemental annuity, to have his entire annuity benefit recomputed under the law in effect at the time he is separated from reemployment. A deposit to cover the reemployment service is mandatory for

such annuity redetermination.

After this last period of service, the employee elected under section 8344 (a) (3) (B) of Title 5 of the United States Code to have his entire annuity benefit recomputed. He made the required contribution of $5,068 and his life annuity payments from the Fund were increased to $9,936 per year.

The Fund is a qualified trust under section 401(a) of the Code and is exempt from Federal income tax under section 501(a). See Rev. Rul. 68-486, 1968-2 C.B. 184.

Section 402(a) of the Code provides that the amount actually distributed or made available to any distributee by an exempt employees' trust shall be taxable to him in the year in which so distributed or made available, under section 72 (relating to annuities).

Section 72(d) of the Code provides that where part of the consideration for an annuity is contributed by the employer and, during the three-year period beginning on the date on which an amount is first received under the contract as an annuity, the aggregate amount receivable by the employee under the terms of the contract is equal to or greater than the consideration for the contract contributed by the employee, then all amounts received as an annuity under the contract shall be excluded from gross income until there has been so excluded an amount equal to the consideration for the contract contributed by the employee. Thereafter, all amounts received under the contract shall be included in gross income.

The obligation to pay the annuitant the recomputed annuity ($9,936 per year in this case) is ordinarily fixed immediately following the employee's separation from reemployment. The employee's election to have his entire annuity recomputed brings into existence a new contract for which the exclusion from gross income must be determined. The employee's basis in this new contract is his unused basis in the original contract, together with the amount he contributed after his period of reemployment. Since the employee in this case had recovered his contributions for the original contract, his basis in the new contract is his contribution of $5,068 made after his separation from reemployment. This contribution of $5,068 will be recovered in less than three years under the new contract.

Accordingly, all amounts received by the taxpayer from the Fund are excludable from his gross income under section 72(d) of the Code until he has recovered his contributions ($5,068) to the Fund. Thereafter, all amounts received by the taxpayer from the Fund are includible in his gross income.

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26 CFR 1.72-16: Life insurance contracts purchased under qualified employee plans.

Premiums paid by trustee on life insurance contract after transfer to employee's trust where employee's beneficiary is entitled to proceeds in event of employee's death. See Rev. Rul. 74-76, this page.

Section 78.—Dividends Received from Certain Foreign Corporations by Domestic Corporations Choosing Foreign Tax Credit

26 CFR 1.78-1: Dividends received from certain foreign corporations by certain domestic corporations choosing the foreign tax credit.

Whether in the case of an election under section 963 of the Code, the dividends paid by the foreign corporation which constitute the fractional element in computing the foreign tax credit under section 902 must be translated into United States dollars at the rate of exchange used in computing the earnings and profits under section 1.964-1 of the regulations for the taxable year to which they relate. See Rev. Rul. 74-230, page 187.

Part III. Items Specifically Excluded From Gross Income

Section 101.—Certain Death Benefits

26 CFR 1.101-1: Exclusion from gross income of proceeds of life insurance contracts payable by reason of death.
(Also Section 72; 1.72-16.)

Employee's life insurance policy transferred to pension trust.

The transfer of a participating employee's life insurance contract to a trust under a profit-sharing plan permitting the assignment of such a policy with a cash surrender value in lieu of voluntary cash contributions and providing that the cash surrender value would be payable to the employee upon retirement or earlier termination of employment and that the insurance proceeds continue to be payable to his beneficiary is not a "transfer for valuable consideration" under section 101(a)(2) of the Code.

Rev. Rul. 74-76

Advice has been requested whether, under the circumstances described below, the transfer by an employee of a life insurance contract having a cash surrender value constitutes a "transfer for valuable consideration" within the meaning of section 101(a)(2) of the Internal Revenue Code of 1954.

A corporation maintains a qualified profit-sharing plan that permits voluntary employee contributions of up to ten percent of compensation. In lieu of voluntary cash contributions, the plan permits a participating employee to assign life insurance contracts having cash surrender values as his voluntary contributions to the exempt trust forming part of the plan.

An employee-participant owned a life insurance contract which had an existing cash surrender value. The life insurance contract was assigned directly to the profit-sharing trust as a voluntary employee contribution. The cash surrender value of the contract did not exceed 10 percent of the employee's compensation. Under the terms of the plan the proceeds of the contract continued to be payable to the employee's beneficiary and the cash surrender value of the contract was payable to the participant upon his retirement or termination of employment, if earlier.

Section 101(a)(1) of the Code provides that gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.

Section 101(a)(2) of the Code provides that in the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from the gross income of the recipient shall not exceed the amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee.

Section 1.101(b)(4) of the Income Tax Regulations provides that a transfer for a valuable consideration, within the meaning of section 101(a)(2) of the Code, occurs only where there is an absolute transfer for value of the right to receive all or a part of the proceeds of a life insurance contract.

In Rev. Rul. 73-338, 1973-2 C.B. 20, an agreement between an employee, the employer, and a trust provided for the employer to purchase an existing insurance policy from the employee for its cash surrender value and to transfer it to the trustee as part of the employer's required contribution under a qualified pension plan providing incidental death benefits. The employee died and, as required by the terms of the plan, the insurance proceeds were paid to the trustee who turned them over to the insured's widow, the beneficiary.

Rev. Rul. 73-338 holds that, substantively, there was no absolute transfer of the right to receive all or part of the proceeds of the life insurance policy, the arrangement having no significant change in the beneficial ownership of the proceeds of the life insurance policy. Thus, the transfer did not come within the purview of section 101(a)(2) of the Code.

In this case, the insurance proceeds are payable to the designated beneficiary of the participant upon his death. Furthermore, the cash surrender value of the contract is payable to the participant upon his normal retirement date or termination of employment, if earlier. Therefore, there is no significant change in the beneficial ownership of the life insurance contract.

Accordingly, the transfer of the life insurance contract was not a transfer for valuable consideration within the meaning of section 101(a)(2) of the Code.

Premiums paid by the trustee after the transfer of the policy to the trust are includible in the employee's gross income, pursuant to the provisions of section 1.72-16(a) of the regulations, but only to the extent that such premiums represent the cost of life insurance protection under the contract.

Section 103.—Interest on Certain Governmental Obligations

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

Announcement 74-55

Correction to T.D. 7199

In 1972-39 I.R.B. 5, 18 and in 1972-2 C.B. 45, 60, there is an error in the reprint of section 1.103-8(g)(2)(v) of T.D. 7199. The correct language of that section, as it appears in the Federal Register for August 3, 1972, is as follows:

> "(v) An expenditure has a significant purpose other than the control of pollution *if it results in* an increase in production or capacity, or in a material extension of the useful life of a manufacturing or production facility or a part thereof." [Italics added.]

As printed in the Bulletin and Cumulative Bulletin, the italicized material read: "if it is designed to result in."

A pen-and-ink change should be made on page 18 of 1972-39 I.R.B. and page 60 of 1972-2 C.B. to correct this error.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.
(Also Section 61; 1.61-7.)

Interest on political subdivision warrants. Interest on negotiable warrants received from a bank escrow account, into which proceeds from bonds issued by a political subdivision to finance acquisition of land for a dam were deposited to pay the warrant interest and principal to landowners who elected to take warrants instead of cash for their land, is not excludable under section 103(a)(1) of the Code.

Rev. Rul. 74-113

Advice has been requested whether, under the circumstances described below, the interest on certain warrants to be issued by a political subdivision of a State will be excludable from the gross income of the holders of the warrants under the provisions of section 103(a)(1) of the Internal Revenue Code of 1954.

The political subdivision proposes to issue bonds to finance the acquisition of land for the construction of a dam. The property owners selling land to the political subdivision will be required to sell it free and clear of any encumbrances. They will be provided by the political subdivision with the choice of receiving cash or negotiable warrants bearing interest at the current market rate for comparable securities. At the same time the warrants are issued, the political subdivision will be required to transfer a portion of the bond proceeds equal to the face amount of the warrants issued to a special escrow account in a bank. The special escrow account will be held in trust for the payment of the warrants as they become due. Interest earned on the amounts placed in the

special escrow account will be used to pay interest due on the warrants and the cost of administering the account. The political subdivision will not be permitted to invade the special escrow account for its own use.

The terms of the warrants will provide that the holder of the warrant will be entitled to receive the face amount of the warrant at the maturity date plus annual interest at a specified percentage payable out of the special escrow account.

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

In the instant case, the political subdivision will make an immediate and full payment for the land when it pays the purchase price by issuing warrants and depositing cash equal to the face amount of the warrants in a special escrow account. Since the payment of the face amount of the warrants will be made from the amounts deposited in the special escrow account and the interest on the warrants will be paid only out of the earnings of such account, the political subdivision will not be liable with respect to the warrants. Thus, the warrants will not represent obligations of the political subdivision within the meaning of section 103(a)(1) of the Code.

Accordingly, the interest on the warrants to be issued by the political subdivision in exchange for land will not be excludable from the gross income of the holders of the warrants under the provisions of section 103(a)(1) of the Code.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Industrial development bonds for water pollution control facilities. A resolution by a political subdivision, not qualifying as a "bond resolution," that authorizes an agreement obligating the political subdivision to construct and operate water pollution control facilities for use by an industrial corporation and the issuance of bonds by the political subdivision to finance the construction of such facilities constitutes "some other similar official action" within the meaning of section 1.103-8(a)(5)(iii) of the regulations.

Rev. Rul. 74-207

The governing body of a political subdivision of a State adopted a resolution on January 4, 1974, authorizing (1) the execution of an agreement with an industrial corporation obligating the political subdivision to construct and operate water pollution control facilities as defined in section 1.103-8(g)(2) of the Income Tax Regulations for the use of the corporation, and (2) the issuance of bonds by the political subdivision to finance the construction of such facilities. The resolution does not qualify as a "bond resolution" as that term is used in section 1.103-8(a)(5).

The political subdivision and the industrial corporation executed the agreement on January 25, 1974. Under the terms of the agreement, the political subdivision is committed to issue revenue bonds in a sufficient amount to finance the construction of the facilities. Neither the political subdivision nor the industrial corporation had commenced construction or acquisition of the water pollution control facilities at the time the agreement was executed. The construction was commenced after January 25, 1974, and was subsequently completed.

Held, the resolution of the political subdivision together with the agreement between the political subdivision and the industrial corporation constitute "some other similar official action" and, thus, satisfy the requirement set forth in section 1.103-8(a)(5)(iii) of the regulations that, in the absence of a bond resolution, some other similar official action toward issuance of the obligations must be taken by the issuer of the obligations prior to the commencement of construction or acquisition of the facilities.

Compare Rev. Rul. 73-186, 1973-1 C.B. 48, which holds, in part, that the approval of the issuance of bonds by the electors of a political subdivision at a special election constitutes "some other similar official action" toward the issuance of such bonds for purposes of satisfying the requirement of section 1.103-8(a)(5)(iii) of the regulations.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Whether a bank receiving interest on tax-exempt securities held by it under "purchase and resale" agreements with customers is entitled to treat such interest from its gross income. See Rev. Rul. 74-27, page 24.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Bonds issued by the Swinomish Indian Tribal Community in the State of Washington. See Rev. Rul. 74-179, page 279.

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26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.

Rev. Rul. 74-289

A political subdivision of a State issued industrial development bonds within the meaning of section 103(c)(2) of the Internal Revenue Code of 1954 in the amount of $4,000,000 for the purpose of financing facilities for use by an industrial corporation. The political subdivision elected to apply the provisions of section 103(c)(6)(D) to the bond issue in order that it would qualify as a $5,000,000 exempt small issue. All of the stock of the industrial corporation is owned by a charitable foundation trust which is an organization described in section

501(c)(3) and exempt from tax under section 501(a).

The trust, the industrial corporation, and the facilities financed with the bond proceeds are located within the boundaries of the same incorporated municipality. None of the trust's assets have been or will be used in connection with the operations of the industrial corporation, and none of the capital expenditures by the trust have been or will be incurred with respect to the operations of the industrial corporation. The trust has not derived and will not derive any "unrelated business taxable income" within the meaning of section 512 of the Code.

Held, although the trust and the industrial corporation are related persons within the meaning of section 267(b)(8) of the Code, none of the capital expenditures made by the trust with respect to its exempt activities in the incorporated municipality within three years before and after the date of the issuance of the bonds will be considered "capital expenditures" within the meaning of section 103(c)(6)(D).

Section 104.—Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.
(Also Section 61; 1.61-1.)

Damages for alienation of affections; custody of minor child. Amounts received as damages for alienation of affections or for the surrender of the custody of a minor child, whether under agreement of the parties or pursuant to judgment of the court, are excludable from gross income; Sol. Op. 132 superseded.

Rev. Rul. 74-77[1]

An individual taxpayer received certain amounts in settlement of his suit for damages on account of alienation of affections and in consideration for the surrender of the custody of his minor child. These items relate to personal or family rights, not property rights, and may be treated together. None of the amounts received constituted exemplary or punitive damages.

Held, amounts received by the taxpayer as damages for alienation of affections or for the surrender of the custody of his child, whether under agreement of the parties or pursuant to judgment of the court, are not income.

Sol. Op. 132, I-1 C.B. 92 (1922), is hereby superseded since the position stated therein is set forth under the current statute and regulations in this Revenue Ruling.

Section 105.—Amounts Received Under Accident and Health Plans

26 CFR 1.105-4: Wage continuation plans.

Sick pay; retroactive payment. A cash-method calendar-year Government employee who, in the year following his retirement on disability before reaching retirement age, received retroactively the disability annuity payments that he was entitled to but did not receive in the previous year may claim for the year of receipt any sick pay exclusion attributable to his absence from work in the previous year, in addition to his allowable sick pay exclusion for the year following his retirement, even though the combined exclusion exceeds the maximum sick pay exclusion allowable under section 105(d) of the Code for a single year of sickness or disability.

Rev. Rul. 74-65

Advice has been requested whether a taxpayer is entitled to exclude sick pay in excess of $5,220 from his gross income in a single year, under the circumstances described below.

The taxpayer, a United States Government employee who files his returns on a calendar year basis and uses the cash receipts and disbursements method of accounting, was stricken with a disabling disease that caused him to be absent from work beginning Friday, September 1, 1972. The taxpayer's work week was the usual 5-day week, Monday through Friday. He received his normal weekly rate of pay as sick pay for the 30-day period September 1 through September 30, when his accumulation of sick leave was exhausted and he retired on disability. His disability retirement was effective October 1, 1972, and he did not reach retirement age before 1974. He was entitled to receive monthly disability annuity payments of $450 on the first day of each month, beginning November 1, 1972. However, he did not receive any annuity payments until January 1973, when he received $1,350 ($450 for each of the two payment dates November 1 and December 1, 1972, and $450 for the payment date January 1, 1973). He continued to receive the disability annuity throughout 1973 and, under the provisions of section 105(d) of the Internal Revenue Code of 1954, was entitled to exclude these payments from his gross income to the extent of $100 per week. His exclusion for 1973 amounted to $5,220 since that particular year included 261 normal workdays.

In view of the language of section 105(d) of the Code that limits the sick pay exclusion to amounts not in excess of a weekly rate of $100, and since the taxpayer was entitled to exclude his regular disability annuity received in 1973 to the extent of $100 per week (or $5,220 for the year), the specific question is whether he is entitled to exclude, in addition to that amount, any part of the retroactive disability annuity payment of $900 (that is, $450 attributable to each of the payment dates of November 1, 1972, and December 1, 1972), that he received in 1973.

Section 451 of the Code provides, in part, that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 105(a) of the Code sets forth the general rule that, except as otherwise provided in section 105, amounts received by an employee through accident or health insurance for personal injuries or sickness are includible in gross income to the extent such amounts are attributable to contributions by the employer that were not includible in the gross income of the employee, or to the extent such amounts are paid by the employer.

Under the provisions of section 105(d) of the Code, wages or payments in lieu of wages received by an employee pursuant to a wage continuation plan for a period during which the employee is absent from work on account of personal injuries or sickness are excludable from gross income, subject to various limitations. One of the limitations provided by section 105(d) is that the exclusion does not apply to the extent that the amounts received exceed a weekly rate of $100.

Rev. Rul. 59-323, 1959-2 C.B. 41, holds that a taxpayer who reports his income on a calendar year basis and under the cash receipts and disbursements method of accounting is required to include in his gross income for the year of receipt the amounts referred to in section 105(a) of the Code unless such amounts may be excluded therefrom under some other provision of section 105. It further holds, in effect, that, to the extent provided in subsections (b), (c), and (d) of section 105, such amounts received in a specific calendar year should be excluded from the taxpayer's gross income for the year of receipt, even though attributable to absence from work in the previous year.

The fact that section 105(d) of the Code limits the sick pay exclusion by providing that it does not apply to the extent that the amounts received exceed a weekly rate of $100, does not necessarily impose an annual limit on the amount of sick pay that a taxpayer may exclude.

Therefore, under the provisions of section 105(d) of the Code, the taxpayer in the circumstances described is entitled to exclude from his gross income for 1973, in addition to the $5,220 exclusion attributable to the regular disability annuity payments received in 1973, $880 of the retroactive disability annuity payment made in 1973 attributable to his absence from work in 1972 (that is $100 per week for the eight weeks and four days in October and November 1972).

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26 CFR 1.105-4: Wage continuation plans.

Sick pay received for nonworking days. Payments received by a sick or injured employee for nonworking days under a plan which provides payments for each calendar day of his sickness or disability are not excludable from gross income under section 105(d) of the Code. Further, a nonworking holiday that occurs on a day which is not a regular working day should be considered a nonworking day for purposes of computing the sick pay exclusion. Rev. Rul. 63-219 modified.

Rev. Rul. 74-185

Advice has been requested whether the sick-pay exclusion provision of section 105(d) of the Internal Revenue Code of 1954 applies to payments received by a sick or injured employee in lieu of wages under the circumstances described below.

A taxpayer normally works five days per week, Monday through Friday, for a salary of $200, or $40 per working day. His employer provides a sick-pay plan for all of his employees by means of group insurance. Under the plan an employee who is absent from work because of accidental injury receives fifty percent of his normal daily wages for each calendar day, including nonworking days, of his disability due to the injury, with no waiting period required. An employee who is absent from work because of sickness also receives fifty percent of his normal daily wages for each calendar day of his sickness, but these payments begin only after a seven-day waiting period.

The taxpayer was hospitalized on Thursday, February 10, 1972, when he was injured in a traffic accident on his way home from work. He was released from the hospital the following day but continued to receive medication and treatment for his injuries while he was at home through Monday, February 14th. He returned to work on Tuesday, February 15th. Under his employer's sick-pay plan he received $80 for this period of absence; that is, $20 per day for Friday, Saturday, Sunday, and Monday, the four calendar days of his disability due to injury.

Section 105(a) of the Code provides that amounts received by an employee through accident or health insurance for personal injuries or sickness are includible in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of his employee, or (2) are paid by the employer.

An exception to this general rule is provided by section 105(d) of the Code which states, in part, that gross income does not include amounts referred to in section 105(a) if such amounts constitute wages or payments in lieu of wages received by an employee pursuant to the provisions of a wage continuation plan for a period during which the employee is absent

from work on account of personal injuries or sickness.

More specifically, section 105(d) of the Code provides that if the amounts attributable to the first 30 calendar days of such period are at a rate that does not exceed 75 percent of the regular weekly rate of wages of the employee, the exclusion does not apply (1) to such amounts to the extent they exceed a weekly rate of $75, and (2) to such amounts attributable to the first seven calendar days in such period unless the employee is hospitalized on account of personal injuries or sickness for at least one day during such period.

Section 1.105-4(a)(4) of the Income Tax Regulations provides as follows:

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

Rev. Rul. 63-219, 1963-2 C.B. 76, which modified Rev. Rul. 58-371, 1958-2 C.B. 39, provides an interpretation of section 1.105-4(a)(4) of the regulations in the case of payments attributable to a nonworking holiday occurring at some time (other than the first or last day) during a continuing period of sickness or injury which prevents the employee from working. In that Revenue Ruling the Service held that the sick-pay exclusion of section 105(d) of the Code is applicable to wages or payments in lieu of wages received for such a nonworking holiday.

A nonworking holiday is generally a day which is otherwise a normal working day, but for the fact that it is a day set aside by law or custom on which ordinary business is suspended to commemorate some event or honor some person. On the other hand, nonworking days such as Saturday or Sunday are usually not regular working days, but are more like vacation days.

Accordingly, amounts received by the taxpayer in the instant case for Saturday and Sunday are not excludable under section 105(d) of the Code. Instead, payments received by the taxpayer for these two days are includible in gross income under section 61(a).

However, the amounts received for Friday and Monday, the two days of the taxpayer's absence that were working days, are excludable to the extent provided by section 105(d) of the Code. More specifically, $15 per day is excludable under the facts of this case, which is an amount that does not exceed a weekly rate of $75.

Therefore, Rev. Rul. 63-219 is hereby modified to remove any implication that the exclusion from gross income provided by section 105(d) of the Code applies to payments attributable to nonworking days such as Saturday and Sunday during a continuing period of absence from work due to sickness or injury where, as in the instant case, the sick pay plan provides payment for each calendar day of disability or sickness, including such nonworking days.

Where a nonworking holiday, such as July 4, occurs on a Saturday, it should be considered a nonworking day because it is the particular day of the week (Saturday) and not the event being commemorated that primarily accounts for absence from work. Therefore, insofar as Rev. Rul. 63-219 implies that payments attributable to a nonworking holiday, which is co-existent with a nonworking day, occurring within a period of absence from work due to sickness or injury are excludable under section 105(d) of the Code, it is hereby further modified.

Section 108.—Income from Discharge of Indebtedness

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

Whether an election pursuant to section 108 of the Internal Revenue Code of 1954 requires recomputation of the investment credit to reflect a reduction in the basis of the property under section 1017. See Rev. Rul. 74-184, page 8.

Section 111.—Recovery of Bad Debts, Prior Taxes, and Delinquency Amounts

26 CFR 1.111-1: Recovery of certain items previously deducted or credited. (Also Section 61; 1.61-1.)

Recoveries; funds diverted by bank officers. Insurance proceeds received by a cash-method Federal savings and loan association from a bonding company in settlement of a claim for losses suffered from improper diversion of funds by corporate officers in prior years are not excludable from gross income under section 111 of the Code even though if received instead of diverted such funds would have been fully offset by deducting additions to the bad debt reserve.

Rev. Rul. 74-34

Advice has been requested whether, under the circumstances described below, insurance proceeds received by a corporation from a bonding company are excludable from gross income if received in settlement of a claim for losses suffered because the corporation's officers improperly diverted funds in prior taxable years.

The taxpayer is a Federal savings and loan association that computes its Federal income tax liability under the cash receipts and disbursements method of accounting and determines its deduction for bad debts under the reserve method. During the taxable years 1956 through 1961, certain officers of the taxpayer misappropriated funds by authorizing another corporation to collect and to retain for services rendered a portion of the taxpayer's origination fees and discounts on mortgages purchased. The taxpayer

did not receive and, thus, did not report any of the misappropriated funds as income. In 1971 the taxpayer received 100*x* dollars from a bonding company in settlement of the taxpayer's claim for losses suffered attributable to the diversion of funds by its officers.

If the diverted funds had been received by the taxpayer during the taxable years 1956 through 1961, the taxpayer would not have incurred any additional Federal income tax liability. The income would have been fully offset by deducting additions to the bad debts reserve under section 593 of the Internal Revenue Code of 1954.

Amendments made to section 593 of the Code by section 6 of the Revenue Act of 1962, Pub. L. 87-834, 1962-3 C.B. 111, 127, and section 432(a) of the Tax Reform Act of 1969, Pub. L. 91-172, 1969-3 C.B. 10, 87, have limited the deductible additions that can be made to the reserve for bad debts. As a consequence, the taxpayer cannot offset the insurance proceeds received in 1971 by an addition to its bad debts reserve.

The question is whether the insurance proceeds are excludable under section 111 of the Code from the taxpayer's gross income in the year received.

Except as otherwise provided, section 61 of the Code requires all items of income to be included in gross income from whatever source derived.

Section 111 of the Code and the regulations thereunder provide in effect that gross income does not include the recovery of items, including losses, previously deducted or credited for Federal income tax purposes to the extent that no reduction in tax resulted.

Under section 111 of the Code, an exclusion is allowed only if the amount recovered relates back to an item previously deducted or credited. In the instant case, no amount was ever deducted with respect to the embezzlement losses, nor could any such amount have been deducted at any time, as the losses represented income items that were never taken into income by the corporation. See *Alsop v. Commissioner,* 290 F.2d 726 (2d Cir. 1961).

Accordingly, it is held that section 111 of the Code has no applicability in this case and the insurance proceeds recovered by the taxpayer with respect to the funds diverted in prior taxable years are includible in full in the taxpayer's gross income under section 61 for the taxable year in which received.

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

Treatment of a condemnation award received in the year after a residence was destroyed by flood and a casualty loss deduction taken. See Rev. Rul. 74-206, page 198.

Section 117.—Scholarships and Fellowship Grants

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

Research grant; recipient not degree candidate. A research grant received by a recipient, not a candidate for a degree, from an exempt organization unrelated to his employer to enable him to travel, study, and consult with people in foreign countries concerning his chosen field of work was not compensation for employment services, did not benefit his employer or the grantor organization, and is excludable from the recipient's gross income under section 117(a)(1) of the Code.

Rev. Rul. 74-86

Advice has been requested whether a grant received by a taxpayer is excludable from his gross income under section 117(a) of the Internal Revenue Code of 1954, under the circumstances described below.

The taxpayer, who was not a candidate for a degree, was awarded a grant by an organization described in section 501(c)(3) of the Code, that is exempt from tax under section 501(a). His selection, by a committee appointed by the organization, was based on professional ability and leadership potential rather than on educational qualifications. The purpose of the grant was to enable the recipient to travel, study, and consult with people in foreign countries, thereby providing him with an opportunity to broaden his experience by exposure to techniques and problems in his chosen field and allowing him to make inquiries along whatever lines he believed to be most useful to him and to his work.

The grant is for three to six months of interviews, professional consultation, and field trips in foreign countries. It is intended to pay the cost of travel to, from, and in the host countries, plus a reasonable allowance for living expenses, but is not restricted to such purposes. As a condition to receiving the grant, the taxpayer was obligated to submit a report of his experience to the grantor within one month after his return to the United States. The taxpayer's proposed study had direct application to his work and responsibilities as an executive with a state youth authority. However, the taxpayer's employer and the grantor organization were unrelated and the employer had no right to select the grant recipient or to control his itinerary once he was selected. Furthermore, the purpose of the grant was not to benefit the taxpayer's employer. In addition, no money was furnished to the grantor organization by the employer in connection with the grant.

Upon receiving the grant, the taxpayer spent three months in foreign countries studying current mental health and correctional issues related to organizational and social change, the effectiveness of recent rehabilitation programs, and new ways of coping with crime and delinquency.

Section 117(a)(1) of the Code excludes from gross income any amount received as a scholarship at an educational institution or as a fellowship grant, including the value of contributed services and accommodations. Section 117(a)(2) excludes any amount received to cover expenses for travel, research, clerical help, or equipment, that are incident to such a scholarship or a fellowship grant, but only to the extent that the amount is so expended by the recipient. Section 1.117-1(b) of the Income Tax Regulations provides, in part, that to be excludable from the recipient's gross income under section 117(a)(2) amounts received to cover such specified expenses incidental to a scholarship or fellowship grant must be specifically designated to cover such expenses and so expended.

Section 117(b)(2) of the Code provides, in part, that the amount of a scholarship or fellowship grant that may be excluded from the gross income of an individual who is not a candidate for a degree is limited to $300 a month for a period (whether or not consecutive) not to exceed 36 months. This section further requires, in the case of a recipient who is not a candidate for a degree, that the grantor qualify under one of four designated classifications, including an organization described in section 501(c)(3) which is exempt from tax under section 501(a).

Whether an amount received by an individual is excludable from his gross income under section 117 of the Code depends upon the facts and circumstances under which the payment is made. The exclusion provision applies only to scholarship or fellowship grants. Section 1.117-3(a) and (c) of the regulations provides, in part, that a scholarship or fellowship grant is an amount paid or allowed to or on behalf of, an individual to aid him in pursuing studies or research.

Section 1.117-4(c) of the regulations provides, however, that any amount paid or allowed to or on behalf of an individual shall not be considered to be a scholarship or fellowship grant if the amount represents compensation for past, present, or future employment services, payment for services that are subject to the direction or supervision of the grantor, or payments to enable the recipient to pursue research or studies primarily for the benefit of the grantor.

The facts of the instant case indicate that the purpose of the grant to the taxpayer was to aid him in the pursuit of his studies or research, and was not paid to him as compensation for services or payment for services subject to the direction and supervision of the grantor, or payments to enable him to pursue studies or research primarily for the benefit of the grantor. Although the grantor required the taxpayer to submit a report at the end of his participation, the report was not a means of making the results of the taxpayer's research available to the grantor, but was a means of assisting the administration of the grant program. See Rev. Rul. 61-65, 1961-1 C.B. 17.

Accordingly, it is held that the amount received by the taxpayer is excludable from his gross income as a fellowship grant under section 117(a)(1) of the Code, subject to the limitations contained in section 117(b)(2).

While the grantor intended that the grant would offset the taxpayer's expenses of travel, including meals and lodging while traveling, neither the taxpayer's application nor the grant award specifically designated that any or all of the amount awarded was to be used for the purposes specified in section 117(a)(2) of the Code. Accordingly, none of the amount awarded is excludable under section 117(a)(2).

Compare Rev. Rul. 71-344, 1971-2 C.B. 94, which holds, under the facts in that case, that a supply allowance award was specifically designated to cover the taxpayer's expenses of travel, research, and equipment incidental to his fellowship.

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

Scholarships; pastoral trainees at State mental health institute. Amounts received by participants in a clinical pastoral education program conducted by a State mental health institute for seminary students and ordained clergy, who learn more effective mental health principles in ministry and any services they render to the institute are incidental to their training, are excludable from gross income as scholarships or fellowship grants to the extent provided in section 117(b)(2) of the Code; Rev. Rul. 70-648 distinguished.

Rev. Rul. 74-186

Advice has been requested whether amounts received by participants in a clinical pastoral education program are scholarships or fellowship grants within the meaning of section 117 of the Internal Revenue Code of 1954 under the circumstances described below.

The program is conducted by an institute that is a unit of the Division of Educational and Research Services in a State's Department of Mental Health. The institute is designated by State law to be maintained as a teaching hospital for the primary purpose of training mental health personnel and conducting psychiatric research. The institute controls the selection of pastoral trainees and their program of study.

The training program is divided into three levels: Basic Clinical Pastoral Education, Clinical Pastoral Residency, and Pastoral Supervisory Training. Participants in the Basic Clinical Pastoral Education category must have completed at least one year of theological education. For a three-month period they attend lectures and

seminars, participate as pastoral members in assigned wards, visit with newly admitted patients, and occasionally conduct Vespers and Sunday services. With the approval of the staff, participants may carry on sustained pastoral counseling with certain patients. Generally, the participants are seminary students who, after completing this training, return to their seminaries to complete the remainder of their theological curriculum.

For the Clinical Pastoral Residency, the participants, who have to be either seminary students or ordained clergy, attend a full year of clinical pastoral education. During this period they attend lectures and seminars and have sustained pastoral counseling with no more than two persons or families at any given time. The program is geared not only for the participants who desire to use this clinical experience for the parish ministry, but also for participants who intend to function in a distinctive area of the ministry, such as the institutional chaplaincy, pastoral counseling, or the teaching ministry.

The Pastoral Supervisory Training is designed to prepare participants for the teaching ministry. Participants are all ordained clergy who for a six-month period conduct individual pastoral counseling on a sustained and sophisticated level. In addition, they learn the theory and techniques of teaching and supervising students, supervise a trainee group's pastoral work and in turn are supervised by a fully certified Chaplain Supervisor.

Under the various levels of the program, approximately 50 percent of the time of all participants is devoted to lectures, seminars and individual supervisory sessions. The other 50 percent of their time is devoted to pastoral duties and patient relationships as a part of their learning more effectively mental health principles in ministry. Also, at all levels of the program they are under some degree of supervision by institute personnel.

The institute is operated on funds supplied by State appropriations and Federal grants and it is separate and apart from the state hospital, the function of which is to provide care and treatment of persons who are mentally ill. The admission of patients is under the control of the director of the institute and patients are selected to meet the needs of the teaching program. An average of 40 patients are admitted and discharged a month, staying for an average of 70 days. The institute is authorized to carry 260 staff members and 90 student positions.

There is a sufficient number of qualified staff personnel to adequately service the patients' counseling needs without assistance from the pastoral trainees. Also, if the program were discontinued the institute could discharge the full-time teaching staff used for the program and secure a part-time minister to meet the religious needs of the patients for approximately ten percent of the cost of the program. Regular staff members in the chaplaincy program receive a housing allotment that student participants do not receive. Usually the participants are involved in the program 40 hours per week and accrue sick and annual leave as do regular staff members. No degrees are awarded as a result of completing the program at any level and participants incur no obligation to work for the institute or any other agency after completing their training.

Section 61 of the Code provides that, unless otherwise excluded by law, gross income means all income from whatever source derived including, but not limited to, compensation for services.

Subject to certain qualifications and limitations, section 117(a) of the Code and section 1.117-1 of the Income Tax Regulations provide that gross income of an individual does not include any amount received as a scholarship at an educational institution or as a fellowship grant.

Whether an amount received by an individual is excludable from his gross income under section 117 of the Code depends upon the facts and circumstances under which the payment is made. The exclusion provision applies only to scholarships or fellowship grants. A scholarship or fellowship grant is an amount paid or allowed to an individual for the primary purpose of furthering the education and training of the recipient in his individual capacity.

Section 117(b)(2) of the Code limits the exclusion provided for by section 117(a), in the case of an individual who is not a candidate for a degree, to $300 per month for the number of months during which amounts are received under the grant, limited to a lifetime exclusion of 36 months, whether or not consecutive.

Section 1.117-4(c) of the regulations provides, in part, that any amount or amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research shall not be considered to be an amount received as a scholarship or fellowship grant if such amount represents compensation for past, present, or future employment services, if such amount represents payment for services which are subject to the direction or supervision of the grantor, or if such studies or research are primarily for the benefit of the grantor. Any of these conditions will negate the existence of a scholarship or fellowship grant as defined in these regulations.

In *Wroblewski v. Bingler,* 161 F. Supp. 901 (W.D. Pa. 1958), the court held that a taxpayer who was a resident in psychiatry at a psychiatric institute was not in receipt of compensation for services but was in receipt of an excludable fellowship. In that case, the court stated that although the services of the taxpayer may have supplemented those of employees of the institute, such services

were not of primary or material benefit to the institute within the meaning of section 1.117-4(c) of the regulations.

The facts in the instant case are substantially similar to those in the *Wroblewski* case and the amounts paid to the participants enable them to pursue studies which further their education in their individual capacity, and any services rendered by them to the institute are incidental to the training.

Accordingly, it is held that the amounts received by the participants under the clinical pastoral education program are excludable from their gross incomes under section 117 of the Code, but only to the extent such amounts do not exceed the limitations under section 117(b)(2).

The foregoing situation is distinguishable from that discussed in Rev. Rul. 70-648, 1970-2 C.B. 21, which holds that amounts paid by a hospital to ministerial interns and residents participating in a program that provides advanced training in pastoral care and offers spiritual ministry to hospital patients are not excludable scholarships or fellowship grants but represent compensation for services. Under the facts in that case it was held that the participants in applying their theological and pastoral knowledge as ministers, to the physical, emotional, and spiritual needs of hospital patients in the specific area to which the participants were assigned, substantially aided the hospital in treating its patients and therefore the stipends paid were for the performance of "employment services" by them within the meaning of section 1.117-4(c) of the regulations.

Rev. Rul. 70-648 distinguished.

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26 CFR 1.117-4: Exclusion of amounts received as a scholarship or fellowship grant. (Also Section 61; 1.61-2.)

Grant from National Endowment for the Humanities. Amounts received by a junior college professor, not a candidate for a degree, from the National Endowment for the Humanities for the purpose of studying the methods employed by a foreign university in teaching languages, under a grant reserving to the grantor a nonexclusive license to use and reproduce for government use any publishable matter arising out of the professor's activities, are not excludable from his income as a scholarship or fellowship grant.

Rev. Rul. 74-95

Advice has been requested whether, under the circumstances set forth below, amounts received under a grant are excludable from a taxpayer's gross income under section 117(a) of the Internal Revenue Code of 1954.

The taxpayer, who was not a candidate for a degree, was the recipient of a fellowship grant by the National Endowment for the Humanities, a governmental agency. The announced purpose of the grant program was to enable junior college professors, chosen on the basis of their ability as teachers and interpreters of the humanities, to increase their understanding of the subjects they teach and to improve their teaching ability. Each applicant was to specify his proposed area of study and to explain its contribution to his development as a teacher and interpreter of humanistic knowledge and to a better understanding of matters of current national concern, or of other matters of significance to humanistic knowledge and the quality of national life.

The taxpayer applied for, and was granted, funds to study the methods employed by a university outside the United States in the teaching of language. While the grant included an amount for travel expenses and research fees, the amount awarded was a lump sum, and no part was specifically designated for such expenses.

The grantor reserved a nonexclusive license to use and reproduce for government purposes, without payment, any publishable matter, including copyrighted matter, arising out of the taxpayer's activities.

Section 61 of the Code provides that, unless otherwise excluded by law, gross income means all income from whatever source derived including, but not limited to, compensation for services.

Subject to certain limitations and qualifications, section 117(a) of the Code provides that the gross income of an individual does not include any amount received as a scholarship at an educational institution or as a fellowship grant.

Whether an amount received by an individual is excludable from his gross income under section 117 of the Code depends upon the facts and circumstances under which the payment is made. The exclusion provision applies only to scholarships or fellowship grants. A scholarship or fellowship grant is an amount paid or allowed to an individual for the primary purpose of furthering the education and training of the recipient in his individual capacity.

Section 1.117-4(c) of the Income Tax Regulations provides, in part, that any amount or amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research shall not be considered to be an amount received as a scholarship or fellowship grant if such amount represents compensation for past, present, or future employment services, if such amount represents payment for services which are subject to the direction or supervision of the grantor or if such studies or research are primarily for the benefit of the grantor. Any of these conditions will negate the existence of a scholarship or fellowship grant as defined in these regulations.

The Supreme Court of the United States in the case of *Bingler v. Johnson,* 394 U.S. 741(1969), 1969-2 C.B. 17, upheld the validity of section

1.117-4(c) of the regulations, referred to above. In support of its view that under the provisions of those regulations, a stipend is not a scholarship or a fellowship within the meaning of section 117 of the Code if the grantor requires a *quid pro quo* from the recipient in the form of rendition of services for the grantor, the Court stated that, "The thrust of the provision dealing with compensation is that bargained-for payments, given only as a *quo* in return for the *quid* of services rendered—whether past, present, or future—should not be excludable from income as 'scholarship' funds."

The Tax Court of the United States in referring to the *Johnson* case stated that, "The regulations are thus designed, at least in part, to distinguish relatively disinterested payments made primarily for the purpose of furthering the education of the recipient from payments made primarily to reward or induce the recipient's performance of services for the benefit of the payor." *Jerry S. Turem*, 54 T.C. 1494 (1970).

Rev. Rul. 72-263, 1972-1 C.B. 40, holds that a stipend paid to a physician for postdoctoral research training at a medical school under a National Institutes of Health (NIH) grant is not excludable from gross income as a scholarship or fellowship. In Rev. Rul. 72-263 NIH reserved the rights to make royalty-free use of any copyrighted material produced as a result of the research and also reserved the patent rights to any invention arising from the research.

Based on the above it is concluded that the grant is made primarily for the benefit of the grantor because of the right retained by the grantor, in the form of a *nonexclusive* license, to any materials resulting from the recipient's research.

A further indication that the objectives of the grant program were not solely focused on the experience to be gained by the recipients is shown by the grantor's evaluation of each applicant's ability as an "interpreter of the humanities," and of the contribution to be made by the proposed area of study to "a better understanding of matters of current national concern, or of other matters of significance to humanistic knowledge and the quality of national life."

Accordingly, in the instant case, the amounts received by the taxpayer from the National Endowment for Humanities grant are not excludable from the taxpayer's gross income under the provisions of section 117(a) of the Code, but are includible in his gross income under section 61 as compensation for services.

Part IV.—Standard Deduction for Individuals

Section 142.—Individuals not Eligible for Standard Deduction

26 CFR 1.142-2: Standard deduction not allowable.

Whether the nondiscrimination clause of Paragraph 11 of the Protocol to the United States-Canada Income Tax Convention prevents the United States from denying a Canadian citizen who is both a resident and a nonresident of the United States during the taxable year the benefit of using the standard deduction. See Rev. Rul. 74-239, page 372.

Part V.—Deductions for Personal Exemptions

Section 152.—Dependent Defined

26 CFR 1.152-1: General definition of a dependent.

Treatment of adoption payments received by adoptive parents from the Maryland State Department of Social Services in determining who furnished the principal support of the adopted child for purposes of claiming the child's dependency exemption. See Rev. Rul. 74-153, page 20.

Part VI.—Itemized Deductions for Individuals and Corporations

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.
(Also Sections 263, 1012; 1.263(a)-1, 1.1012-1.)

Warehouse charges on whiskey in bond. An accrual method domestic wholesale liquor corporation that purchases whiskey warehouse certificates, taking title to whiskey in bonded warehouses, may not deduct as business expenses the accrued storage, moving, taxes, and other charges it must pay when it withdraws the whiskey but must add the warehouse charges to the basis of the whiskey withdrawn. If the certificates are sold, it may not consider such charges in computing its gain or loss. I.T. 3240 superseded.

Rev. Rul. 74-264 [1]

The taxpayer, a domestic corporation using the accrual method of accounting, is engaged in the wholesale liquor business. In the course of its business the taxpayer purchases whiskey warehouse certificates for whiskey stored in bonded warehouses. Title to the whiskey rests in the taxpayer as certificate holder. During the period that the whiskey is stored, often a period of years, charges for storage, moving, taxes, etc., accrue against the whiskey and are assessed against the certificates. The certificates are unregistered and the warehouses do not know the identity of the holders. As a matter of practice, such charges are not paid by certificate holders until the whiskey is withdrawn. In the instant case, the taxpayer sometimes withdraws the whiskey and pays the charges accrued against the certificates. In other instances, the taxpayer sells the certificates in which case the charges assessed against the certificates are not paid by the taxpayer as they will be paid by whomever is the holder of the certificates when the whiskey is withdrawn.

Held, when the taxpayer withdraws the whiskey from the storage warehouse and the charges assessed against the warehouse certificates are paid by the taxpayer they are added to the

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

basis of the whiskey. Such charges are not deductible as ordinary business expenses. See Rev. Rul. 70-356, 1970-2 C.B. 68 which holds similarly, in the case of an individual taxpayer, that payments for insurance and storage costs are not deductible under section 212 of the Internal Revenue Code of 1954, but must be capitalized under sections 263 and 1012.

Held further, when the taxpayer sells the whiskey warehouse certificates such charges that are not paid by or collectible from the taxpayer are not added to the basis of the certificates in computing the gain or loss on their sale, and are not deductible expenses of the taxpayer.

I.T. 3240, 1938-2 C.B. 140, is superseded, since the position set forth therein is restated under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.162-1: Business expenses.

Corporation's leasing arrangement with municipality. A leasing arrangement under which a municipality will issue bonds for the financing of equipment to be acquired by a manufacturing corporation and leased, for the term of the bonds plus one day, to the city which will sublease it to the corporation for the term of the bonds for subrentals sufficient to retire the bonds, is a financing arrangement entitling the corporation as owner of the equipment to the tax treatment contained in Rev. Rul. 68-590.

Rev. Rul. 74-290

The taxpayer, a domestic corporation engaged in a manufacturing business, entered into a leasing arrangement with a municipality. Under the arrangement the taxpayer will acquire equipment that will be installed in its plant and will lease such equipment to the city. The municipality will issue bonds which are not the general obligations of such municipality. The proceeds from the bonds will be paid to the taxpayer as a lump-sum rental payment under the lease. By reason of section 103(c) of the Internal Revenue Code of 1954 the interest on such bonds is not exempt under section 103(a). The lump sum rental payment is to equal the lesser of (a) the total amount of the proceeds of the bonds, or (b) the total cost of acquisition and installation of the equipment. If the proceeds are insufficient to cover the cost of the equipment, the taxpayer will be responsible for the difference. The lease term is for the term of the bonds plus one day.

The municipality and the taxpayer are to enter into a sublease agreement under which the municipality will sublease the equipment to the taxpayer for a term equal to the term of the bonds.

The rental is payable ratably over the term of the sublease and will be sufficient to pay principal and interest on the bonds, any bond premium, and any expenses related to the issuance of the bonds. Under the agreements the rental payments under the sublease are the sole source of payment for amounts due with respect to the bonds. Any excess proceeds received by the municipality on the sale of the bonds in excess of the cost of the equipment will be applied in reduction of the sublease payments.

On any termination of the sublease there will be an immediate termination of the lease (except for expiration of the sublease when the lease will terminate one day later). In addition, in the event of damage, destruction, or condemnation of the equipment, the proceeds from any insurance payment or condemnation award in excess of the total unpaid sublease rental payments, that is, principal and interest on the bonds, bond premium, and expenses of issuing the bonds will accrue to the benefit of the taxpayer.

Held, the transaction described above is a financing arrangement for Federal income tax purposes and the taxpayer is the owner of the equipment for Federal income tax purposes. Consequently, the taxpayer is permitted the tax treatment contained in Rev. Rul. 68-590, 1968-2 C.B. 66, such as any available deduction for interest, depreciation, ordinary and necessary business expenses, and investment credit.

For the proper treatment of bond related costs paid by the taxpayer, see Rev. Rul. 73-134, 1973-1 C.B. 60.

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26 CFR 1.162-1: Business expenses.

Deductibility of taxes imposed under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. See Rev. Rul. 74-70, page 116.

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26 CFR 1.162-1: Business expenses.

Deductibility of Federal Home Loan Mortgage Corporation's guarantee and management fees by certificate holders in mortgage participation pool. See Rev. Rul. 74-221, page 365.

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26 CFR 1.162-1: Business expenses.

Whether a taxpayer who was divested of his property in a bankruptcy proceeding sustained a deductible expense under the provisions of section 162 of the Code. See Rev. Rul. 74-240, page 52.

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26 CFR 1.162-2: Traveling expenses.
(Also Section 274; 1.274-5.)

Rev. Rul. 74-208

A public official incurred unreimbursed traveling expenses in connection with the receipt of an award, which had no intrinsic value, from a nongovernmental organization for the performance of his official duties as an employee of the United States Government.

Held, since the expenses in question arose out of the performance of his duties as a public official and both benefit and advance the interests of his trade or business, such expenses are deductible as ordinary and necessary business expenses under section

162(a) of the Internal Revenue Code of 1954, provided the substantiation requirements of section 274(d) of the Code are met.

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26 CFR 1.162-2: Traveling expenses. (Also Section 262; 1.262-1.)

Travel expenses; temporary or intermittent services for Federal Government. An individual who renders temporary or intermittent services to the Government for a nominal sum while engaged in private employment, receiving a per diem allowance that must be included in income, may deduct his travel expenses including meals and lodging provided the sleep and rest rule is met and he can substantiate the amount, time, and business purpose for each expense. However, if his private employment has been severed or the duration of his services at a particular location will exceed a period that can reasonably be considered temporary, no deduction will be allowed. G.C.M. 23672 superseded.

Rev. Rul. 74-291[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the positions set forth in G.C.M. 23672, 1943 C.B. 66.

The question presented is whether individuals who render services to the Federal Government for nominal amounts may deduct as business expenses their traveling expenses, including the cost of meals and lodging.

Under various circumstances, the Federal Government seeks the advice or services of individuals and asks them to make trips to Washington or elsewhere for this purpose. While these individuals are away from their permanent homes or regular places of business on Government assignments, the Government may pay them specific per diem amounts which are compensatory and includible in their gross incomes under section 61 of the Internal Revenue Code of 1954. The total payments received by such individuals are always at least sufficient to cover the business expenses they incur in connection with the services rendered.

Under section 162(a)(2) of the Code a taxpayer may deduct all the ordinary and necessary traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) incurred while away from home in the pursuit of a trade of business. On the other hand, section 262 specifies that, with certain exceptions not relevant here, no deduction shall be allowed for personal, living, or family expenses.

A taxpayer is considered to be "away from home" for purposes of a deduction for meals and lodging under section 162(a)(2) of the Code when travel requires him to be away long enough for him to need and to get substantial sleep or rest to meet the demands of his trade or business. *United States v. Correll,* 389 U.S. 299 (1967), 1968-1 C.B. 64.

Generally, a taxpayer's home for purposes of the statute is considered to be located at his regular or principal place of business or employment, regardless of where he maintains his place of abode. Rev. Rul. 73-529, 1973-2 C.B. 37, and Rev. Rul. 60-189, 1960-1 C.B. 60.

If an individual continues in private employment at his original place of business and renders only intermittent services to the Federal Government, his "home" for Federal income tax purposes continues to be his regular place of business, and any traveling expenses incurred in serving the Government while away from such "home," including the cost of meals and lodging if the substantial sleep or rest rule is met, will be deductible as business expenses. For example, if an individual engaged in business in New York City is called upon to make overnight or longer trips to Washington, D.C. to consult with and give advice to representatives of any governmental agency, the ordinary and necessary expenses incurred in traveling between New York and Washington, including the cost of meals and lodging while in Washington, will be treated as deductible business expenses. This is also true if his stays in the latter city are of extended duration, provided that New York remains his principal place of employment during the tax year. Rev. Rul. 60-189, and Rev. Rul. 54-497, 1954-2 C.B. 75.

The same Federal income tax treatment is accorded such expenses in cases where the services rendered to the Government are substantially continuous, provided the individuals have not severed their connections with the private organizations by which they have been employed and the Government service is temporary in nature. Employment is temporary for this purpose only if its termination can be foreseen within a reasonably short period of time. In general, employment at a given location is treated as temporary if both its actual and anticipated duration is less than one year. However, an employment or stay of an anticipated or actual duration of a year or more at a particular location is viewed as strongly tending to indicate presence there beyond a temporary period. Rev. Rul. 63-64, 1963-1 C.B. 30, and Rev. Rul. 60-189. For example, if the nature of the services rendered to the Government requires that the individual remain in Washington the greater part of the time during an anticipated and actual period of ten months, it will be considered that Washington is not his "home" and that the expenses of traveling between New York and Washington, including the necessary cost of his meals and lodging while in Washington, D.C., will be treated as

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

deductible business expenses.

If, however, an individual serving the Government has severed his connection with the private organization which he previously served, or if he maintains such connection but his employment with the Government is of indefinite rather than temporary duration, it will be considered that his business location, post, or station and, therefore, his "home" is in Washington, or at such other location where he may be assigned, with the result that amounts expended for meals and lodging at such location are not deductible by him in computing his income.

In some cases individuals serving Federal agencies render the services outside the United States. In general, what has been said above concerning an employee's home is equally applicable in the case of such employees. Thus, if an employee's assignment outside the United States is solely for the purpose of doing a certain job and is of a temporary nature, his traveling expenses, including the cost of meals and lodging, will be considered as having been incurred while away from "home" and will be treated as deductible business expenses. For example, if an individual serving a Federal agency on a per diem basis is directed to proceed to a foreign area for a specific duty in that area for a temporary period, his "home" will continue to be within the United States and the ordinary and necessary traveling expenses, including the cost of meals and lodging while away from home, will be treated as deductible business expenses.

Unless the taxpayer can properly substantiate his travel expenses, including the amount, time, and business purposes for each expense, no deduction is allowable under section 162 of the Code.

G.C.M. 23672 is hereby superseded, since the positions stated therein are set forth under the current law in this Revenue Ruling.

26 CFR 1.162-2: Traveling expenses.
(Also Section 262; 1.262-1.)

Travel expenses; doctor attending professional seminars abroad. Travel expenses incurred by a doctor on a trip which combined vacation travel abroad with attendance at brief professional seminars in each of the countries visited are not deductible business expenses under section 162 of the Code but are non-deductible personal expenses under section 262.

Rev. Rul. 74-292

Advice has been requested concerning the Federal income tax treatment of expenditures by an individual taxpayer for a trip to two distant countries under the circumstances described below.

A taxpayer, engaged in the active practice of medicine in the State in which he lives, is a member of a professional association. During the taxable year, the association sponsored a 14-day trip to two distant foreign countries and the arrangements for the trip were handled by a travel agency.

The object and design of the trip was to combine travel to certain cities in each of the two countries with three professional seminars in each country. Each seminar was to be of two hours duration and was to be held in a different city. Three seminars were held in each country at the hotels where the taxpayer stayed and he signed attendance sheets at all of them. He also made an optional side trip to a well-known tourist attraction in each of the countries visited. At the conclusion of the trip he received a Certificate of Continuing Education in Medicine.

The taxpayer paid to the travel agency the cost of air fare, hotel accommodations, meals, a special escort, transportation to and from hotels, and tips. No part of the cost was attributable to the seminars, which were arranged for him by the sponsoring professional association.

Section 162(a) of the Internal Revenue Code of 1954 provides for the deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including traveling expenses (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business. Section 262 provides, with exceptions not here material, that no deduction shall be allowed for personal, living, or family expenses.

Section 1.162-2(a) of the Income Tax Regulations provides, in part, that only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel, are business expenses.

Under section 1.162-2(b)(1) of the regulations, if a taxpayer travels to a destination and while at such destination engages in both business and personal activities, traveling expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, the traveling expenses to and from the destination are not deductible even though the taxpayer engages in business activities while at such destination. However, expenses while at the destination which are properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible.

Section 1.162-2(b)(2) of the regulations provides, in part, that whether a trip is related primarily to the taxpayer's trade or business or is pri-

marily personal in nature depends upon the facts and circumstances in each case. The amount of time during the period of the trip which is spent on personal activities compared to the amount of time spent on activities directly relating to the taxpayer's trade or business is an important factor in determining whether the trip is primarily personal.

In *Esfandiar Kadivar*, 32 CCH Tax Ct. Mem. 427 (1973), a doctor took a trip to several foreign countries. The trip was arranged by a medical association and travel arrangements were handled by a travel agency. The object and design of the trip was to combine travel to faraway cities with five medical seminars (each of one hour's duration) to be held at tourist hotels. No part of the cost of the trip was allocated by the travel agency to the seminars. The taxpayer attended all five seminars. The United States Tax Court stated that the trip was primarily for pleasure and the fact that a few hours were spent at brief medical seminars did not convert what was in all other respects a vacation into a business trip. The Court therefore held that since the cost of the trip was not incurred in any activity related to the taxpayer's trade or business no portion of such cost was deductible.

In the instant case the facts show that (1) the six two-hour professional seminars did not convert what was in all respects a vacation into a business trip; (2) the expenses incurred for travel were not related primarily to the taxpayer's trade or business; and (3) no other expenses were incurred that were directly attributable to the conduct of the taxpayer's trade or business. The participation in some incidental activity by the taxpayer related to his trade or business will not change what otherwise was a vacation trip into a business trip.

Accordingly, the taxpayer's entire cost of the trip under the facts presented is not an ordinary and necessary business expense under section 162 of the Code, but rather is a nondeductible personal or living expense under section 262.

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26 CFR 1.162-2: Traveling expenses.

Whether moving expenses are deductible when the taxpayer also claims travel expenses that qualify as ordinary and necessary expenses incurred while away from home in the pursuit of a trade or business. See Rev. Rul. 74-242, page 69.

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26 CFR 1.162-5: Expenses for education.

Educational expenses; dentist; postgraduate orthodontic study. Expenditures incurred in taking postgraduate studies in orthodontics by a dentist engaged in general practice who returned to dental school on a full-time basis while continuing his practice on a part-time basis and, after completing his training, limited his practice to orthodontic patients are deductible under section 162 of the Code.

Rev. Rul. 74-78

Advice has been requested whether, under the circumstances described below, expenditures incurred by a dentist in taking postgraduate studies in orthodontics are deductible for Federal income tax purposes.

The taxpayer, a dentist engaged in general dental practice, returned to dental school for postgraduate study in orthodontics. He attended dental school on a full-time basis continuing his dental practice on a part-time basis. Upon completion of his postgraduate training he became an orthodontist and limited his practice to orthodontic patients.

Section 162 of the Internal Revenue Code of 1954 provides for the deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-5 of the Income Tax Regulations provides, in part, that expenditures made by a taxpayer for his education may be deductible as ordinary and necessary business expenses even though the education may lead to a degree if the education (1) maintains or improves skills required by the taxpayer in his employment or other trade or business, or (2) meets the express requirements of the taxpayer's employer, or the requirements of applicable law or regulations imposed as a condition to the retention of an established employment relationship, status, or rate of compensation. Expenses incurred for education which fall within either of the foregoing tests are deductible provided the education is not part of a program of study being pursued by the taxpayer leading to his qualification in a new trade or business or is not required of him in order to meet the minimum educational requirements for qualification in his employment or other trade or business.

As an example of a change in duty that is not a new trade or business, section 1.162-5(3)(ii), Example (4), of the regulations provides, "C, while engaged in the private practice of psychiatry, undertakes a program of study and training at an accredited psychoanalytic institute which will lead to qualifying him to practice psychoanalysis. C's expenditures for such study and training are deductible because the study and training maintains or improves skills required by him in his trade or business and does not qualify him for a new trade or business."

In the instant case the expenditures by the taxpayer for postgraduate studies in orthodontics were not incurred in connection with qualifying him for a new trade or business but were expenditures in connection with improving his skills as a dentist. Accordingly, such expenditures are deductible as ordinary and necessary expenditures under section 162 of the Code.

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

26 CFR 1.162-7: Compensation for personal services.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

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26 CFR 1.162-10: Certain employee benefits.
(Also Section 170; 1.170-3.)

Employer's contributions; union educational and cultural trust. A statement in an exemption ruling that contributions to a tax-exempt union educational and cultural trust are deductible by the donors under section 170 of the Code does not preclude the deduction under section 162 of payments made to the trust by an employer as a result of a collective bargaining agreement if the payments otherwise qualify as business expenses.

Rev. Rul. 74-51

Advice has been requested whether amounts paid by an employer to a union educational and cultural trust fund are deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code of 1954 instead of as charitable contributions under section 170.

The employer corporation and a union local entered into a collective bargaining agreement embodying the following provision:

> All Employers shall remit weekly an amount equal to one percent (1%) of their gross weekly production payroll covering all Employees under this Agreement to a Trust Fund to be established for educational, cultural, and charitable purposes.

The trust agreement of the fund provides, generally, that the fund is to include all money, securities, and other property transferred to it by the employers or others and is to be operated exclusively for the benefit of educational, cultural, and charitable uses and purposes selected by the trustees. The trustees, without limiting that discretion, will endeavor to develop educational, cultural and charitable programs for the benefit of individuals working or desiring to work in that industry. No part of the fund is to be distributed to a contributor, or an official of the contributor, or a trustee, and, in the event of termination of the fund, all monies are to be distributed for the specified purposes. The trust is irrevocable although it may be amended to the extent necessary to continue its present exemption under the Internal Revenue Code, and to facilitate administration of the fund.

The trust fund is exempt under section 501(a) of the Code from Federal income taxes as an organization described in section 501(c)(3). See Rev. Rul. 72-101, 1972-1 C.B. 144. The following statement was contained in the exemption ruling issued by the Internal Revenue Service: "Contributions made to the trust are deductible by donors as provided in section 170 of the Code."

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

> (a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *
>
> * * * * *
>
> (b) CHARITABLE CONTRIBUTIONS AND GIFTS EXCEPTED.—No deduction shall be allowed under subsection (a) for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section.

Section 1.162-10 of the Income Tax Regulations, referring to "certain employee benefits," provides, in part, that amounts paid or accrued within the taxable year for a welfare or similar benefit plan are deductible under section 162(a) of the Code if they are ordinary and necessary expenses of the trade or business.

Section 1.162-15 of the regulations provides, in part, that no deduction is allowable under section 162(a) of the Code for a contribution or gift by an individual or a corporation if any part thereof is deductible under section 170. However, this limitation applies only to payments which are in fact contributions or gifts within the meaning of section 170.

The question presented is whether the statement in the exemption ruling, "Contributions made to the trust are deductible by donors as provided in section 170 of the Code," precludes deductibility by the taxpayer under section 162(a) of the amounts required by the bargaining agreement to be contributed to the trust fund.

The statement in the exemption ruling is directed only to those payments qualifying as charitable contributions. It does not apply in the case of payments which are ordinary and necessary trade or business expenses within the meaning of section 162(a) of the Code.

The Internal Revenue Service considered an analogous situation in Rev. Rul. 58-238, 1958-1 C.B. 90, which concerned payments made by an employer to a "joint apprenticeship and training trust fund," established in accordance with the provisions of a collective bargaining agreement between the employer and a union. The fund was used to defray the cost of daytime schooling of apprentices and the employment of a full-time training director. It was noted that an expense of this nature relates to the regular conduct of the employer's business, the consideration for which is intended to produce benefits flowing directly to the employer in the form of more efficient and skilled employees. Furthermore, it is stated that the employer is subject to a legally binding and enforceable agreement to pay fixed and determinable amounts into the trust. That Revenue Ruling held that the payments referred to therein were ordinary and necessary business expenses.

Consistent with the foregoing, since the trustees endeavor to develop educational, cultural and charitable programs for the benefit of individuals

working or desiring to work in that industry, and since the payments were made by the employer with a reasonable expectation of direct economic benefit, commensurate with the amount of the transfer, it is concluded that the payments made by the employer to the union trust fund as required by the collective bargaining agreement were not contributions within the meaning of section 170 of the Code but are ordinary and necessary business expenses, deductible under section 162(a).

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26 CFR 1.162-10: Certain employee benefits.

Employer's lump-sum payment to Workmen's Compensation Insurance Fund. An employer's lump-sum payment covering past employment loss obligations required by a State to permit the employer to withdraw from the Workmen's Compensation Insurance Fund and become self-insured is a deductible business expense in the year paid.

Rev. Rul. 74-139

Advice has been requested whether the taxpayer may deduct as an ordinary and necessary business expense, in the year paid, a lump-sum payment made by it to State *S* in order to withdraw from *S*'s Workmen's Compensation Insurance Fund and become self-insured.

All employees of the taxpayer, a domestic corporation, are covered by the Workmen's Compensation Insurance Fund of *S*. The taxpayer pays *S* a premium each year for Workmen's Compensation. This premium is used to pay compensation, medical costs, and other miscellaneous benefits to the taxpayer's employees or families of employees who have been injured or killed while engaged in their employment.

Because of anticipated increases by *S* in its Workmen's Compensation Insurance premiums, the taxpayer has decided to become self-insured. In order for the taxpayer to withdraw from the workmen's compensation plan and become self-insured, the taxpayer's liability to the Industrial Commission of *S* for losses incurred and losses which may be incurred for past employment must be determined.

Final approval by the Commission of the taxpayer's adoption of a self-insurance plan is contingent upon the taxpayer's payment of the settlement amount to the Bureau of Workmen's Compensation. Once paid, no portion of the settlement amount will revert to the taxpayer.

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

Section 1.162-10(a) of the Income Tax Regulations states, in part, that amounts paid within the taxable year for sickness, accident, hospitalization, medical expense, welfare or similar benefit plan, are deductible under section 162(a) of the Code if they are ordinary and necessary expenses of the business.

Rev. Rul. 70-577, 1970-2 C.B. 36, and Rev. Rul. 71-246, 1971-1 C.B. 54, hold that taxpayers who made voluntary lump-sum payments into certain State Unemployment Reserve Funds during the taxable year for the purpose of reducing their present liability or reducing their liability for future years, can deduct such payments as ordinary and necessary business expenses in the year paid regardless of whether their books are kept on the cash or accrual method of accounting.

Accordingly, it is held that the taxpayer may deduct as an ordinary and necessary business expense, in the year paid, the lump-sum payment made by it to State *S* in order to withdraw from the Workmen's Compensation Insurance Fund.

26 CFR 1.162-11: Rentals.

Rent paid; husband's business use of joint property. Rent paid by a husband to his wife for the use of their jointly-owned Wisconsin real estate that the husband used in his business is deductible as a business expense on the husband's separate income tax return; I.T. 3901 superseded.

Rev. Rul. 74-209[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 3901, 1948-1 C.B. 30.

A husband and wife, each using the cash receipts and disbursements method of accounting, held Wisconsin real estate as joint tenants, and the husband used the property in his business. As payment for the use of his wife's share of the property, the husband paid to her one-half of the fair rental value of the property. The husband and wife reported their income from the property in separate Federal income tax returns, and the question raised is whether the husband is entitled to deduct as a business expense on his return the rent paid to his wife.

On the basis of the provisions of sections 234.21, 246.01 and 246.03 of the current Wisconsin Statutes, a husband and wife holding Wisconsin real estate as joint tenants may each report one-half of the net income from such property for Federal income tax purposes.

Sections 234.21, 246.01 and 246.03 of the current Wisconsin Statutes provide as follows:

234.21. *Actions Between Cotenants.* —One joint tenant or tenant in common and his executors or administrators may maintain an action for money had and received against his cotenant for receiving more than his

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[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1, C.B. 576.

just proportion of the rents or profits of the estate owned by them as joint tenants or tenants in common.

246.01. *Realty of.*—The real estate of every description, including all held in joint tenancy with her husband, and the rents, issues and profits thereof of any female now married shall not just be subject to the disposal of her husband, but shall be her sole and separate property as if she were unmarried.

246.03. *May Receive, Hold and Convey Property.*—Any married female may receive by inheritance or by gift, grant, devise or bequest from any person, hold to her sole and separate use, convey and devise real and personal property and any interest or estate therein of any description, including all held in joint tenancy with her husband, and the rents, issues and profits thereof in the same manner and with like effect as if she were unmarried, and the same shall not be subject to the disposal of her husband nor be liable for his debts. Any conveyance, transfer or lien executed by either husband or wife to or in favor of the other shall be valid to the same extent as between other persons.

On the basis of the above quoted provisions of law, there is a definite obligation on the part of the taxpayer to pay to his wife one-half of the fair rental value of the real estate held by them as joint tenants which is used by him in his business. To deny the taxpayer the right to deduct fair rent paid to his wife would, in effect, disregard the wife's right of participation in possession and use of the property, and would conflict with the long standing position of the Service that income from property held in joint tenancy is taxable to the tenants in proportion to their respective interests in the property.

Accordingly, in the instant case, the husband is entitled to deduct as a business expense in his separately filed income tax return the rent he paid to his wife for his use of the Wisconsin real estate owned by them as joint tenants.

I.T. 3901 is hereby superseded since the position stated therein is set forth under the current law in this Revenue Ruling.

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26 CFR 1.162-11: Rentals.

Whether taxes paid by tenant for a landlord on business property are additional rent and deductible by tenant. See Rev. Rul. 74-244, page 118.

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26 CFR 1.162-20: Expenditures attributable to lobbying, political campaigns, attempts to influence legislation, etc., and certain advertising.

Whether expenses incurred for fund-raising activities carried on by an organization to influence the nomination and election of an individual to public office are deductible pursuant to section 162 of the Internal Revenue Code of 1954. See Rev. Rul. 74-21, page 14.

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26 CFR 1.162-20: Expenditures attributable to lobbying, political campaigns, attempts to influence legislation, etc., and certain advertising.

Whether political campaign funds expended by a candidate for radio and television announcements and billboard advertising are deductible. See Rev. Rul. 74-23, page 17.

Section 163.—Interest

26 CFR 1.163-1: Interest deduction in general.
(Also Sections 446, 461; 1.446-1, 1.461-1.)

Accrued interest on convertible debentures. An accrual-method corporation that issued convertible debentures providing that no interest will be paid from the last interest payment date preceding the date of conversion, and whose taxable year ends between debenture interest payment dates, may not accrue and deduct at the end of its taxable year the interest attributable to the period from the most recent interest payment date; I.T. 2884 revoked and Rev. Rul. 68-170 clarified.

Rev. Rul. 74-127

Advice has been requested whether interest on convertible debentures since the most recent payment date may be accrued and deducted by the obligor corporation at the end of its taxable year.

The taxpayer, a domestic corporation, issued 20-year debenture bonds that were convertible into its own capital stock. Interest was payable on April 1 and October 1 of each year. The debentures provide that upon conversion of the debenture between interest payment dates, no interest will be payable for such period. The taxpayer computes its income under an accrual method of accounting and on the fiscal year ending August 31.

Section 1.461-1(a)(2) of the Income Tax Regulations provides that under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred that determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

Rev. Rul. 68-170, 1968-1 C.B. 71, holds that when a bondholder converted his bonds into stock prior to an interest payment date, no deduction for interest is allowed to the issuer for the period from the prior interest payment date to the date of the conversion since no interest ever became due or accruable for that period.

I.T. 2884, XIV-1 C.B. 151, holds that when gold notes of a corporation were converted to preferred stock of that corporation in January 1934, the unpaid interest from August 1, 1933, to December 31, 1933, was properly treated as an accrued liability deductible in the Federal income tax return for 1933. Under I.T. 2884 interest on the notes was payable semi-annually on the first day of February and August at a rate of 10 percent. Upon the exchange of notes for preferred stock in January 1934, payment of the accrued interest was not made and the

liability therefor was cancelled. The amount of interest accrued in 1933 and claimed as a deduction for the year 1933 constituted taxable income in the taxable year 1934.

In the instant case all of the events had not occurred by August 31 that under section 1.461-1(a)(2) of the regulations allow the taxpayer to deduct the interest on the convertible bonds. That is, between August 31 and the following September 30 of each year, there exists the possibility of all debenture holders converting their debentures into the taxpayer's capital stock thus eliminating all liability of the taxpayer to pay interest on the debentures for the April-September 30 interest period. It is irrelevant for the purpose of the "all events test" of section 1.461-1(a)(2) that it is unlikely that all debenture holders will convert during that period. See *Helvering v. Brown,* 291 U.S. 193 (1934), XIII-1 C.B. 223 (1934).

Accordingly, it is held that interest on convertible debentures attributable to the period since the most recent payment date may not be accrued and deducted by the obligor corporation at the end of its taxable year, for Federal income tax purposes. Rev. Rul. 68-170 is hereby clarified to illustrate the treatment of the deductibility of interest on debentures that have not been converted during the interest payment period.

I.T. 2884 is hereby revoked since the position set forth therein is contrary to the provisions of section 1.461-1(a)(2) of the regulations. All of the events had not occurred at December 31, 1933, to determine the fact of liability for interest on the gold notes issued by the corporation.

Any change from a taxpayer's present method of accounting for the deduction of interest on convertible debentures accruing between payment dates to the correct method as set forth in this Revenue Ruling is a change in a method of accounting to which sections 446 and 481 of the Code and the regulations thereunder apply.

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26 CFR 1.163-1: Interest deduction in general.

Interest paid; late-payment charge by a public utility. A late-payment charge assessed by a public utility, no part of which is for a specific service performed in connection with the customer's account, is deductible as interest.

Rev. Rul. 74-187

Advice has been requested whether a late-payment charge assessed by a public utility is deductible as interest under section 163 of the Internal Revenue Code of 1954.

A public utility charges for its service at rates set by a State agency. In addition to the standard rates based on the amount of service used, the utility charges an additional five percent if a bill is paid more than 20 days after the due date.

Section 163(a) of the Code provides that there shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

For income tax purposes, interest has been defined by the Supreme Court of the United States as the amount one has contracted to pay for the use of borrowed money and as the compensation paid for the use or forbearance of money. See *Old Colony Railroad Co. v. Commissioner,* 284 U.S. 552 (1932), XI-1 C.B. 274 (1932), and *Deputy v. Dupont,* 308 U.S. 488 (1940), 1940-1 C.B. 118. The United States Board of Tax Appeals has stated that interest is the compensation allowed by law or fixed by the parties for the use, forbearance, or detention of money. *Fall River Electric Light Co.,* 23 B.T.A. 168 (1931).

It is not necessary for the parties to a transaction to label a payment made for the use of money as interest for it to be so treated. The facts of the transaction control its character, not the terminology. Rev. Rul. 72-315, 1972-1 C.B. 49.

The fact that the late-payment charge is a one-time charge does not preclude a finding that it is interest. See Rev. Rul. 69-188, 1969-1 C.B. 54, which holds that a "loan processing fee" (points) paid by a mortgagor-borrower as compensation to a lender solely for the use or forbearance of money is considered to be interest. Nor does the effective rate of the late-payment charge preclude a finding that it is interest. See Rev. Rul. 72-2, 1972-1 C.B. 19, and *Kena, Inc.,* 44 B.T.A. 217 (1941).

Rev. Rul. 72-315, which concerns the deductibility of finance charges paid on a revolving charge account, states that a charge that is not paid for the use or forbearance of money but is paid to compensate the lender for the cost of specific services performed in connection with the borrower's account does not qualify as interest but is a service charge. That Revenue Ruling holds, however, that the amount charged to a customer's revolving charge account in that case is solely for the privilege of deferring payment and is deductible as interest.

Accordingly, it is held that, in the absence of evidence that the late-payment charge assessed by the public utility is for a specific service performed in connection with a customer's account, such late-payment charge is deductible as interest under section 163 of the Code.

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26 CFR 1.163-3: Deduction for discount on bonds issued on or before May 27, 1969. (Also Section 249; 1.249-1).

Premiums paid on call of convertible debt obligations. Reasonable amounts paid by a corporation on the call of its convertible debt obligations in excess of the normal premium may be deducted as business expenses if the call was made, or a binding obligation to repurchase at a specified call premium was entered into, before

April 23, 1969; Rev. Ruls. 67-409 and 69-243 revoked.

Rev. Rul. 74-210

The Internal Revenue Service has reconsidered its position with respect to the deductibility of premiums paid by a taxpayer on the repurchase of its callable convertible notes in excess of the amounts which it was legally obligated to pay upon the call of such notes.

In Rev. Rul. 67-409, 1967-2 C.B. 62, the Service announced that it would not follow the decision of the Seventh Circuit Court of Appeals in *Roberts & Porter, Inc. v. Commissioner,* 307 F.2d 745 (7th Cir. 1962). In *Roberts & Porter, Inc.,* the court held that the premiums paid by the taxpayer on the purchase of its callable convertible notes in excess of the amounts which it was legally obligated to pay upon calling the notes constituted ordinary and necessary business expenses within the meaning of section 162 of the Internal Revenue Code of 1954, and section 1.61-12 of the Income Tax Regulations prior to its amendment by T.D. 6984, 1969-1 C.B. 38. The Service had argued in that case that such excess amounts were not deductible. The reason for the redemption was to keep the notes from being converted into stock with the possible sale of the stock to outsiders. The price was equivalent to the value of the stock into which the notes could be converted.

In Rev. Rul. 69-243, 1969-1 C.B. 56, the Service reiterated the position taken in Rev. Rul. 67-409, and held, under section 1.163-3 of the regulations as added by T.D. 6984, above, that a corporation which entered into an agreement to repurchase its callable convertible debentures at a specified price may not, upon repurchase of such bonds or debentures at a greater price, deduct any amount paid in excess of the call premium specified in each bond or debenture. Thus, under these Revenue Rulings a deduction for premiums paid by a corporation on the redemption or repurchase of its own bonds or similar evidence of indebtedness is limited to an amount which relates to the cost of borrowing money. Therefore, amounts paid in excess of such costs were regarded as being nondeductible expenditures.

However, in *Head Ski Co. v. United States,* 323 F. Supp. 1383 (D. Md. 1971), *aff'd per curiam,* 454 F.2d 732 (4th Cir. 1972), and *Southwest Grease & Oil v. United States,* 308 F. Supp. 107 (D. Kan. 1969), *aff'd per curiam,* 435 F.2d 675 (10th Cir. 1971), the courts rejected the rationale of Rev. Rul. 67-409 and Rev. Rul. 69-243, and held, following the *Roberts & Porter, Inc.* decision, that taxpayers could deduct the excess costs of repurchasing callable convertible evidences of indebtedness as ordinary and necessary business expenses. In all of these decisions the price paid was geared to the value of the stock into which the evidences of indebtedness could be converted.

In *Head Ski Co.,* the convertible note was sold in 1963. The note required that *Head Ski Co.* pay interest quarterly, allowed no prepayment until April 30, 1968, and required the entire principal to be paid by May 1, 1973. In 1964, prior to any prepayment date, management decided that it was in the best interest of the company to pay off the convertible note. The price paid was an amount between the then bid price and the asking price of the shares of stock into which the note could be converted.

In *Southwest Grease & Oil Co.,* the corporation issued convertible debentures on February 15, 1958, due February 15, 1973. After February 15, 1960, they were subject to redemption, upon 30 days notice. However, if called for redemption, the securities could be converted to stock up to the actual date of redemption. Since the corporation had no stock registered with the SEC to honor the conversion privilege and, upon consideration of the costs involved in such registration, and other factors, the corporation, in 1961, determined to redeem the debentures. The amount paid upon redemption was equal to the then value of the stock into which the debentures could be converted.

In view of these decisions, the Service will no longer adhere to the position set forth in Rev. Rul. 67-409 and Rev. Rul. 69-243.

Section 414 of the Tax Reform Act of 1969 (Act), Pub. L. 91-172, 1969-3 C.B. 10, 83, added section 249 to the Internal Revenue Code. Section 249 of the Code provides, in general, that no deduction shall be allowed to the issuing corporation for any premiums paid or incurred upon the repurchase of a bond, debenture, note, or certificate, or other evidence of indebtedness which is convertible into the stock of the issuing corporation, to the extent the repurchase price exceeds an amount equal to the adjusted issue price plus a normal call premium on bonds or other evidence of indebtedness which are not convertible.

Section 414(c) of the Act provides that section 249 of the Code shall apply to a convertible bond or other evidence of indebtedness repurchased after April 22, 1969, other than such a bond or other evidence of indebtedness repurchased pursuant to a binding obligation incurred on or before April 22, 1969, to repurchase such bond or other evidence of indebtedness at a specified call premium.

In *Head Ski Co.,* the court noted that section 249 of the Code, as enacted, specifically covers deduction for premiums paid for the redemption of convertible notes. The court observed that Congress was aware of the court cases construing section 1.61-12(c)(1) of the regulations in a manner contrary to the position of the Internal Revenue Service and that the intention of Congress was to enact legislation to change the law *prospectively.*

In the case of repurchase of such evidences of indebtedness which do not come within the ambit of section 249 of the Code, amounts expended by taxpayers on the call of convertible evidences of indebtedness will be deductible under the rationale of the *Roberts & Porter, Inc., Head Ski Co.*, and *Southwest Grease & Oil Co.* decisions, as long as taxpayers can show facts substantially similar to those in the cited cases. But see *United States v. Haskel Engineering & Supply Co.*, 380 F.2d 786 (9th Cir. 1967), where the court disallowed the corporate taxpayer a deduction under either section 162 or section 163 of the Code for premiums paid, on a pro rata basis, to the corporation's only two shareholders for redemption of bonds held by the shareholders because the premiums paid were unreasonable in amount. The case did not involve convertible bonds. The Service will continue to follow the *Haskel Engineering & Supply Co.* decision in cases involving similar questions.

Rev. Rul. 67-409 and Rev. Rul. 69-243 are hereby revoked.

Section 164.—Taxes

26 CFR 1.164-1: Deduction for taxes.

Real estate taxes; sewage disposal system. Real estate tax increases imposed on all property owners within a municipality to pay off general revenue bonds sold to build a sewage disposal system and to provide for its maintenance are deductible as real estate taxes under section 164 of the Code.

Rev. Rul. 74-52

Advice has been requested whether an increase in the real estate taxes of all of the property owners within a municipality is deductible for Federal income tax purposes under the circumstances described below.

A municipality built a sewage disposal system and financed the cost of the facility by selling general revenue bonds pledging the credit of the municipality. The board of trustees of the municipality incorporated the cost of paying the bonds, and maintenance of the system, into its general budget through an increase in the real estate taxes imposed on all the property owners within the municipality, rather than through charges on a use rate.

Section 164(a) of the Internal Revenue Code of 1954 provides, in part, that State and local, and foreign, real property taxes are allowed as a deduction for the taxable year within which paid or accrued.

Section 1.164-3(b) of the Income Tax Regulations provides that the term "real property taxes" means taxes imposed on interests in real property and levied for the general public welfare, but it does not include taxes assessed against local benefits.

A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Section 1.164-4(a) of the regulations. The instant situation is not one in which municipal charges for services are measured by the benefits which may be, or have been, derived from such services. Further, this is a situation where taxes are levied for the general public welfare by the proper taxing authorities at a like rate against all property over which such authorities have jurisdiction, and this is not a tax assessed against local benefits. Accordingly, the increased real estate taxes imposed on the property owners within the municipality are deductible as real estate taxes under section 164 of the Code.

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26 CFR 1.164-1: Deduction for taxes.
(Also Section 265; 1.265-1.)

State income tax allocable to exempt cost-of-living allowance. A civilian employee of the U.S. Government stationed in Hawaii may not deduct the portion of that State's income tax that is allocable to a cost-of-living allowance exempt from Federal tax.

Rev. Rul. 74-140

Advice has been requested concerning the deductibility of State income taxes paid by an individual under the circumstances described below.

A civilian employee of the Government of the United States was stationed in Hawaii and received a cost-of-living allowance that was exempt from Federal income tax under section 912 of the Internal Revenue Code of 1954. However, the cost-of-living allowance was subject to the income tax imposed by the State of Hawaii.

Section 164 of the Code provides, in part, for the deduction of State and local income taxes paid or accrued during the taxable year.

Section 265 of the Code provides, in part, as follows:

> No deduction shall be allowed for—
> (1) Expenses.—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.

Accordingly, it is held in the instant case that the portion of the State income taxes paid by the taxpayer that is allocable to the cost-of-living allowance, a class of income wholly exempt under section 912 of the Code, is nondeductible under section 265. *Rinehart v. United States*, 68-2 U.S.T.C. 87, 937 (W. D. Okla. 1968), *aff'd* 429 F. 2d 1286 (10th Cir. 1970); *Mary A. Marsman*, 18 T.C. 1 (1952), *aff'd in part and rev'd in part*, 205 F. 2d 335 (4th Cir. 1953), *aff'd after remand*, 216 F. 2d 77 (4th Cir. 1954), *cert. denied*, 348 U.S. 943 (1955); *George W. P. Heffelfinger*, 5 T.C. 985 (1945); *James F. Curtis*, 3 T.C. 648 (1944).

For a similar conclusion see Rev. Rul. 61-86, 1961-1 C.B. 41, which provides that in the case of an estate or trust, that portion of its State income taxes that is allocable to exempt income other than exempt interest income is nondeductible under section 265 of the Code.

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26 CFR 1.164-2: Deduction denied in case of certain taxes.

Deductibility of Federal Insurance Contributions Act Tax imposed on employers. See Rev. Rul. 74-176, page 68.

Section 165.—Losses

26 CFR 1.165-1: Losses.
(Also Sections 801, 1091; 1.801-8, 1.1091-1.)

Mutual life insurance company; wash sale. A loss sustained by a mutual life insurance company on the sale of stock from its general asset accounts is not deductible if the company purchases substantially identical stock and allocates it to its segregated asset accounts within the 6-day period proscribed by the "wash sale" provisions of section 1091 of the Code.

Rev. Rul. 74-4

Advice has been requested whether a deduction is allowable under section 165(a) of the Internal Revenue Code of 1954 under the circumstances described below.

The taxpayer is a mutual life insurance company subject to tax imposed by section 802 of the Code. In addition to life insurance and fixed annuity contracts, it issues contracts with reserves based on segregated asset accounts, including variable annuities. With respect to its variable annuity contracts and other contracts with reserves based on segregated asset accounts issued for qualified pension plans, the taxpayer maintains, under section 801(g), asset accounts that are segregated from its general asset accounts. All of the assets reflected in its general asset accounts and in its segregated asset accounts belong to and are owned by the taxpayer.

Pursuant to section 801(g) of the Code and section 1.801-8(c) of the Income Tax Regulations, a life Insurance company that issues contracts with reserves based on segregated asset accounts must separately maintain and account for each and every income, exclusion, deduction, asset, reserve, and any other liability item that is properly attributable to such segregated asset accounts. Schedules reflecting this separate accounting are attached to and become a part of the company's Federal income tax return, Form 1120L, U.S. Life Insurance Company Income Tax Return, reflecting its life insurance company taxable income from its total operations, including those from its contracts with reserves based on segregated asset accounts.

Section 801(g) of the Code is designed to make insured qualified pension plans competitive with noninsured qualified pension trusts. Noninsured qualified pension trusts account separately for all assets attributable to qualified pension plans and pay no tax on either the investment income or capital gains on such assets. Similarly, the assets held for insured qualified pension plans are segregated and a separate accounting is made so that the investment income or capital gains on such assets held under contracts with reserves based on segregated asset accounts is not taxed.

On March 1, certain shares of stock held in the taxpayer's general asset accounts were sold at a loss. On March 15 of the same year, substantially identical stock was purchased by the taxpayer and allocated to its segregated asset accounts.

The specific quection is whether a deduction for the loss incurred on the sale of stock out of the general asset account is allowable under section 165(a) of the Code where substantially identical stock was purchased and allocated to the segregated asset account within the period proscribed by the "wash sale" provisions of section 1091. The answer to this question depends on whether the foregoing sale and purchase of substantially identical stock was made by the same taxpayer.

Section 1.802-3(f)(2) of the Income Tax Regulations provides, in part, that, except as modified by section 817 of the Code (rules relating to certain gains and losses), the general rules of the Code relating to gains and losses shall apply with respect to life insurance companies.

Under section 165(f) of the Code a deduction is allowed for capital losses sustained during the taxable year, subject to the limitations of sections 1211 and 1212.

Section 1091(a) of the Code provides, in effect, that a taxpayer cannot deduct any loss sustained from the sale or other disposition of stock if, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities. To the same effect see section 1.1091-1 of the regulations.

In the instant case, for its contracts with reserves based on segregated asset accounts, the taxpayer maintains and accounts for such assets separately from its general assets similar to that of noninsured qualified pension trusts. This does not mean, however, that each segregated asset account maintained by an insurance company is a separate taxpayer or that all of the assets held in both the segregated asset accounts and the general asset accounts of one company are not owned by that one company. Therefore, a sale by the taxpayer of stock from its general asset accounts at a loss and a purchase by the same taxpayer of substantially identical stock which is allocated to its segregated asset accounts

within the proscribed period set forth in section 1091(a) of the Code is a "wash sale" within the meaning of section 1091(a).

Accordingly, in the instant case a deduction is not allowable to the taxpayer under section 165(a) of the Code for the loss sustained on the sale of stock from its general asset accounts.

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26 CFR 1.165-1: Losses.
(Also Section 172; 1.172-4.)

Decedent's capital and net operating losses. A capital loss and a net operating loss from business operations sustained by a decedent during his last taxable year are deductible only on the final return filed in his behalf; such losses are not deductible by his estate. A net operating loss carryback for such period may be applied to prior years as provided in section 172 of the Code. Rev. Rul. 54-207 superseded.

Rev. Rul. 74-175

Advice has been requested whether, under the circumstances described below, the estate of a decedent is entitled to deduct certain losses sustained by the decedent prior to his death.

The decedent, who filed his Federal income tax returns on a calendar year basis, died on June 15, 1972. During 1972, but prior to his death, the decedent sold all his stock at a loss. In addition, the decedent sustained a net loss from his business operations for the period ending with the date of his death.

Section 165(a) of the Internal Revenue Code of 1954 provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(c) of the Code provides, in part, that in the case of an individual, the deduction under subsection (a) shall be limited to (1) losses incurred in a trade or business, and (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business.

Section 165(f) of the Code provides that losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212.

Section 172 of the Code allows as a deduction in computing taxable income the aggregate of the net operating loss carryovers and net operating loss carrybacks to such taxable year.

In the absence of any express statutory language, only the taxpayer who sustains a loss is entitled to take the deduction. See *Calvin v. United States,* 354 F. 2d 202 (10th Cir. 1965). Therefore, the business loss and the capital loss sustained by the decedent for the period ending with the date of his death are deductible only on his final income tax return. Thus, no part of such net operating loss or capital loss is deductible by the decedent's estate or carried over to subsequent years. However, a net operating loss carryback resulting from a net business loss on the decedent's final return may be carried back to prior years as provided for in section 172 of the Code.

Compare Rev. Rul. 65-140, 1965-1 C.B. 127, which holds that if there is a change in the marital status because of the death of one of the parties to a marriage, and in a succeeding year the survivor sustains a net operating loss, the loss may be carried back only to that portion of the income reported in a joint return previously filed with the decedent, which vested in the survivor.

Rev. Rul. 54-207, 1954-1 C.B. 147, which holds that a capital loss sustained during the decedent's lifetime is not deductible by his estate, is superseded, since the position set forth therein is restated in this Revenue Ruling.

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26 CFR 1.165-1: Losses.
(Also Section 162; 1.162-1.)

Bankruptcy; deductibility of losses by individual. A cash method taxpayer, against whom a judgment was obtained on his liability as an officer of his company and who subsequently transferred his assets to a trustee in bankruptcy, did not have an allowable loss deduction under section 165 or a business deduction under section 162 of the Code in either the year of transfer or the year the assets were liquidated. If the taxpayer had been an accrual method taxpayer, he would have had an allowable deduction under section 162 in the year the judgment was obtained against him. However, if the liability had no connection with his trade or business, no deduction would be allowable. I.T. 2898 superseded.

Rev. Rul. 74-240[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I. T. 2898, XIV-1 C. B. 70 (1935) as well as to discuss other relevant situations.

The question presented is whether a taxpayer in a bankruptcy proceeding sustained a deductible loss under the provisions of section 165 of the Internal Revenue Code of 1954, either in the year his assets were transferred to the trustee in bankruptcy, or in the year that the assets were liquidated and distributed by the trustee among the creditors and the taxpayer was discharged from any future liability for the debts.

Section 165(a) of the Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

In the case of an individual, section 165(c) of the Code provides that the deduction under section 165(a) shall be limited to—(1) losses incurred in a trade or business; (2) losses incurred

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

in any transaction entered into for profit, though not connected with a trade or buisness; and (3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

Section 1.165-1(a) of the Income Tax Regulations provides, in part, that any loss actually sustained during the taxable year and not made good by insurance or some other form of compensation shall be allowed as a deduction subject to any provision of the internal revenue laws which prohibits or limits the amount of the deduction. Section 1.165-1(b) of the regulations provides, in pertinent part, that in order to be allowed as a deduction under section 165(a) of the Code a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. Only a bona fide loss is allowable, and substance, and not mere form, shall govern in determining a deductible loss.

Section 162 of the Code provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 461(a) of the Code provides the general rule that the amount of any deduction or credit allowed shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(1) of the regulations provides, in part, that under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.

Section 1.461-1(a)(2) of the regulations provides, in part, that under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

Section 1.61-12(b) of the regulations provides, in part, that income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act (11 U.S.C. 32), of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, if immediately thereafter the taxpayer's liabilities exceed the value of his assets.

The application of the law and regulations set out above is illustrated by the three situations set forth below.

Situation (1).—An individual taxpayer, who files his Federal income tax returns on a calendar year basis and uses the cash receipts and disbursements method of accounting, had gross income of 50*x* dollars in 1969. As an officer of his company, he became liable for the defalcations of an employee. He was sued by the creditors and a judgment of 200*x* dollars was entered against him. He was adjudicated bankrupt in 1969 and all of his assets, consisting primarily of real property and shares of stock not connected with his business, were transferred to the trustee in bankruptcy in the same year for application to the payment of his debts. In 1970 the assets were liquidated and distributed among the taxpayer's creditors in satisfaction of his debts, and he was discharged from future liability for the debts.

In the case of *Charles R. Stuart,* 38 B.T.A. 1147 (1938), *nonacq.,* page 3, this Bulletin, the United States Board of Tax Appeals held that a bankrupt individual taxpayer, whose circumstances were similar to those described in *Situation (1),* sustained a loss deductible under section 165 of the Code by reason of the transfer of his assets to the trustee in bankruptcy. Although the Tax Court of the United States (the successor to the Board of Tax Appeals) has never expressly reversed *Stuart,* it has in fact not followed it. In *Homer A. Martin, Jr.,* 56 T.C. 1294, 1299-1300 (1971), the court observed that "the rule is settled that a deductible loss under section 165 is not sustained when a taxpayer delivers his assets to a trustee in bankruptcy." In addition, since the *Stuart* decision is directly contrary to the weight of authority on this point, the Internal Revenue Service will not follow the decision in the *Stuart* case on this issue.

Accordingly, the bankrupt taxpayer in *Situation (1)* did not sustain a deductible loss under the provisions of section 165 of the Code in 1969, the year his assets were transferred to the trustee in bankruptcy.

Payment of the judgment in *Situation (1)* would constitute an ordinary and necessary business expense that would be deductible by the taxpayer under section 162(a) of the Code. *James E. Caldwell & Co. v. Commissioner,* 234 F. 2d 660 (6th Cir. 1956), *rev'g per curiam* 24 T.C. 589, 618-21 (1955). However, the transfer of the assets to the trustee in bankruptcy is not payment of the judgment for purposes of section 162. *B & L Farms Co. v. United States,* 238 F. Supp. 407 (S.D. Fla. 1965), *aff'd per curiam,* 368 F. 2d 571 (5th Cir. 1966), *cert. denied,* 389 U.S. 835 (1967); *Henry C. Mueller,* 60 T.C. 36 (1973), *appeal docketed,* 5th Cir., filed Aug. 6, 1973. Therefore, the transfer of the assets to the trustee in bankruptcy did not give rise to a business expense deduction under section 162.

The estate in bankruptcy received all the taxpayer's assets by operation of law and must report the gains or losses realized upon their sale and claim appropriate deductions for expenses relating to their disposition.

Accordingly, the bankrupt taxpayer in *Situation (1)* did not sustain a deductible loss under the provisions of section 165 of the Code in 1970, the

year his assets were liquidated and distributed among his creditors and the taxpayer was discharged from future liability for the debts.

Situation (2).—The facts are the same as in *Situation (1)* except that the taxpayer uses the accrual method of accounting, rather than the cash receipts and disbursements method of accounting.

In the *Stuart* case, the Service agreed that if the taxpayer had kept his books of account on the accrual method rather than on the cash receipts and disbursements method, he would have been entitled to a deduction in the year a final judgment was obtained against him. This is true because the entry of the final judgment in a specific amount against the taxpayer is an event that determines the fact of the liability and the amount thereof, so as to entitle an accrual method taxpayer to a deduction under section 1.461-1(a)(2) of the regulations. Because this event occurred before the taxpayer was adjudicated bankrupt, the estate in bankruptcy did not intervene between the taxpayer and any deduction allowable to him upon entry of the judgment against him.

Therefore, the taxpayer in *Situation (2)* sustained a deductible expense under section 162 of the Code in 1969, the year in which a final judgment was obtained against him. This deduction was in no way affected by the transfer of the taxpayer's assets to the trustee in bankruptcy, by their liquidation and distribution among his creditors, or by the discharge of the taxpayer from future liability for the debts.

Situation (3).—The facts are the same as in *Situation (1)* except that the liability was personal to the taxpayer, had no connection with his trade or business, and did not proceed from a transaction entered into for profit.

Because the taxpayer is an individual, his loss deduction under section 165(a) of the Code is limited, by the provisions of section 165(c), to losses incurred in a trade or business, losses incurred in a transaction entered into for profit, and losses of property not connected with a trade or business if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. Inasmuch as any loss sustained by the taxpayer in *Situation (3)* does not come within these limitations, it is not deductible under the provisions of section 165(a).

I.T. 2898 is hereby superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.165-1: Losses.

Loss on conversion of U.S. dollars into foreign currency. The conversion by a U.S. citizen of U.S. dollars into foreign currency at an official rate of exchange less favorable than the free market rate does not result in a deductible loss within the meaning of section 165 of the Code.

Rev. Rul. 74-276

Advice has been requested whether, under the circumstances described below, a taxpayer suffers a deductible loss within the meaning of section 165 of the Internal Revenue Code of 1954.

The taxpayer is a United States citizen employed in a foreign country by an agency of the United States Government. In 1972 the taxpayer was paid in United States dollars. Subsequent to being paid, the taxpayer converted some of the dollars into local currency at the United States Embassy. The conversion took place at the foreign country's official exchange rate of seven units of local currency per dollar. The free market exchange rate was ten units of local currency per dollar. The taxpayer used the local currency he obtained for personal living expenses such as food, rent, and entertainment. On his 1972 Federal income tax return the taxpayer claimed a loss deduction computed by multiplying the number of dollars converted at the foreign country's official exchange rate times three-tenths.

Section 165 of the Code provides, in part, that a taxpayer may deduct any loss sustained during the taxable year not compensated for by insurance or otherwise. In the case of individuals, section 165(c) limits the deduction for losses to (1) losses incurred in a trade or business, (2) losses incurred in a transaction entered into for profit, though not connected with a trade or business. and (3) certain casualty and theft losses.

A loss deduction under section 165 of the Code is only allowable with respect to closed and completed transactions. See section 1.165-1(b) of the Income Tax Regulations. The mere acquisition of foreign currency is not a closed and completed transaction.

When an individual taxpayer converts United States dollars into foreign currency at an official exchange rate less favorable to the taxpayer than the free market exchange rate he does not suffer a deductible loss. *S. E. Boyer,* 9 T.C. 1168 (1947). Moreover, any loss the taxpayer may suffer when he exchanges the foreign currency for personal items such as food, rent, or entertainment would be a nondeductible personal expense under section 262 of the Code.

Accordingly, it is held that the taxpayer did not suffer a deductible loss, within the meaning of section 165 of the Code, in any of the transactions described above.

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26 CFR 1.165-1: Losses.

Loss on trustee's sale of margin stock held by insolvent broker. The loss sustained from the sale of stock purchased on margin by an individual investor and sold by the trustee of the insolvent brokerage house holding the stock is a capital loss deductible under section 165 (a) of the Code.

Rev. Rul. 74-293

The taxpayer, an individual investor, purchased shares of common stock on margin for investment purposes through a brokerage house. The taxpayer advanced a portion of the cost of the shares from his own funds, and the remaining portion of the cost was loaned to him by the brokerage house. The brokerage house held the shares in "street name," that is, in the name of the brokerage house. The brokerage house subsequently became insolvent, and the Securities Investor Protection Corporation applied to a Federal district court for a decree adjudicating that customers of the brokerage house were in need of the protection provided by the Securities Investor Protection Act of 1970, 15 U.S.C. section 78aaa-111 (1970), Pub. L. 91-598, 1971-1 C.B. 530. The court issued the decree and appointed a trustee for the liquidation of the business of the brokerage house. As a part of the liquidation proceeding, the trustee sold the taxpayer's shares of stock. The trustee then transferred to the taxpayer the amount realized from such sale reduced by the portion of the shares' cost that had been loaned to the taxpayer by the brokerage house. Due to a decline in the market price of the stock, the amount realized from the sale of the shares was less than the taxpayer's basis in such shares.

Held, the excess of the taxpayer's basis in the shares over the amount realized from their sale is a loss sustained from the sale of a capital asset. Such loss is deductible by the taxpayer under section 165(a) of the Internal Revenue Code of 1954 for the year in which the trustee sold the shares, but only to the extent allowed in section 1211, relating to the limitation on capital losses, and section 1212, relating to the capital loss carryover.

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26 CFR 1.165-1: Losses.

Treatment of loss allowable on worthless security purchased by issuance of negotiable note of taxpayer. See Rev. Rul. 74-80, page 117.

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26 CFR 1.165-1: Losses.

Whether evaluation expenditures incurred by the taxpayer in connection with acquiring residential property are capital expenditures under section 263 of the Code. See Rev. Rul. 74-104, page 70.

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26 CFR 1.165-1: Losses.

Treatment of a condemnation award received in the year after a residence was destroyed by flood and a casualty loss deduction taken. See Rev. Rul. 74-206, page 198.

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26 CFR 1.165-5: Worthless securities.

Worthless stock; status of corporation as affiliate. An insolvent liquidated corporation's debt to a corporate stockholder, carried by the creditor corporation as an account receivable but determined by the Revenue Service to represent risk capital, increases the creditor corporation's basis but does not increase the creditor corporation's percentage of voting stock ownership interest in determining whether the corporation is an affiliated corporation under section 165(g)(3) of the Code.

Rev. Rul. 74-102

Advice has been requested whether, under the circumstances described below, a stockholder's percentage of ownership of the voting power of a corporation is increased.

X had not been a profitable corporation and in 1971 ceased business and completely liquidated. Creditors of *X* received only partial payment of amounts owed them. Nothing was paid to *X*'s stockholders. *X*'s stock and the unpaid balances of its liabilities became worthless in 1971. *Y* corporation owned 75 percent of the stock of *X* and had a balance due it on its open account with *X*. Upon examination of *Y*'s 1971 Federal income tax return, the Internal Revenue Service determined that the balance in this open account was not an uncollectible loan, deductible as a bad debt, but was risk capital that was an addition to *Y*'s basis in the *X* stock. The equity interest resulting from the so called "loan" was not reflected by additional shares of stock possessing voting power.

Y received nothing, either as a creditor or as a stockholder, with respect to the balance in its open account with *X*, and received nothing with respect to its stock.

Section 165(g)(3) of the Internal Revenue Code of 1954, and section 1.165-5 of the Income Tax Regulations, provide, in pertinent part, that a domestic corporation's loss resulting from the worthlessness of a security of an affiliated corporation shall not be treated as a loss from a sale or exchange of a capital asset. For this purpose, a corporation is treated as affiliated with a taxpayer if the taxpayer owns directly stock possessing at least 80 percent of the voting power of all classes of the stock and at least 80 percent of each class of such corporation's nonvoting stock.

Thus, under section 165(g)(3) of the Code, *Y*'s loss as a result of the worthlessness of the *X* stock must be treated as a capital loss, unless the addition to *Y*'s basis of its stock interest in *X* can be considered to increase its voting interest in *X* to at least 80 percent.

In the instant case, the increase in *Y*'s basis of its stock of *X* by the amount of its account receivable from *X* that is considered to be risk capital does not increase its percentage of direct ownership of stock possessing voting power. See *Road Materials, Inc.*, 40 P-H Tax Ct. Mem. 71-761 (1971), *aff'd per curiam*, 29 A.F.T.R. 2d 72-844 (4th Cir. 1972), *cert. denied*, 409 U.S. 1008 (1972). Accordingly, *Y* sustained a capital loss, rather than an ordinary loss, since *Y* did not own directly stock possessing at least 80 percent of the voting power of all classes of *X*'s stock.

Section 167.—Depreciation

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

Clarification of Rev. Rul. 72-507, 1972-2 C.B. 198, regarding the terminology used for the nuclear fuel assemblies subject to the allowance for depreciation. See Rev. Rul. 74-237, page 70.

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

Treatment of an open-pit mine purchased as a dumping area for overburden removed in stripping an adjacent mineral deposit. See Rev. Rul. 74-282, page 150.

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26 CFR 1.167(a)-2: Tangible property.

Depreciation; landscaping. Landscaping consisting of perennial shrubbery and ornamental trees immediately adjacent to the buildings in a newly-constructed apartment complex is property depreciable over the life of the buildings if the replacement of the buildings at the expiration of their useful lives will destroy the landscaping; other landscaping on the grounds of the complex is considered general land improvement the cost of which is to be added to the taxpayer's basis in the land.

Rev. Rul. 74-265

Advice has been requested whether land preparation consisting of shrubbery and other elements of landscaping is depreciable property for Federal income tax purposes, under the circumstances set forth below.

The taxpayer constructed and operated a garden-type apartment complex situated on several acres of land. The surrounding area was landscaped according to an architect's plan to conform it to the general design of the apartment complex. The expenditures for landscaping included the cost of top soil, seeding, clearing and grading, and planting of perennial shrubbery and ornamental trees around the perimeter of the tract of land and also immediately adjacent to the buildings. The replacement of such apartment buildings after the expiration of their useful lives will destroy the immediately adjacent landscaping, consisting of perennial shrubbery and ornamental trees.

Section 167 of the Internal Revenue Code of 1954 sets forth the general rule that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or of property held for the production of income.

Section 1.167(a)-2 of the Income Tax Regulations provides, in part, that the depreciation allowance does not apply to land apart from the improvements or physical developments added to it, generally because land has no determinable useful life. Land preparation may be subject to the depreciation allowance, however, if it is closely associated with depreciable assets so that it is possible to establish a determinable period over which the preparation will be useful in a particular trade or business.

A useful life for land preparation is established if it will be replaced contemporaneously with a related depreciable asset. See Rev. Rul. 72-96, 1972-1 C.B. 66. Whether land preparation will be replaced contemporaneously with a related depreciable asset is necessarily a question of fact, but if the replacement of the asset will require the physical destruction of the land preparation, this test will be considered satisfied.

Accordingly, the landscaping consisting of the perennial shrubbery and ornamental trees immediately adjacent to the apartment buildings is depreciable property under section 167 of the Code since the replacement of the buildings will destroy this landscaping. The cost of this land preparation may therefore be recovered over the established useful life of the apartment buildings.

The balance of the landscaping, including the necessary clearing and general grading, top soil, seeding, finish grading, and planting of perennial shrubbery and ornamental trees around the perimeter of the tract of land, is general land improvement that will be unaffected by the replacement of the apartment buildings and, therefore, will not be replaced contemporaneously therewith. Accordingly, this land preparation is not depreciable property but rather is considered inextricably associated with the land. As such, the cost of this land preparation is added to taxpayer's basis in the land and is not depreciable.

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26 CFR 1.167(a)-8: Retirements.

Depreciation; abnormally retired assets. Depreciation allowable for abnormally retired assets may not be based on the lives used before guideline lives were adopted under the provisions of Rev. Proc. 62-21.

Rev. Rul. 74-114

Advice has been requested whether, under the circumstances described below, the depreciation allowable for abnormally retired assets may be determined by using the lives used before guidelines were adopted where, in fact, guideline lives under Rev. Proc. 62-21, 1962-2 C.B. 418, were adopted to compute the depreciation allowance. It is noted that guideline lives are generally shorter than the useful lives used for depreciation purposes prior to guidelines.

For years through 1967 a taxpayer filed Federal income tax returns on which it deducted its book depreciation as an expense in the determination of taxable income. Depreciation was computed by the taxpayer on the basis of item accounts maintained for all of its machinery and equipment. In its item accounting records an estimated average service life was assigned to each property unit when acquired. For the years 1968 through 1970, the taxpayer elected to be ex-

amined under the provisions of Rev. Proc. 62-21 and adopted guideline lives. In so doing the taxpayer combined its item accounts into a guideline class for those years. For book purposes the taxpayer continued to depreciate these assets in item accounts and over the same lives that had been used for both book and tax purposes prior to the year 1968.

During the years 1968 through 1970 some of the assets depreciated in accounts for which guideline lives were used were abnormally retired from service and, thus, subject to gain or loss computation. The taxpayer proposed to determine depreciation for the abnormally retired assets by using the useful lives used before adopting guidelines without regard to the guideline lives adopted for tax purposes for the years 1968 through 1970.

The specific question is whether the depreciation allowable for abnormally retired assets depreciated under guideline lives may be properly determined by using the lives used before adoption of guideline lives.

Section 1.167(a)-8(c)(3) of the Income Tax Regulations provides the following rule for determining the basis of assets retired where gain or loss is recognized:

> In the case of an abnormal retirement from a multiple asset account the adjustment for depreciation allowed or allowable shall be made at the rate which would have been proper had the asset been depreciated in a single asset account (under the method of depreciation used for the multiple asset account) and using a rate based upon either the average expected useful life or the maximum expected useful life of the asset, depending upon the method of determining the rate of depreciation used in connection with the multiple asset account.

There is no support in the regulations for permitting the determination of the depreciation allowable for abnormal retirements based on the assumption that a different depreciation deduction was not taken by reason of the adoption of guideline lives for the assets beginning in 1968.

Under these circumstances the determination of the depreciation allowable for an abnormal retirement of property which had previously been depreciated in an item account but had been subsequently combined with other assets and depreciated under guideline lives is to be made by computing the depreciation allowable for that asset prior to the adoption of the guideline lives and combining that amount with the depreciation allowable for that asset after adopting the guideline lives to the date of actual retirement. The depreciation allowable for the year of retirement itself must be computed by using the same averaging convention used by the taxpayer in computing depreciation for additions of property.

Under the facts in the instant case the taxpayer in adopting Rev. Proc. 62-21 in 1968 combined item accounts into a guideline class. By combining the item accounts prior to 1968 into a guideline class and dividing the guideline depreciation rate in 1968 by the depreciation rate developed for a class life for years prior to 1968, a comparison of the rates of depreciation in 1967 and 1968 (before and after adoption of guidelines) may be determined. The individual life of each asset abnormally retired from the guideline class during 1968 through 1970 is determined by multiplying the individual life of that asset prior to the adoption of guidelines by the ratio derived from the comparison of the depreciation rates before and after the adoption of guidelines.

For example, the assumption is made that two assets were purchased in January 1965 each at a cost of $30,000 and were depreciated for the entire year 1965 in item accounts under the straight line method and using a 15 year life for one asset and a 10 year life for the other. Each asset had a zero salvage after reducing the amount taken into account as salvage value under the provisions of section 167(f) of the Internal Revenue Code of 1954. For 1968, for the purpose of computing depreciation in accordance with Rev. Proc. 62-21, the taxpayer combined these two assets into a guideline class and computed depreciation using a 10 percent guideline depreciation rate. In 1970, assuming a full year's depreciation, the asset with the 15 year life before adopting the guideline was destroyed and, therefore, the taxpayer sustained an abnormal retirement of the asset.

The class life determined by combining assets into a guideline class for years prior to 1968 would be 12 years, or an 8.33 percent depreciation rate before guidelines developed as shown at the bottom of the page.

A comparison of the two class life depreciation rates indicates that the rate used by the taxpayer before guidelines of 8.33 percent (or 12 years), was 83.33 percent of the class life rate under guidelines of 10 percent (or 10 years), that is $\frac{8.33 \times 100}{10.00} =$ 83.33 percent.

1st asset	$\frac{\$30{,}000}{15 \text{ years}} = \$2{,}000$		annual depreciation
2nd asset	$\frac{\$30{,}000}{10 \text{ years}} = \$3{,}000$		annual depreciation
Total annual depr.		$5,000	
Combined assets		$60,000	= 12 year class life before guideline
Annual depreciation		$ 5,000	

$$\frac{1 \text{ year}}{12 \text{ yr. life}} \times 100 \text{ percent} = 8.33 \text{ percent depreciation rate}$$

Therefore, the depreciation allowable would be determined as follows:

Depreciation Allowable before Guidelines:

Years
1965, 1966, and 1967

$$\frac{\$30,000}{15 \text{ years}} \times 3 \text{ years} = \$6,000$$

The individual useful life of 15 years before guidelines is 12.5 years (83.33 percent of 15 years) under guidelines.

Depreciation Allowable under Guidelines:

Years
1968, 1969, and 1970

$$\frac{\$30,000}{12.5 \text{ years}} \times 3 \text{ years} = \$7,200$$

Total depreciation allowable	$13,200
Original cost	$30,000
Depreciation Allowable	13,200
Unrecovered cost	$16,800

Accordingly, in the instant case in computing gain or loss on abnormal retirements, the depreciation allowable for abnormally retired assets may not be determined by using the lives used before adopting guidelines where, in fact, guideline lives were adopted to compute the depreciation allowance under section 167 of the Code. However, for a taxpayer electing under section 1.167(a)-12 of the regulations to use the class life depreciation system provided for in section 167(m) of the Code, the depreciation allowable for assets retired after 1970 is to be determined in accordance with section 1.167(a)-12(d)(2)(ii) of the regulations.

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26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

Public utilities; election to apply class life depreciation; normalization of tax deferral. An electric utility company that used a "flow-through method of accounting" for its "July 1969 accounting period" with respect to its pre-1970 public utility property other than property depreciated under the straight-line method and did not make an election under section 167(1)(4)(A) of the Code may, if permitted by the State regulatory authority, normalize the tax deferral resulting from an election to apply the class life system under section 167(m) of the Code and section 1.167(a)-11 of the regulations.

Rev. Rul. 74-66

Advice has been requested, under the circumstances described below, whether an electric utility company that used a "flow through method of accounting" (as defined in section 167(1)(3)(H) of the Internal Revenue Code of 1954) for its "July 1969 accounting period" (as defined in section 167(1)(3)(I) of the Code) with respect to its pre-1970 public utility property (other than property under a straight-line method of depreciation) and did not make an election under section 167(1)(4)(A) of the Code, may normalize the tax deferral resulting from its election to apply the class life system under section 167(m) of the Code and section 1.167(a)-11 of the Income Tax Regulations.

In the instant case, the taxpayer, a regulated electric utility company, computed depreciation on all of its utility plant for Federal income tax purposes through 1966 under a straight-line method based on guideline lives under the provisions of Revenue Procedure 62-21, 1962-1 C.B. 418. In its 1967 and 1968 returns the utility company elected to use accelerated depreciation, as provided for in section 167(b)(2) and (3) of the Code, for qualified plant placed in service in 1967 and 1968. The double declining balance method was applied to certain properties and the sum-of-the-years-digits method was applied to certain other properties. The utility company continued to apply the straight-line method to all other depreciable properties through 1968.

The utility company in 1969 received permission (pursuant to Rev. Proc. 67-40, 1967-2 C.B. 674) to change to the double declining balance method or the sum-of-the-years-digits method for its qualified properties acquired subsequent to 1953 and before 1967. The straight-line method continued to be applied to depreciable properties acquired prior to 1954.

In 1969, pursuant to the direction of the state regulatory authority, the income tax savings resulting from the utility company's use of the double declining balance method, the sum-of-the-years-digits method of depreciation, and guideline lives were flowed-through to its customers by reflecting the savings in net income for regulatory purposes.

For the first taxable year ending after December 31, 1970 the utility company elected the class life system under section 167(m) of the Code and section 1.167(a)-11 of the regulations for qualified properties placed in service after December 31, 1970.

Section 1.167(a)-11(b)(4)(ii) of the regulations states, in part, that asset guideline classes, periods, and ranges for such periods for taxable years ending after December 31, 1970, are set forth in Rev. Proc. 72-10, 1972-1 C.B. 721.

Section 1.167(a)-(11)(b)(6)(ii) of the regulations provides that the taxpayer will be considered to normalize the tax deferral resulting from the election to apply this section only if it computes its tax expense for purposes of establishing its cost of service for rate making purposes and for reflecting operating results in its regulated books of accounts using a period of depreciation no less than the lesser of (a) 100 percent of the asset guideline period in effect in accordance with section 1.167(a)-11(b)4(ii) of the regulations for the first taxable

year to which this section applies, or (b) the period for computing its depreciation expense using the same period for rate making purposes and for reflecting operating results in its regulated books of accounts, and (c) makes adjustments to a separate reserve to reflect the deferral of taxes resulting from the election to apply this section. A determination whether the taxpayer is considered to normalize the tax deferral resulting from the election to apply this section shall be made in a manner consistent with the principles for determining whether a taxpayer is using the "normalization method of accounting" (within the meaning of section 167(l)(3)(G) of the Code).

Section 1.167(a)-11(b)(6)(iii) of the regulations provides, in part, that if a taxpayer, who has elected to apply this section, is required under section 1.167(a)-11(b)(6)(i) to normalize the tax deferral resulting from the election to apply this section to eligible public utility property, and fails to normalize such tax deferral, the election to apply this section to such property shall terminate as of the beginning of the taxable year for which the taxpayer fails to normalize the tax deferral.

However, section 1.167(a)-11(b)(6) of the regulations does not require a taxpayer who uses a flow-through method of accounting for its public utility property (as defined in section 167(l)(3) of the Code) to normalize the tax deferral resulting from the election to apply this section in the case of such property.

Accordingly, for Federal income tax purposes, the electric utility company in the instant case may (if permitted by the state regulatory authority), but is not required to, normalize the tax deferral resulting from the election to apply the class life system under section 167(m) of the Code and section 1.167(a)-11 in the case of public utility property for which the taxpayer used a flow-through method of accounting.

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26 CFR 1.167(b)-0: Methods of computing depreciation.
(Also Section 446; 1.446-1.)

Depreciation; change in method; useful life redetermined by Service. A taxpayer may not retroactively change from the straight line method of computing depreciation to a declining balance method upon the Service's redetermination of the estimated useful life of the asset in a later year, notwithstanding a footnote on the taxpayer's original return indicating that he would use a declining balance method for assets with a useful life equal to the redetermined useful life.

Rev. Rul. 74-154

Advice has been requested whether, under the circumstances described below, a taxpayer may retroactively change the method of depreciation that was used in computing the depreciation deduction of an asset on the original filed Federal income tax return.

In 1970, the taxpayer acquired and first placed in service a newly constructed shopping center complex, estimating its useful life to be 20 years. A footnote was included on the depreciation schedule of the Federal income tax return filed for that year to the effect that current year additions of assets having a useful life of 25 years or less would be depreciated by the straight line method and assets having a useful life in excess of 25 years would be depreciated by a declining balance method. Based on an estimated useful life of 20 years, the taxpayer adopted the straight line method of depreciation for the shopping center. During 1972, in connection with the audit of the taxpayer's Federal income tax return for 1970, the estimated useful life of the shopping center when placed in service was determined to be in excess of 25 years. The taxpayer then requested that he be allowed to recompute depreciation of the asset using a declining balance method beginning with 1970, the year in which the shopping center was first placed in service.

Section 167(a) of the Internal Revenue Code of 1954 provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income.

Section 1.167(b)-0(c) of the Income Tax Regulations provides, in part, that in the case of item accounts, any method of depreciation that results in a reasonable allowance may be selected for each item, but such method thereafter must be applied consistently to that particular item.

Section 1.167(e)-1(a) of the regulations provides, in part, that any change in method of computing depreciation allowances with respect to a particular account is a change in method of accounting under section 446 of the Code. Such change will be permitted only with the consent of the Commissioner of Internal Revenue, with certain exceptions not pertinent to the instant case.

Section 1.446-1(e)(3) of the regulations provides, in part, that in order to secure the consent of the Commissioner for a change in method of accounting, Form 3115 must be filed with the Commissioner within 180 days after the beginning of the taxable year in which it is desired to make the change.

In *M. Pauline Casey*, 38 T.C. 357, 386, *acq.*, 1963-2 C.B. 4, the court stated, in part, as follows:

* * * If taxpayers were permitted, at will, and without such consent, to change their method of taking depreciation every time a change in basis or estimated useful life was determined, administrative problems would vastly increase. We have no doubt that the provisions of the Code and regulations denying taxpayers the right to make changes in method without respon-

dent's consent reflect at least in part an effort on the part of Congress and the Secretary to lessen administrative burden. We think this view is particularly applicable to efforts to make retroactive changes.

Moreover, in *Clinton H. Mitchell,* 42 T.C. 953, *acq.,* 1965-2 C.B. 6, the court held that a taxpayer who adopted an acceptable method of depreciation on his original return was not entitled in a later taxable year to retroactively change such method of depreciation, notwithstanding a written note on the original return that attempted to reserve the right to alter the claimed depreciation.

Rev. Rul. 72-491, 1972-2 C.B. 104; *Silver Queen Motel,* 55 T.C. 1101 (1971), *acq.,* 1972-2 C.B. 3; and *Robert M. Foley,* 56 T.C. 765 (1971), *acq.,* 1972-2 C.B. 2, each involved a situation in which a taxpayer had originally used an *erroneous* method of depreciation. In each instance it was determined that the taxpayer could adopt any proper method of depreciation without the consent of the Commissioner. However, in the *Foley* case, the taxpayer was required to obtain the consent of the Commissioner to change methods of depreciation with respect to those assets for which he had selected an *acceptable* method of depreciation.

In the instant case, the straight line method of depreciation adopted by the taxpayer was an *acceptable* method of depreciation and, in accordance with section 1.167(b)-0(c) of the regulations, such method thereafter must be applied consistently to that asset unless the consent of the Commissioner is obtained to change methods of depreciation. Furthermore, in accordance with section 1.446-1(e)(3) of the regulations, any authorized change is effective beginning with the taxable year during which the consent of the Commissioner is requested.

Accordingly, the taxpayer, in the instant case, may not retroactively change the method of depreciation used in computing the depreciation deduction of an asset on the original filed Federal income tax return.

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26 CFR 1.167(b)-0: Methods of computing depreciation.

Methods of depreciation to be used by a cooperative organization in computing depreciation for Federal income tax purposes and for the purpose of determining its allowable deduction for patronage dividends. See Rev. Rul. 74-303, page 243.

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

Procedures for changing certain methods of computing depreciation. See Rev. Proc. 74-11, page 420.

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26 CFR 1.167(h)-1: Life tenants and beneficiaries of trusts and estates.

Treatment of depreciation or depletion of partnership property where an estate or a trust is a partner. See Rev. Rul. 74-71, page 158.

Section 170.—Charitable, etc., Contributions and Gifts

26 CFR 1.170-3: Contributions or gifts by corporations.

Amounts paid by an employer to a union educational and cultural trust fund. See Rev. Rul. 74-51, page 45.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Whether a charitable contribution deduction is allowable for a transfer of unexpended political campaign contributions to the United States Government. See Rev. Rul. 74-22, page 16.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Whether a public charity exercises sufficient control over a supporting exempt foundation that is trustee of a fund, so that the fund, that otherwise qualifies as a pooled income fund under section 642(c)(5) of the Code, will continue to so qualify. See Rev. Rul. 74-132, page 152.

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26 CFR 1.170A-6: Charitable contributions in trust.
(Also 1.170A-8.)
(Also Section 664; 1.664-4.)

Contributions to charitable remainder unitrust. A contribution of appreciated income-producing securities to a university through a charitable remainder unitrust, whose governing instrument contained no express or implied obligation to sell or exchange the securities, is a deductible charitable contribution, subject to the limitations of section 170(b) of the Code, in an amount equal to the actuarial computation of the present value of the remainder interest valued at net fair market value at the time the securities were transferred to the trust.

Rev. Rul. 74-53

Advice has been requested as to the amount of the charitable contribution that is allowable as a deduction under section 170 of the Internal Revenue Code of 1954 under the circumstances described below.

A made a gift to a university, an organization described in section 170(c) and section 170(b)(1)(A)(ii) of the Code, through a charitable remainder unitrust. The property transferred to the trust consisted of appreciated securities, earning taxable income, owned by *A* and held by him as capital assets for more than 6 months at the time of the transfer. The governing instrument of the trust complies with the provisions of section 664 and the Income Tax Regulations applicable thereto.

Pursuant to the trust instrument the university is the trustee. However, in the future it is possible that an independent trustee may succeed the university as trustee. In the event that there is a successor trustee, such trustee shall have all the title, powers, discretion, and immunity given to the university as trustee.

The university, in its discretion and capacity as trustee, may retain the contributed securities; sell the securities and invest the proceeds in shares in a mutual fund; or sell the securities and invest the proceeds in other investments in order to realize a rea-

sonable amount of income or gain from the sale or disposition of trust assets. Thus, there was no express or implied obligation imposed upon the trustee to sell or exchange the securities.

Section 170 of the Code provides, subject to certain limitations, a deduction for charitable contributions to organizations described in section 170 (c), when payment is made within the taxable year.

Section 170(f)(2) of the Code provides that in the case of property transferred in trust, no deduction shall be allowed under section 170 for the value of a contribution of a remainder interest unless the trust is one of the specified forms, including a charitable remainder unitrust (described in section 664(d)(2)).

Section 170(b)(1)(A) of the Code provides, in pertinent part, that charitable contributions made to organizations described therein, including an educational organization as described in section 170(b)(1)(A)(ii), shall be allowed as a deduction to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year.

However, the deduction would be limited by section 170(b)(1)(D)(i) of the Code to 30 percent of the contribution base unless the taxpayer made the election to have the provisions of sections 170(e)(1) apply. Section 170(e)(1) relates in pertinent part to a reduction in the amount of any charitable contribution of property in the case of certain contributions of capital gain property and, absent such election, does not apply to the appreciated securities contributed to the university through the charitable remainder unitrust. If the taxpayer makes the election to have section 170(e)(1) apply his deduction limitation would be 50 percent of the contribution base.

Since the university is an organization described in section 170(c) of the Code, contributions to it are deductible for Federal income tax purposes. Accordingly, the contribution to the charitable remainder unitrust under the facts and circumstances presented is deductible under section 170 subject to the limitations of section 170 (b), in an amount equal to the actuarial computation of the present value of the remainder interest for each $1.00 of initial trust corpus, valued at net fair market value at the time the appreciated securities were transferred to the trust. See section 1.170A-6(b)(2) of the regulations referring to section 1.664-4.

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26 CFR 1.170A-8: Limitations on charitable deductions by individuals.

Treatment of a charitable contribution to a charitable remainder unitrust. See Rev. Rul. 74-53, page 60.

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26 CFR 1.170A-9: Definition of section 170(b)(1)(A) organization.
(Also Section 509; 1.509(a)-3.)

Private foundation status; association of churches of different denominations. An exempt organization whose membership is comprised of churches of different denominations qualifies as an association of churches within the meaning of section 170(b)(1)(A)(i) of the Code for purposes of classification as an organization that is not a "private foundation" within the meaning of section 509(a)(1).

Rev. Rul. 74-224

Advice has been requested whether an organization which has a membership comprised of churches of various denominations qualifies as an "association of churches" within the meaning of section 170(b)(1)(A)(i) of the Internal Revenue Code of 1954 for purposes of classification as an organization described in section 509(a)(1).

The organization is recognized as exempt under section 501(c)(3) of the Code and was created to act as the coordinating agency for its member churches for the purposes of developing the spirit of Christian fellowship and cooperative mission among the denominations and churches in a particular geographical area and to promote through cooperative effort the spiritual, moral, social, and civic welfare of the area. Membership is comprised of Catholic and Protestant Churches of various denominations. The Governing Board of the organization consists of two voting members from each Church.

The organization engages in a number of activities such as provision of clergymen at hospitals and college campuses, pastoral counseling, coordinated religious educational programs and facilities, and coordinated efforts to aid the poor. Support for the organization is primarily derived from its members and public contributions.

Section 509(a)(1) of the Code provides that the term "private foundation" does not include an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)). An organization is described in section 170(b)(1)(A)(i) if it is a church or a convention or association of churches. Neither the Code nor the regulations thereunder define what constitutes a convention or association of churches.

Although the term "convention or association of churches" has a historical meaning generally referring to a cooperative undertaking by churches of the same denomination, nothing in the legislative or religious history of the term prevents its application to a cooperative undertaking by churches of differing denominations, assuming such convention or association otherwise qualifies for recognition of exemption as an organization described in section 501(c)(3). The term is not limited in its application to a group of churches of the same denomination. Accordingly, the organization described herein is an association of churches within the meaning of sec-

tion 170(b)(1)(A)(i) of the Code for purposes of classification as an organization described in section 509 (a)(1).

Section 172.—Net Operating Loss Deduction

26 CFR 1.172-4: Net operating loss carrybacks and net operating loss carryovers.

Treatment of a net operating loss sustained by a decedent for the period ending with the date of his death. See Rev. Rul. 74-175, page 52.

Section 173.—Circulation Expenditures

26 CFR 1.173-1: Circulation expenditures.

Circulation expenses; subscriber list purchased. Acquisition costs incurred by a publisher upon purchase of another publisher's circulation list are not deductible as circulation expenditures.

Rev. Rul. 74-103

X corporation publishes a local newspaper. On January 1, 1971, *X* entered into a contract with *Y* corporation, also a publisher, for the purchase of a list of subscribers to *Y*'s publications, a newspaper which had similar subscribers. Pursuant to the contract *X* was to have exclusive use of the list of subscribers. Under the contract, *X* was liable to pay 2,000*x* dollars of which 1,500*x* dollars was paid in 1971. In return for *X*'s payment *Y* transferred its circulation list to *X*.

Section 173 of the Internal Revenue Code of 1954 provides, in part, that notwithstanding section 263 of the Code, all expenditures (other than expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical) to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical shall be allowed as a deduction.

Held, since the list of subscribers was a part of the business of *Y*, another publisher, the purchase by *X* of the list of subscribers was a purchase of circulation through the purchase of a part of the business of another publisher and the costs incurred by *X* for the list of subscribers are not deductible under section 173 of the Code.

Section 174.—Research and Experimental Expenditures

26 CFR 1.174-1: Research and experimental expenditures; in general.

Ct. D. 1961

SUPREME COURT OF THE UNITED STATES
No. 73-641
Edwin A. Snow et ux.,
Petitioners v. Commissioner
of Internal Revenue
[416 U.S. 500]
On writ of certiorari to the
United States Court of Appeals
for the Sixth Circuit
[May 13, 1974]

Syllabus

Petitioner Edwin A. Snow, who had advanced part of the capital in a partnership formed in 1966 to develop a special-purpose incinerator and had become a limited partner, was disallowed a deduction under § 174(a)(1) of the Internal Revenue Code of 1954, on his individual income tax return for that year for his pro rata share of the partnership's operating loss. Though there were no sales in 1966, expectations were high and the inventor-partner was given about a third of his time to the project, an outside engineering firm doing the shopwork. The Tax Court and the Court of Appeals both upheld disallowance of the deduction, which § 174(a)(1) provides for "experimental expenditures which are paid or incurred by [the taxpayer] during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account." *Held*: It was error to disallow the deduction, which was "in connection with petitioner's trade or business, and the disallowance was contrary to the board legislative objective of the Congress when it enacted § 174 to provide an economic incentive, especially for small and growing businesses, to engage in the search for new products and new inventions.
482 F. 2d 1029, reversed.

DOUGLAS, J., delivered the opinion of the Court, in which all Members joined except STEWART, J., who took no part in the consideration or decision of the case.

MR. JUSTICE DOUGLAS delivered the opinion of the Court.

Section 174(a)(1) of the Internal Revenue Code of 1954, 26 USC § 174, allows a taxpayer to take as a deduction "experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account." Petitioner was disallowed as a deduction his distributive share of the net operating loss of a partnership, Burns Investment Company, for the taxable year 1966. The U.S. Tax Court sustained the Commissioner, 58 TC 585. The Court of Appeals affirmed, 482 F. 2d 1029 (CA6 1973). The case is here on a writ of certiorari because of an apparent conflict between the Court of Appeals for the Sixth Circuit with that of the Fourth Circuit in *Cleveland* v. *Commissioner*, 297 F. 2d 169 (CA4 1961).

Petitioner was a limited partner in Burns, having contributed $10,000 for a four-percent interest in Burns. The general partner was one Trott who had previously formed two other limited partnerships, one called Echo, to develop a telephone answering device and the other Courier, to develop an electronic tape recorder. Petitioner had become a limited partner in each of these other limited partnerships.[1]

Burns was formed to develop "a special purpose incinerator for the consumer and industrial markets." Trott was the inventor and had conceived of this idea in 1964 and between then and 1966 had made a number of prototypes. His patent

[1] Both Echo and Courier claimed research and development expenses in 1965 and 1966; and they were not challenged by the Commissioner, apparently because their products were in a more advanced stage of development and were available for sale or licensing.

counsel had told him in 1965 that several features of the burner were in his view patentable but in 1966 advised him that the incinerator as a whole had not been sufficiently "reduced to practice" in order to develop it into a marketable product. At that point Trott formed Burns, petitioner putting up part of the capital. Thereafter various models of the burner were built and tested.

During 1966 Burns reported no sales of the incinerator or any other product but expectations were high; and Trott was giving about one-third of his time to the project, an outside engineering firm doing the shop work.[2]

Trott obtained a patent on the incinerator in 1970 and it is currently being produced and marketed under the name Trash-Away.[3]

Section 174 was enacted in 1954 to dilute some of the conception of "ordinary and necessary" business expenses under § 162 (then § 23(a) of the Act) adumbrated by Justice Frankfurter in a concurring opinion in *Deputy* v. *DuPont*, 308 U.S. 488, 499 (1940), [1940-1 C.B. 118] where he said the section in question (old § 23 (a)) "involves holding one's self out to others as engaged in the selling of goods or services." The words "trade or business" appear, however, in about 60 different sections of the 1954 Act.[4] Those other sections are not helpful here because Congress wrote into § 174 "in connection with" and § 162 is more narrowly written than is § 174, allowing "a deduction" of "ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business." That and other sections are not helpful here.

The legislative history makes fairly clear the reasons. Established firms with ongoing business had continuous programs of research quite unlike "small or pioneering business enterprises." [5] Mr. Reid of New York, Chairman of the House Committee on Ways and Means, made the point even more explicit when he addressed the House on the bill: [6]

"Present law contains no statutory provisions dealing with the deduction of these expenses. The result has been confusion and uncertainty. Very often, under present law, small businesses which are developing new products and do not have established research departments are not allowed to deduct their expenses despite the fact that their large and well-established competitors can obtain the deduction. . . . This provision will greatly stimulate the search for new products and the new inventions upon which the future economic and military strength of a Nation depends. *It will be particularly valuable to small and growing businesses.*" (Emphasis added.)

Congress may at times in its wisdom discriminate taxwise between various kinds of business, between old and oncoming business and the like. But we would defeat the congressional purpose somewhat to equalize the tax benefits of the ongoing companies and those that are upcoming and about to reach the market by perpetuating the discrimination created below and urged upon us here.

We read § 174 as did the Fourth Circuit Court of Appeals in *Cleveland* "to encourage expenditure for research and experimentation." 297 F. 2d. at 173. That incentive is embedded in § 174 because of "in connection with," making irrelevant whether petitioners were rich or poor.

We are invited to explore the treatment of "hobby-losses" under § 183. But that is far afield of the present inquiry for it is clear that in this case under § 174 the profit motive was the sole drive of the venture.

Reversed.

MR. JUSTICE STEWART took no part in the consideration or decision of this case.

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[2] Treas. Reg. § 1.174-2(2) provides: "The provisions of this section apply not only to costs paid or incurred by the taxpayer for research or experimentation undertaken directly by him but also to expenditures paid or incurred for research and experimentation caused in his behalf by another person or organization such as, . . . an engineering company or similar contractor. . . ."

[3] Prior to 1970 Burns was incorporated and it produces and markets Trash-Away, petitioner being its Chairman of the Board.

[4] Saunders, Trade or Business, Its Meaning Under the Internal Revenue Code, So. Cal. 12th Inst. on Fed. Tax. 693 (1960).

[5] Hearing on H. R. 8300, 83d Cong., 2d Sess., pt. I, p. 105.

[6] 100 Cong. Rec. 3425 (1954).

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26 CFR 1.174-1: Research and experimental expenditures; in general.
(Also Sections 615, 617; 1.615-1, 1.617-1.)

Research and experiments; mining exploration; core and noncore drill holes. Expenditures paid or incurred before January 1, 1970, by a domestic corporation under a mining lease agreement involving the drilling of core and noncore holes in connection with the production of minerals are mining exploration expenditures subject to the provisions of either section 615 or 617 of the Code. Additional expenditures required to use the drill holes for designing and testing a new mining method are research and experimental expenditures and are subject to the provisions of section 174.

Rev. Rul. 74-67

Advice has been requested regarding the treatment, for Federal income tax purposes, of expenditures for the drilling and subsequent use of drill holes under the circumstances described below.

A taxpayer, a domestic corporation, is engaged primarily in the business of exploring, developing, and producing minerals. Under an agreement with a State, the taxpayer entered into an option to lease mining rights in a mineral deposit on a large tract containing phosphate and other specified minerals that occurred at a moderate depth.

The taxpayer's objective was to develop a profitable operation by (1)

delineating the size and grade of the ore body by using conventional drilling methods, and (2) perfecting a new hydraulic mining method whereby the mineralized sediments could be extracted efficiently and profitably through drill holes.

The total project included the drilling of holes for three distinct purposes. First, core holes were drilled at widely scattered points over the leased area for maximum coverage of geologic information. Secondly, some of these core holes were also used, at additional cost, for testing the new hydraulic mining method. Finally, holes without the cores were drilled in closely-spaced clusters and used for optimum production with the new mining method.

This operation of the taxpayer resulted in its obtaining two patents. One covered a process whereby ore could be extracted as a slurry by inserting a water jet under pressure through a drill hole. The other patent covered an apparatus called an eductor, that draws out a mineral slurry from the drill hole by an airlift system. The use of the patented method and apparatus is feasible under appropriate geologic and economic conditions.

The expenditures for drilling the holes and testing the hydraulic method of extraction were paid or incurred during the years 1962-1966. The expenditures for developing the patented method and apparatus were paid or incurred during the years 1966-1968.

Sections 615 and 617 of the Internal Revenue Code of 1954 and the regulations thereunder prescribe rules for the treatment of expenditures for ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (other than oil and gas) paid or incurred by a taxpayer before the beginning of the development stage of the mine or other natural deposit.

Section 174(a)(1) of the Code provides:

> * * * a taxpayer may treat research and experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction * * *.

Section 1.174-1 of the Income Tax Regulations provides, in part, that research or experimental expenditures may be deducted in the year paid or incurred, or they may be deferred and amortized.

Section 1.174-2 of the regulations provides, in part, that research and experimental expenditures are those expenditures incurred in a taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense. The term includes costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention or similar property, and the improvement of already existing property of the type above mentioned. The costs of obtaining a patent and perfecting a patent application are also includible as research or experimental expenditures.

Section 1.174-2(c) of the regulations provides that section 174 of the Code is not applicable to any expenditures paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore, oil, gas, or any other mineral.

Accordingly, in the instant case, it is held that the expenditures paid or incurred before January 1, 1970, for drilling the core and noncore holes are mining exploration expenditures that are subject to the provisions of section 615 or 617 of the Code; such expenditures paid or incurred after December 31, 1969, are subject to the provisions of section 617.

It is further held that, where the drill holes, either core or noncore, are also used for the purpose of designing and testing an apparatus, developing a new and innovative method of extracting ores or minerals, and similar purposes, the additional expenditures required for such use are for research and experimental purposes and are subject to the provisions of section 174 of the Code and the regulations thereunder.

Section 183.—Activities Not Engaged In for Profit

26 CFR 1.183-1: Activities not engaged in for profit.

Whether rental expense incurred upon subletting an apartment at a loss is deductible. See Rev. Rul. 74-28, page 67.

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26 CFR 12.9: Election to postpone determination with respect to the presumption described in section 183(d).

T.D. 7308

TITLE 26 — INTERNAL REVENUE. — CHAPTER I, SUBCHAPTER A, PART 12. — TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1971

Activities not engaged in for profit

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

The following regulations relate to section 183(e) of the Internal Revenue Code of 1954, as added by section 311(a) of the Revenue Act of 1971 (85 Stat. 525) [1972-1 C.B. 443], which permits a taxpayer to elect to postpone the determination of the presumption that an activity is engaged in for profit if it is profitable in two years during a period of five consecutive years (seven consecutive years in the case of activities concerning the breeding, training, showing or racing of horses).

The regulations provide, generally,

that an election with respect to an activity shall be made by filing a statement with the service center where the taxpayer's return is filed within three years after the due date of the return (determined without regard to extensions) for the first taxable year in which the taxpayer engages in such activity or, if earlier, upon notice that a district director proposes to disallow deductions attributable to an activity not engaged in for profit under section 183, by filing a statement with the district director who issued such notification within 60 days after such notice. (For purposes of the election a taxpayer shall be treated as not having engaged in any activity during any taxable year beginning before January 1, 1970.) The election must include a general extension of the three year statute of limitations, with respect to all years in the five or seven year period, commencing with the year in which the taxpayer first engages in the activity, to 18 months after the due date of the return (determined without regard to extensions) for the last taxable year in the five or seven year period.

The regulations set forth herein are temporary and are designed to provide rules governing the manner and time for making an election to postpone a determination of whether an activity is engaged in for profit. The regulations are effective until the issuance of final regulations to be prescribed by the Commissioner and approved by the Secretary or his delegate.

In order to provide such temporary regulations under section 183(e) of the Internal Revenue Code of 1954, the following regulations are adopted:

Section 12.9 is added immediately following § 12.8 and reads as follows:

§ 12.9 Election to postpone determination with respect to the presumption described in section 183 (d).

(a) *In general.* An individual, electing small business corporation, trust or estate may elect in accordance with the rules set forth in this section to postpone a determination whether the presumption described in section 183(d) applies with respect to any activity in which the taxpayer engages until after the close of the fourth taxable year (sixth taxable year, in the case of an activity described in § 1.183-1(c)(3)) following the taxable year in which the taxpayer first engages in such activity. The election must be made in accordance with the applicable requirements of paragraphs (b), (c) and (d) of this section. Except as otherwise provided in paragraphs (c) and (e) of this section, an election made pursuant to this section shall be binding for the first taxable year in which the taxpayer first engages in the activity and for all subsequent taxable years in the five (or seven) year period referred to in the first sentence of this paragraph. For purposes of this section, a taxpayer shall be treated as not having engaged in an activity during any taxable year beginning before January 1, 1970.

(b) *Period to which an election applies.* An individual, trust, estate, or small business corporation may make the election. The five year presumption period (seven year presumption period in the case of an activity described in § 1.183-1(c)(3)) to which the election shall apply shall be the five (or seven) consecutive taxable years of such taxpayer beginning with the taxable year in which such taxpayer first engages in the activity. For purposes of this section, a taxpayer who engages in an activity as a partner, engages in it in each of his taxable years with or within which ends a partnership year during which the activity was carried on by the partnership.

(c) *Time for making an election.* A taxpayer who is an individual, trust, estate or small business corporation may make the election provided in section 183(e) by filing the statement and consents required by paragraph (d) of this section within—

(1) 3 years after the due date of such taxpayer's return (determined without extensions) for the taxable year in which such taxpayer first engages in the activity, but not later than

(2) 60 days after such taxpayer receives a written notice (if any) from a district director that the district director proposes to disallow deductions attributable to an activity not engaged in for profit under section 183.

The provisions of subdivision (2) of this paragraph shall in no event be construed to extend the period described in subdivision (1) of this paragraph for making such election. Notwithstanding the time periods prescribed in subdivisions (1) and (2) of this paragraph, if no election has been made before a suit or proceeding described in section 7422(a) is maintained or a petition is filed in the Tax Court for a redetermination of a deficiency for any taxable year within the presumption period to which the election would apply, no election may be made except with the consent of the Commissioner which will not be given unless no appreciable delay in the suit or proceeding will be caused.

(d) *Manner of making election.* (1) The election shall be made by the individual, trust, estate, or electing small business corporation, as the case may be, engaged in the activity, by filing a statement which sets forth the following information—

(i) The name, address, and taxpayer identification number of such taxpayer, and, if applicable, of the partnership in which he engages in the activity,

(ii) A declaration stating that the taxpayer elects to postpone a determination as to whether the presumption described in section 183(d) applies until after the close of the taxpayer's fourth taxable year (sixth taxable year, in the case of an activity

described in § 1.183-1(c)(3)) following the taxable year in which the taxpayer first engaged in such activity and identifying that first such taxable year, and,

(iii) A description of each activity (as defined in § 1.183-1(d)(1)) with respect to which the election is being made.

(2) For an election to be effective, there must be attached to the statement properly executed consents, in the form prescribed by the Commissioner, extending the period prescribed by section 6501 for the assessment of any tax to a date which is not earlier than 18 months after the due date of the return (determined without extensions) for the final year in the presumption period to which the election applies, as follows:

(i) Consents for each of the taxpayer's taxable years in the presumption period to which the election applies,

(ii) If the election is made by an electing small business corporation, a consent of each person who is a shareholder during any taxable year to which the election applies, for each of such shareholder's taxable years with or within which end each of the corporation's taxable years in the presumption period,

(iii) If a taxpayer referred to in subdivision (2)(i) of this paragraph or shareholder referred to in subdivision (2)(ii) of this paragraph is married at the time of the election, in the case of his present spouse, a consent for each of such spouse's taxable years which correspond to the taxable years (other than prior years of the shareholder during no part of which he was a shareholder) for which consents are required by subdivision (2)(i) or (ii) of this paragraph as the case may be.

Such consents shall not be construed to shorten the period described in section 6501 for any taxable year within the presumption period to which the election applies.

(3) The statement, with the required consents attached, shall be filed—

(i) With the service center at which the taxpayer making the election is required to file his return, or

(ii) If the taxpayer is notified by a district director that, pursuant to section 183 he is proposing to disallow deductions with respect to an activity not engaged in for profit, with such district director.

(e) *Subsequent invalidations.* If, after a timely election has been made, but still within the presumption period, a suit or proceeding (as described in section 7422(a)) is maintained by the electing taxpayer, a shareholder referred to in subdivision (ii) of paragraph (d)(2) of this section, or spouse referred to in subdivision (iii) of paragraph (d)(2) of this section for any taxable year for which a consent is required by this section and the taxpayer, shareholder, or spouse has not been issued a notice of deficiency (as described in section 6212(a)) with respect to such taxable year, such election shall not be effective to postpone the determination whether the presumption applies, for such taxable year, but the consents extending the statute of limitations filed with the election shall not thereby be invalidated. The immediately preceding sentence shall not apply to a suit or proceeding maintained by the spouse of an electing taxpayer for a taxable year for which such spouse has filed a separate return, or a suit or proceeding maintained by a shareholder for a taxable year in which he was not such a shareholder. An election by an individual taxpayer or electing small business corporation, shall be subsequently invalidated for all years in the presumption period to which it had applied if—

(1) The electing taxpayer or shareholder taxpayer files a joint return for one of the first three (five, in the case of an activity described in § 1.183-1(c)(3)) taxable years in such presumption period, and

(2) The spouse with whom he files such joint return has not previously executed a consent described in subdivision (iii) of paragraph (d)(2) of this section, and

(3) Within one year after the filing of such joint return (or, if later, 90 days after March 14, 1974), such spouse has not filed a consent described in paragraph (d)(2) of this section.

An election by an electing small business corporation shall be invalidated for all years in the presumption period to which it applies if a person who was not a shareholder on the date of election becomes a shareholder during the first three (or five) years of the presumption period to which the election applies and does not, within 90 days after the date on which he becomes a shareholder (or, if later, 90 days after March 14, 1974), file a consent required by paragraph (d)(2) of this section. Invalidation of the election by operation of this paragraph will in no case affect the validity of the consents filed with such election.

(f) *Extension of time for filing election in hardship cases.* The Commissioner may, upon application by a taxpayer, consent to an extension of time prescribed in this section for making an election if he finds that such an extension would be justified by hardship occurred by reason of the time at which this section is published. The burden will be on the taxpayer to establish that under the relevant facts the Commissioner should so consent.

Because of the need for immediate guidance with respect to the provisions contained in this Treasury decision, it is found impracticable to issue it with notice and public procedure thereon under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved March 12, 1974.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 14, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 15, 1974. 39 F.R. 9949)

Part VII.—Additional Itemized Deductions for Individuals

Section 212.—Expenses for Production of Income

26 CFR 1.212-1: Nontrade or nonbusiness expenses.
(Also Section 183; 1.183-1.)

Subletting of residence. A taxpayer who, for reasons connected with his health, sublets his apartment for an amount less than his rent may deduct, under section 183 of the Code, the rental expense incurred to the extent that it does not exceed the gross income derived from the property reduced by the deductions that would be allowed without regard to whether or not the subletting was engaged in for profit.

Rev. Rul. 74-28

Advice has been requested whether a taxpayer who sublets his residence for an amount less than the rent he has to pay for the premises may deduct the rent he pays his landlord.

For health reasons, the taxpayer was forced to move out of his apartment before the end of his lease term. Rather than pay damages to his landlord for breaking the lease, he decided to sublet the apartment for the remainder of the lease term. The taxpayer realized at the time that the conditions in the housing market were such that he would not make a net profit on the subletting. Thus, his reason for subletting was to minimize the loss he would incur if he were to continue to pay rent on an unoccupied apartment. In fact, the taxpayer did sublet the apartment for an amount less than the rent he had to pay his own landlord for the premises.

Section 212 of the Internal Revenue Code of 1954 permits a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income.

Section 1.212-1(b) of the Income Tax Regulations provides, in part, that the term "income" for purposes of section 212 includes not merely income of the taxable year but also income that the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. Ordinary and necessary expenses paid or incurred in the management, conservation, or maintenance of a building devoted to rental purposes are deductible notwithstanding that there was actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under section 212 even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.

Section 1.212-1(h) of the regulations provides that ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

If a taxpayer has occupied property as his personal residence he must show that he has converted his use of the property from a personal to an income or profit-producing use before taking a deduction under section 212 of the Code. *Warren Leslie, Sr.*, 6 T.C. 488 (1946), *acq.*, 1946-1 C.B. 3. A taxpayer who sublets an apartment or house for an amount less than the rent he himself must pay for the premises has not converted the lease into income-producing property since, as long as the sublessee's rent is lower than the amount the taxpayer pays his own landlord, the taxpayer cannot expect to realize any real economic profit from the subletting and, in fact, the net loss from the property will continue indefinitely.

Section 1.212-1(b) of the regulations, which refers to deducting expenses incurred in maintaining property held merely to minimize a loss thereto, permits a taxpayer to continue to deduct expenses incurred in connection with property that the taxpayer originally expected would produce a profit but has failed to do so. The regulation does not allow taxpayers to deduct expenses if the venture that minimizes losses was initiated for personal, as opposed to profit, reasons. Here the taxpayer originally leased the apartment for personal reasons and was subletting it because of his health, another personal reason.

Accordingly, in the instant case the taxpayer may not deduct the rent he pays his landlord as an ordinary and

necessary expense paid or incurred during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. However, under section 183 of the Code the taxpayer, who sublet his apartment without a good faith expectation of profit, may deduct the rental expense incurred but only to the extent that this expense does not exceed the amount of gross income derived from the property reduced by the deductions that would be allowed that year without regard to whether or not the subletting was engaged in for profit.

Section 213.—Medical, Dental, etc., Expenses

26 CFR 1.213-1: Medical, dental, etc., expenses.

Deductibility of medical expenses that are compensated for by an award from the Crime Victims Compensation Board of the State of New York. See Rev. Rul. 74-74, page 18.

Section 214.—Expenses for Household and Dependent Care Services Necessary For Gainful Employment

(Also Section 164; 1.164-2.)

Household and dependent care expenses; employer's FICA tax. The tax imposed on an employer by section 3111 of the FICA, in connection with wages that are deductible under section 214 of the Code as amounts paid for household and dependent care services, is an integral part of the cost of the services and is deductible under section 214.

Rev. Rul. 74-176

The Internal Revenue Service has been asked to state its position with respect to the deductibility of the employer's share of FICA taxes, imposed by section 3111 of the Federal Insurance Contributions Act (chapter 21 of subtitle C of the Internal Revenue Code of 1954), in connection with wages that are deductible under section 214 as amounts paid for household services and for care of a dependent child, disabled dependent, or disabled spouse.

The question is whether this tax is an integral part of the cost of the services so that it may be deducted under section 214 of the Code, inasmuch as it is a Federal excise tax, which is specifically not deductible under section 1.164-2 of the Income Tax Regulations, relating to the deduction for taxes.

Section 214(a) of the Code provides that in the case of an individual who maintains a household that includes as a member one or more qualifying individuals, there shall be allowed as a deduction, subject to certain limitations, the employment-related expenses paid by him during the taxable year.

"Employment-related expenses" are defined in section 214(b) of the Code as amounts paid for (A) expenses for household services, and (B) expenses for the care of a qualifying individual, but only if such expenses are incurred to enable the taxpayer to be gainfully employed.

Section 1.164-2 of the regulations provides, in part, that no deduction is allowable for specified taxes, including Federal duties and excise taxes. However, the fact that any such tax is not deductible as a tax under section 164 does not prevent its deduction under another section of the Code, provided it otherwise qualifies for such deduction.

Rev. Rul. 57-489, 1957-2 C.B. 207, involves the question of whether the employer's share of FICA taxes is deductible as a medical expense when its payment is necessitated by an expenditure that is deductible as a medical expense under section 213 of the Code. Section 213 allows a deduction, subject to certain limitations, for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or his dependent. Rev. Rul. 57-489 holds, under the facts involved therein, that the tax is an integral part of the medical expense that necessitates its payment and that it is, therefore, deductible under section 213.

It is likewise concluded in the instant case that when a taxpayer makes an employment-related expenditure for household services and for the care of a dependent child, disabled dependent, or disabled spouse, which is deductible under section 214 of the Code, and the expenditure necessitates the payment of the employer's share of the FICA taxes, such tax is an integral part of the expenditure and is, therefore, deductible under section 214.

Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant-Stockholder

26 CFR 1.216-1: Amounts representing taxes and interest paid to cooperative housing corporation.

Cooperative housing corporation. A corporation whose stockholders are each entitled to the perpetual use and occupancy of a private room in a single-family house purchased by the corporation and to share, in common with the other stockholders, the rest of the dwelling which includes cooking and sanitation facilities does not qualify as a "cooperative housing corporation" within the meaning of section 216(b)(1)(B) of the Code.

Rev. Rul. 74-241

Advice has been requested whether, under the circumstances described below, a corporation qualifies as a "cooperative housing corporation" within the meaning of section 216(b)(1)(B) of the Internal Revenue Code of 1954.

The corporation purchased a single-family house and the land on which it

was located. Each stockholder of the corporation is entitled to the perpetual right to use and occupy a private room in the house and to share in common with the other stockholders the rest of the dwelling which includes common cooking and sanitation facilities. None of the private rooms contains cooking or sanitation facilities.

Section 216(b)(1)(B) of the Code provides that the term "cooperative housing corporation" means a corporation each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation.

For purposes of section 216(b)(1)(B) of the Code, the term "apartment in a building" means an independent housekeeping unit consisting of one or more rooms which contains facilities for cooking, sleeping, and sanitation normally found in a principal residence.

Since a stockholder's room in the house purchased by the corporation does not have cooking and sanitation facilities, it does not constitute an apartment in a building. Accordingly, the corporation does not qualify as a "cooperative housing corporation" within the meaning of section 216(b)(1)(B) of the Code.

Section 217.—Moving Expenses

26 CFR 1.217-2: Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.
(Also Section 162; 1.162-2.)

Moving and traveling expenses; professor on sabbatical leave. Moving expenses incurred by a university professor who went on a ten-month sabbatical leave for postdoctoral research training are not deductible under section 217 of the Code; however, expenses for travel, meals, and lodging incurred during such period are deductible under section 162.

Rev. Rul. 74-242

Advice has been requested whether, under the circumstances described below, a taxpayer is entitled to a deduction for moving expenses under section 217 of the Internal Revenue Code of 1954.

In 1971, the taxpayer, a university professor, went on sabbatical leave for both an anticipated and actual duration of ten months in order to engage in postdoctoral research training. In doing so, he moved from the university to the location of the training, incurring expenses of $1,000 for the moving of household and personal goods. The taxpayer incurred traveling expenses of $1,500, including his transportation costs in going to and returning from the training location, as well as costs for his meals and lodging while at such location. While undergoing the research training he received a monthly stipend that was includible in his gross income. The stipend did not qualify for exemption as a scholarship or fellowship grant under section 117 of the Code because it was compensatory. The taxpayer deducted both the moving expense of $1,000 and the traveling expenses of $1,500 on his Federal income tax return for the taxable year in which they were incurred and paid.

Section 162(a)(2) of the Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business.

Section 217(a) of the Code provides, in part, that there shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.

Section 1.217-2(c)(3)(iii) of the Income Tax Regulations (applicable to taxable years beginning after December 31, 1969) provides that a place of work is not considered to be the taxpayer's principal place of work for moving expense purposes if the taxpayer maintains an inconsistent position, for example, by claiming an allowable deduction under section 162 of the Code (relating to trade or business expenses) for traveling expenses "while away from home" with respect to expenses incurred while he is not away from such place of work and after he has incurred moving expenses for which a deduction is claimed under section 217.

For purposes of the traveling expense deduction under section 162 of the Code, Rev. Rul. 60-189, 1960-1 C.B. 60, provides that the Service will normally raise no question concerning the temporary nature of an employment or stay at a particular location if the anticipated and actual duration is for less than one year.

The issue of whether a deduction under section 217 of the Code for moving expenses is allowable to a person who incurs such expenses in transporting his family and household goods to a place at which he was temporarily employed so as to be considered away from home in the pursuit of a trade or business for purposes of section 162 was considered by the United States Tax Court in the case of *Robert J. Schweighardt*, 54 T.C. 1273 (1970). The Court, after citing section 1.217-1(c)(3)(iii) of the regulations (applicable to taxable years beginning before January 1, 1970) stated that, in general, a place of work is not to be considered a taxpayer's principal place of work under section 217, if a deduction is allowable under section 162 for traveling expenses while away from home. In sustaining the disallowance of the taxpayer's claimed deduction for moving

expenses, the court stated that the reference in section 217 to a new "principal place of work" means a new place where the taxpayer will be employed on a permanent or indefinite basis as distinguished from a temporary basis.

Based on the foregoing it is held that the taxpayer is not entitled to a deduction for the $1,000 moving expenses under section 217 of the Code. However, he is entitled to a deduction for traveling expenses of $1,500 under section 162.

Part VIII.—Special Deductions for Corporations

Section 249.—Limitation on Deduction of Bond Premium on Repurchase

26 CFR 1.249-1: Limitation on deduction of bond premium on repurchase.

Deductibility of premiums paid by a taxpayer on repurchasing of its callable convertible obligations. See Rev. Rul. 74-210, page 48.

Part IX.—Items Not Deductible

Section 262.—Personal, Living, and Family Expenses

26 CFR 1.262-1: Personal, living, and family expenses.

Whether individuals who render services to the Federal Government for nominal amounts may deduct as business expenses their traveling expenses, including the cost of meals and lodging, incurred while away from home. See Rev. Rul. 74-291, page 42.

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26 CFR 1.262-1: Personal, living, and family expenses.

Whether any expenditures for a trip sponsored by a professional association are deductible where only a small portion of the time is devoted to business activities. See Rev. Rul. 74-292, page 43.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.
(Also Section 165; 1.165-1.)

Evaluation expenditures in connection with acquisitions of residential property. Evaluation expenditures incurred by a domestic corporation in connection with the acquisition of existing residential property for renovation and resale are capital expenditures that must be taken into account as part of the cost of acquiring the property. However, if such expenditures do not result in the acquisition of property they are deductible as losses in the taxable year the corporation decides not to acquire the property.

Rev. Rul. 74-104

The taxpayer is a domestic corporation in the business of acquiring existing residential property to renovate and subsequently sell to the general public. Prior to acquiring property for renovation, the taxpayer incurs expenditures in evaluating a potential locality to determine the feasibility of selling such property in the locality. The evaluation expenditures include the cost of securing an initial report from an independent agent, and salaries, travel, and other related costs subsequently incurred by the taxpayer in evaluating the agent's report and the locality involved.

Section 263 of the Internal Revenue Code of 1954 provides, in part, that no deduction shall be allowed for any amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-2 of the Income Tax Regulations provides, in part, that capital expenditures include the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

Held, since the taxpayer is in the trade or business of acquiring residential property for renovation and sale and since the evaluation expenditures are incurred by the taxpayer in connection with acquiring existing residential property and are of benefit beyond the current taxable year through the sale of the renovated property, such expenditures are capital expenditures under section 263 of the Code that must properly be taken into account as part of the cost of acquiring the property. However, if the evaluation expenditures do not result in the acquisition of property for renovation, such expenditures are deductible under section 165 (concerning losses) in the taxable year that the taxpayer decides not to acquire the property.

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26 CFR 1.263(a)-1: Capital expenditures; in general.

Whether storage and other charges accruing against whiskey warehouse receipts are capital expenditures. See Rev. Rul. 74-264, page 40.

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26 CFR 1.263(a)-2: Examples of capital expenditures.
(Also Section 167; 1.167(a)-1.)

Capital expenditures; nuclear fuel assemblies. Terminology is clarified with respect to nuclear fuel assemblies, used in generating electricity, the costs of which must be capitalized and depreciated; Rev. Rul. 72-507 clarified.

Rev. Rul. 74-237[1]

The Internal Revenue Service has reconsidered Rev. Rul. 72-507, 1972-2 C.B. 198, regarding the terminology used for the nuclear fuel assemblies used in generating electricity.

Rev. Rul. 72-507 held that the costs of nuclear fuel elements are capital expenditures subject to the allowance for depreciation under section 167 of the Code. The useful lives and salvage values for the fuel elements are questions of fact.

Rev. Rul. 72-507 states, in part, that "* * * nuclear fuel elements are placed in assemblies in a nuclear core. Once the assemblies are placed in the nuclear core of the nuclear power

[1] Also released as Technical Information Release 1289, dated April 29, 1974.

reactor it is necessary to replace approximately ⅓ to ⅕ of the fuel elements in the core each year because of waste fission products that have accumulated in the core as by-products of the nuclear fission process. This accumulation has the effect of dampening the chain reaction. When this occurs, some of the fuel elements are removed and the remaining fuel elements, along with replacement fuel elements, are rearranged to permit them to continue to efficiently support a nuclear chain reaction."

The nuclear fuel elements considered in Rev. Rul. 72-507, are in fact nuclear fuel assemblies usually fabricated by the following method. A number of enriched uranium pellets are inserted into a tube to create a fuel rod. A number of fuel rods, fixed in position by spacers, are enclosed in a metal channel that is capped on both ends. The channel spacers and caps provide for the location of the fuel rods, control the water flow distribution in combination with the orifices in the caps, support the fuel rods during fuel handling operations, and assist the positioning of the control rods.

The expenditures for nuclear fuel assemblies (i.e., the composite of fabricated nuclear fuel and container) are capital expenditures subject to an allowance for depreciation under section 167 of the Code.

Rev. Rul. 72-507 is clarified concerning the terminology used for nuclear fuel assemblies subject to the allowance for depreciation.

Section 265.—Expenses and Interest Relating to Tax-Exempt Income

26 CFR 1.265-1: Expenses relating to tax-exempt income.

Deductibility of State income taxes by an individual receiving exempt income. See Rev. Rul. 74-140, page 50.

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26 CFR 1.265-2: Interest relating to tax-exempt income.

Disallowance of interest on loans to carry exempt securities. The provisions of section 265(2) of the Code do not apply to disallow deduction by a registered broker-dealer, who is required to identify and segregate the proceeds of loans secured by customers' securities by Securities and Exchange Commission Rule 15c3-3, for interest paid on loans from commercial banks to finance purchases by customers with margin accounts using the customers' securities, including tax-exempt obligations, as collateral.

Rev. Rul. 74-294

Advice has been requested whether section 265(2) of the Internal Revenue Code of 1954 applies to disallow the deduction for interest paid under the circumstances described below.

The taxpayer, a corporation, is a member firm of a stock exchange, and, as a registered broker-dealer, is subject to the jurisdiction of the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934. The taxpayer's business includes buying and selling securities, including tax-exempt obligations, as a principal and as a broker for its customers, underwriting issues of securities, making loans to its customers to finance their purchases of securities, and providing investment and financial counseling.

In the ordinary course of the taxpayer's business, it permits customers with margin accounts to buy securities on credit. In a typical transaction, the customer is required to put up a percentage of the purchase price of the security which he wishes to purchase. The percentage is set by the Federal Reserve Board. The taxpayer lends the remaining percentage of the purchase price to the customer. The taxpayer's loan to the customer is secured by the customer's securities (including tax-exempt obligations) held by the taxpayer. In order to obtain part of the funds necessary to finance customers, the taxpayer regularly borrows from commercial banks, using as collateral securities (including tax-exempt obligations) held for the accounts of customers. The customers, as beneficial owners, remain entitled to any interest or dividends accruing on such securities.

In November 1972, the Securities and Exchange Commission announced the adoption of Rule 15c3-3 under the Securities Exchange Act of 1934, effective January 15, 1973, which requires the taxpayer and other registered broker-dealers to identify and segregate the proceeds of loans secured by customers' securities. Paragraph (e)(2) of Rule 15c3-3 provides:

> It shall be unlawful for any broker or dealer to accept or use any of the amounts under items comprising Total Credits under the formula referred to in paragraph (e)(1) except for the specified purposes indicated under items comprising Total Debits under the formula, and, to the extent Total Credits exceed Total Debits, at least the net amount thereof shall be maintained in the Reserve Bank Account pursuant to paragraph (e)(1).

"Total Credits" referred to in paragraph (e)(2) include "monies borrowed collateralized by securities carried for the accounts of customers." "Total Debits" referred to in paragraph (e)(2) comprise the permissible uses for such monies. Such uses are limited to the financing of customers, deposits of cash against securities borrowed for customer accounts, and to pay customers for securities sold for their accounts where the taxpayer has failed to deliver the securities to the buyer (for a period not greater than 30 days) and, therefore, the corporation has not yet received the sales proceeds from the buyer. To the extent the borrowed monies are not so used, they must be deposited in the "Special Reserve Bank Account" which the taxpayer is required to maintain under paragraph (e)(1) of Rule 15c3-3.

The purpose of Rule 15c3-3, as expressed in an announcement by the

Securities and Exchange Commission, is:

* * * to accomplish a separation of the brokerage operation of the firm's business from that of its firm activities such as underwriting and trading. SEC Release No. 9856 (1972-73 Transfer Binder) *CCH Fed. Sec. L. Rep.* paragraph 79,083, at 82,343.

By requiring the taxpayer to be able to directly trace the use of proceeds from loans secured by customers' securities to one of the three permitted uses or to the Special Reserve Bank Account, the Securities and Exchange Commission has effectively segregated the financing of customers from the other activities of the taxpayer.

Section 265(2) of the Code provides for a disallowance of interest on indebtedness incurred or continued to purchase or carry tax-exempt securities. Rev. Proc. 72-18, 1972-1 C.B. 740, sets forth guidelines for the application of section 265(2) to certain types of taxpayers, including dealers in tax-exempt obligations.

Section 5 of Rev. Proc. 72-18 provides that in the case of a corporation and other dealers in tax-exempt obligations, section 265(2) of the Code applies to indebtedness directly traceable to the purchase of tax-exempt obligations and borrowed funds where the use of the borrowed funds cannot be directly traced. Excluded from the application of section 265(2) are borrowed funds which are neither directly nor indirectly traceable to tax-exempt obligations, but rather directly traceable to a dominant business purpose apart from the purchasing or carrying of tax-exempt obligations. In the instant case the taxpayer is precluded by Rule 15c3-3 of the Securities and Exchange Commission from using indebtedness collateralized by customers' securities for the purchase or carrying of other tax-exempt securities.

Accordingly, where the taxpayer properly segregated his funds as required by the Securities and Exchange Commission section 265(2) of the Code does not apply to disallow the deduction for interest paid by the taxpayer on indebtedness collateralized by customer securities.

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26 CFR 1.265-2: Interest relating to tax-exempt income.

Revenue Procedure to clarify Rev. Proc. 72-18 which concerns guidelines for the application of section 265(2) of the Code. See Rev. Proc. 74-8, page 419.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274-5: Substantiation requirements.

Whether unreimbursed travel expenses incurred by a public official in connection with the receipt of an award, which had no intrinsic value, from a nongovernmental organization for the performance of his official duties as an employee of the United States Government qualify as ordinary and necessary business expenses. See Rev. Rul. 74-208, page 41.

Subchapter C. Corporate Distributions and Adjustments
Part I.—Distributions by Corporations
Subpart A. Effects on Recipients

Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.

Distribution of part of assets of acquired corporation following stock-for-stock exchange in reorganization under section 368(a)(1)(B) of the Internal Revenue Code of 1954. See Rev. Rul. 74-35, page 85.

Section 302.—Distributions in Redemption of Stock

26 CFR 1.302-1: General.

Whether cash received by shareholders in lieu of the fractional share interests to which they were entitled in a reorganization defined in section 368(a)(1)(F) qualifies as a distribution in redemption of a portion of their stock. See Rev. Rul. 74-36, page 85.

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26 CFR 1.302-1: General.

Whether dividends in arrears paid at the time of redemption, the premium paid on redemption, and expenses incurred in connection with the redemption are chargeable to earnings and profits. See Rev. Rul. 74-266, page 73.

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26 CFR 1.302-4: Termination of shareholder's interest.

Whether gain is recognized to a corporation under section 311(d) of the Code upon redemption of its stock from a partnership using appreciated property as payment therefor. See Rev. Rul. 74-87, below.

Subpart B. Effects on Corporation

Section 311.—Taxability of Corporation on Distribution

26 CFR 1.311-2: Appreciated property used to redeem stock.
(Also Section 302; 1.302-4.)

Stock redeemed with appreciated property. A transfer by three shareholders of their stock in a corporation, aggregating 10 percent in value of the corporation's stock, to a partnership formed by them will be disregarded where the partnership was formed as part of a plan to have the corporation transfer appreciated real property to the partnership in complete redemption of their aggregate 10 percent interest. Accordingly, the transaction will be treated as a redemption of each individual shareholder's stock followed by a contribution of the appreciated property to the partnership, resulting in the termination of the shareholders' interests under section 302(b)(3) of the Code and the recognition of gain by the corporation under section 311(d)(1).

Rev. Rul. 74-87

Advice has been requested whether, under the circumstances described below, gain is recognized to a corporation under section 311(d)(1) of the Internal Revenue Code of 1954.

Corporation *X* had outstanding 100*x* shares of common stock. *A* owned 4*x* shares, *B* owned 3*x* shares, and *C* owned 3*x* shares. These shares, in the aggregate, represented 10 percent in value of the outstanding stock of *X*.

All three shareholders were unrelated to each other and to the other shareholders. *A*, *B*, and *C* have each owned their respective shares for more than one year. Pursuant to a partnership agreement, they contributed all their shares to a partnership formed by them in exchange for interests in the partnership equal in value to the value of the stock transferred. Thereafter, as part of an over-all plan, *X* redeemed its stock held by the partnership, using as payment therefor appreciated real estate on which *X*'s plant is located. This real estate constituted appreciated property within the meaning of section 311(d)(1)(B) of the Code. In an arm's length transaction, the partnership then leased back the real estate to *X* for a period of ten years. The partnership further served as the managing agent for the property and rendered various related services to *X*.

Section 302(a) of the Code provides, in part, that a redemption will be treated as a distribution in part or full payment in exchange for the stock if, pursuant to section 302(b)(3), the redemption is in complete redemption of all of the stock of the corporation owned by the shareholders.

Section 311(a) of the Code provides, in part, that no gain or loss will be recognized to a corporation on the distribution, with respect to its stock, of property, except as provided in sections 311(b), 311(c), and 311(d). Under section 311(d)(1), gain is recognized to a corporation upon a distribution of appreciated property (property the fair market value of which exceeds its adjusted basis in the hands of the distributing corporation) in redemption of its stock. Section 311(d)(1), however, does not apply where, as provided by section 311(d)(2)(A), a distribution is in complete redemption of all of the stock of the shareholder who, at all times within the twelve-month period ending on the date of distribution, owns at least 10 percent in value of the outstanding stock of the corporation, but only if the redemption qualifies under section 302(b)(3).

Section 1.311-2(b)(2) of the Income Tax Regulations provides, in part, that for the purposes of the twelve-month ownership requirement of section 311(d)(2)(A) of the Code, a shareholder will be considered to have owned stock during the period he is considered to have held the stock by reason of the application of section 1223. Under section 1223(2), by reason of section 723 and section 1.723-1 of the regulations, the holding period of property contributed to a partnership by a partner includes the period for which the property was held by the partner.

In the instant case, the ownership of the *X* stock by the partnership was transitory and illusory since, as part of one overall plan, the partnership then surrendered the *X* stock for property of *X*. This transitory step thus must be disregarded as being wholly without substance. *Bassick v. Commissioner*, 85 F.2d 8 (2nd Cir. 1936), *cert. denied* 299 U.S. 592 (1936); Rev. Rul. 70-522, 1970-2 C.B. 81. Therefore, the transaction is treated as a redemption by *X* of its stock held by *A*, *B*, and *C*, followed by a contribution to the partnership by *A*, *B*, and *C* of the real property received upon redemption of their *X* stock. See generally *Edgar S. Idol*, 38 T. C. 444 (1962), *aff'd* 318 F.2d 647 (8th Cir. 1963); *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945), 1945 C.B. 58.

Accordingly, it is held that (1) the redemption of the *X* stock qualifies as a termination of the interests of *A*, *B*, and *C* in *X* under section 302(b)(3) of the Code, and (2) under section 311(d)(1) gain is recognized by *X* upon the redemptions to the extent that the fair market value of the property distributed exceeds its adjusted basis to *X*, since, for purposes of section 311(d)(2)(A), none of the redeeming shareholders owned at least 10 percent in value of *X*'s stock at all times within the twelve-month period ending on the date of redemption.

Section 312.—Effect on Earnings and Profits

26 CFR 1.312-5: Special rule for partial liquidations and certain redemptions. (Also Section 302; 1.302-1.)

Redemption of preferred stock; computation of earnings and profits. Dividend arrearages paid upon redemption of preferred stock are chargeable to earnings and profits. However, the costs of redemption, including any premium paid and expenses incurred in connection with the redemption, are not chargeable to earnings and profits but are properly chargeable under section 312(e) of the Code to the capital account.

Rev. Rul. 74-266

Advice has been requested as to the effect on earnings and profits of a corporation where preferred stock issued at par is redeemed for an amount in excess of par value plus dividends in arrears.

A corporation has outstanding two classes of stock, common and 7 percent preferred. The preferred shares have preference as to payment of dividends from the corporation's earnings and profits at a stated rate and no more. The preferred stock was issued at par and is redeemable at 105 percent of par value. During the year the corporation redeemed a portion of its preferred stock at 105 percent of par value plus dividends in arrears. The corporation incurred certain expenses in connection with the redemption.

Section 312(a) of the Internal Revenue Code of 1954 provides that as a general rule on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation are de-

creased by the sum of (1) the amount of money, (2) the principal amount of the obligations of the corporation, and (3) the adjusted basis of other property, so distributed. Section 316 (a) provides, in general, that every distribution made by a corporation is made out of earnings and profits to the extent thereof. Section 312(e) provides for an exception to these general rules in the case of a redemption to which section 302(a) applies. Under section 312(e) the part of the distribution which is properly chargeable to capital account is not treated as a distribution of earnings and profits. The term capital account as used in this section is not defined in the Code or regulations.

Upon the redemption of common stock the proper charge to capital account includes the stock's allocable share of the capital paid in for the stock and its pro-rata share of other attributes including unrealized appreciation surplus of the corporation. The proper charge to earnings and profits is the redeemed stock's pro-rata share of the total earnings and profits of the corporation. See Rev. Rul. 70-531, 1970-2 C.B. 76.

The position expressed in Rev. Rul. 70-531 is equally applicable to a redemption of preferred stock. In the instant case, the pro rata portion of the total earnings and profits attributable to the preferred stock redeemed is the amount of dividends in arrears, which was paid at the time of redemption, and, thus, only such amount is chargeable to earnings and profits.

In addition, in *United Nat. Corporation v. Commissioner,* 143 F. 2d 580 (9th Cir. 1944), the United States Court of Appeals for the Ninth Circuit held that where outstanding preferred stock was redeemed for less than its subscription price the amount of such difference did not have an effect upon earnings and profits which could be subsequently distributed to shareholders as dividends. The redemption was viewed by the Court as a readjustment of the capital structure of the corporation. The excess of the issuance price over the redemption price was part of the capital that had been originally paid in for the preferred stock. Such excess never ceased to be capital even though there was no corresponding stock outstanding after the redemption.

Therefore, applying the court's rationale to the instant case, where the redemption price exceeds the subscription price of the redeemed stock, such excess (premium) is treated as a decrease in capital and does not affect the corporation's earnings and profits.

Further, the expenses incurred in connection with the redemption are also properly chargeable to capital. See Rev. Rul. 67-125, 1967-1 C.B. 31, and Rev. Rul. 69-561, 1969-2 C.B. 25, which hold that the expenses attributable to a redemption are capital in nature and not deductible as ordinary and necessary business expenses. Such expenses have, therefore, no effect upon earnings and profits.

Accordingly, it is held that in computing earnings and profits available for payment of dividends: (1) the dividends in arrears paid at the time of redemption are chargeable to earnings and profits; and (2) no part of the cost of redemption of 105 percent of the par value plus the expenses incurred in connection with the redemption is chargeable to earnings and profits. In addition, under section 312(e) of the Code the cost of redemption of 105 percent of the par value plus the expense incurred in connection with the redemption is properly chargeable to capital account as that account is defined in Rev. Rul. 70-531.

Subpart C. Definitions; Constructive Ownership of Stock

Section 316.—Dividend Defined

26 CFR 1.316-1: Dividends.

Whether gain realized by a United States citizen from the sale of stock in a foreign corporation, which is income treated as a dividend covered by the provisions of section 1248 of the Code, may be offset by net capital losses (section 1211) incurred from the sale of other domestic securities. See Rev. Rul. 74-60, page 236.

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26 CFR 1.316-2: Sources of distribution in general.

Dividends; source. Examples illustrate the treatment of a distribution as a taxable dividend, reduction in basis of stock, or capital gain applying the principles for the source of a distribution under section 1.316-2(a) of the regulations.

Rev. Rul. 74-164

Advice has been requested concerning the taxable status of corporate distributions under the circumstances described below.

X corporation and *Y* corporation each using the calendar year for Federal income tax purposes made distributions of $15,000 to their respective shareholders on July 1, 1971, and made no other distributions to their shareholders during the taxable year. The distributions were taxable as provided by section 301(c) of the Internal Revenue Code of 1954.

Situation 1.

At the beginning of its taxable year 1971, *X* corporation had earnings and profits accumulated after February 28, 1913, of $40,000. It had an operating loss for the period January 1, 1971 through June 30, 1971, of $50,000 but had earnings and profits for the entire year 1971 of $5,000.

Situation 2.

At the beginning of its taxable year 1971, *Y* corporation had a deficit in earnings and profits accumulated after February 28, 1913, of $60,000. Its net profits for the period January 1, 1971 through June 30, 1971, were $75,000 but its earnings and profits for the entire taxable year 1971 were only $5,000.

Situation 3.

Assume the same facts as in *Situation* 1 except that *X* had a deficit in earnings and profits of $5,000 for the entire taxable year 1971.

Situation 4.

Assume the same facts as in *Situation* 1 except that *X* had a deficit in earnings and profits of $55,000 for the entire taxable year 1971.

Section 301(a) and 301(c) of the Code provides, in part, that: (1) the portion of a distribution of property made by a corporation to a shareholder with respect to its stock which is a dividend (as defined in section 316), shall be included in the shareholder's gross income; (2) the portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock; and (3) the portion which is not a dividend to the extent that it exceeds the adjusted basis of the stock and is not out of increase in value accrued before March 1, 1913, shall be treated as gain from the sale or exchange of property.

Section 316(a) of the Code provides that the term "dividend" means any distribution of property made by a corporation to its shareholders out of its earnings and profits accumulated after February 28, 1913, or out of its earnings and profits of the taxable year computed as of the close of the taxable year without diminution by reason of any distribution made during the year, and *without regard to the amount of earnings and profits at the time the distribution was made.*

Section 1.316-2(a) of the Income Tax Regulations provides, in part, that in determining the source of a distribution, consideration should be given first, to the earnings and profits of the taxable year; and second, to the earnings and profits accumulated since February 28, 1913, only in the case where, and to the extent that, the distributions made during the taxable year are not regarded as out of the earnings and profits of that year.

Applying the foregoing principles, in *Situation* 1, the earnings and profits of *X* corporation for the taxable year 1971 of $5,000 and the earnings and profits accumulated since February 28, 1913, and prior to the taxable year 1971, of $40,000 were applicable to the distribution paid by it on July 1, 1971. Thus, $5,000 of the distribution of $15,000 was paid from the earnings and profits of the taxable year 1971 and the balance of $10,000 was paid from the earnings and profits accumulated since February 28, 1913. Therefore, the entire distribution of $15,000 was a dividend within the meaning of section 316 of the Code.

In *Situation* 2 the earnings and profits of *Y* corporation for the taxable year 1971 of $5,000 were applicable to the distribution paid by *Y* corporation on July 1, 1971. *Y* corporation had no earnings and profits accumulated after February 28, 1913, available at the time of the distribution. Thus, only $5,000 of the distribution by *Y* corporation of $15,000 was a dividend within the meaning of section 316 of the Code. The balance of such distribution, $10,000 which was not a dividend, applied against and reduced the adjusted basis of the stock in the hands of the shareholders, and to the extent that it exceeded the adjusted basis of the stock was gain from the sale or exchange of property.

In the case of a deficit in earnings and profits for the taxable year in which distributions are made, the taxable status of distributions is dependent upon the amount of earnings and profits accumulated since February 28, 1913, and available at the dates of distribution. In determining the amount of such earnings and profits, section 1.316-2(b) of the regulations provides, in effect, that the deficit in earnings and profits of the taxable year will be prorated to the dates of distribution.

Applying the foregoing to Situations 3 and 4 the distribution paid by *X* corporation on July 1, 1971, in each situation was a dividend within the meaning of section 316 of the Code to the extent indicated as follows:

Situation #3

Accumulated Earnings and Profits (E&P) 1/1	$ 40,000	
E&P deficit for entire taxable year ($5,000) Prorate to date of distribution 7/1 (½ of $5,000)	(2,500)	
E&P available 7/1	$ 37,500	
Distribution 7/1 ($15,000)	(15,000)	taxable as a dividend
E&P deficit from 7/1-12/31	(2,500)	
Accumulated E&P balance 12/31	$ 20,000	

Situation #4

Accumulated E&P 1/1	$ 40,000	
E&P deficit for entire taxable year ($55,000) Prorate to date of distribution 7/1 (½ of $55,000)	(27,500)	
E&P available 7/1	$ 12,500	
Distribution 7/1 ($15,000)	(12,500)	taxable as a dividend
E&P deficit from 7/1-12/31	(27,500)	
Accumulated E&P balance 12/31	$(27,500)	

Part II.—Corporate Liquidations
Subpart A. Effects on Recipients

Section 332.—Complete Liquidations of Subsidiaries

26 CFR 1.332-2: Requirements for nonrecognition of gain or loss.
(Also Section 61; 1.61-12.)

Liquidation of subsidiary; cancellation of parent's note. Distribution of a parent corporation's note in connection with the complete liquidation of its wholly-owned subsidiary that had received the note as security for a loan to the parent is not income to the parent from the discharge of indebtedness under section 61(a)(12) of the Code; the note is property for purposes of section 332(a) and no gain or loss is recognized to the parent on the receipt of the note.

Rev. Rul. 74-54

Advice has been requested concerning the tax treatment of an indebtedness owed by a parent corporation to a subsidiary corporation under the circumstances described below.

P corporation owned all of the stock of *S* corporation for a number of years. *P* and *S* were both engaged in the manufacturing business. In 1969, *P* borrowed 2,000*x* dollars from *S* to repay a bank loan made by *P*. A note for this amount was given to *S* by *P*. The note provided for repayment in five equal annual installments, with interest, beginning one year from the date of the note. In 1972, after three annual installment payments on the note by *P*, *S* adopted a plan of complete liquidation and distributed all of its assets to *P*, including the note, which was reflected as a receivable on the books of *S*, in complete cancellation and redemption of all of the *S* stock. There was no specific forgiveness of the indebtedness represented by the note prior to the liquidation, and the note was cancelled in connection with the liquidation.

The liquidation of *S* met the requirements of section 332(b) of the Internal Revenue Code of 1954. Section 332(a) provides that no gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation as defined in section 332(b).

Section 61(a)(12) of the Code provides that gross income means all income from whatever source derived, including income from discharge of indebtedness. Section 1.61-12(a) of the Income Tax Regulations provides, in part, that the discharge of indebtedness, in whole or in part, may result in the realization of income.

Section 1.301-1(m) of the regulations provides that the cancellation of indebtedness of a shareholder by a corporation shall be treated as a distribution of property.

In *Helen Gilmore*, 40 B.T.A. 945 (1939), *acq.* 1940-1 C.B. 2, the issue was whether a principal shareholder of a corporation realized ordinary income from the discharge of indebtedness upon receipt and cancellation of his indebtedness to such corporation pursuant to a distribution in complete liquidation of the corporation. It was found as a fact that no forgiveness of indebtedness occurred, that all the corporation's assets were distributed, and that the indebtedness was treated as an asset by the distributing corporation at the time of the liquidation. The Commissioner contended that there was a constructive forgiveness of the indebtedness because the debt was never paid and was wiped out by the liquidation. The United States Board of Tax Appeals recognized that the effect of the liquidation was similar to a forgiveness of the indebtedness in that the taxpayer was saved the inconvenience of actually paying the amount of the indebtedness and receiving it back in distribution. The Board concluded, however, that since the indebtedness was treated by the corporation as an asset, and since all of its assets were distributed in complete liquidation, there was no forgiveness of the indebtedness, and that the proper treatment of the indebtedness for tax purposes was that it was property distributed in the liquidation which was to be taken into account by the shareholder in determining the amount realized from the liquidation.

It is held that, in the instant case, the note is property for purposes of section 332(a) of the Code and, therefor, no gain or loss is recognized to *P* on the receipt of its note distributed in complete liquidation of *S*. Accordingly, *P* does not realize income under section 61(a)(12) or section 1.301-1(m) of the regulations by reason of the cancellation of the note in connection with the liquidation.

Section 334.—Basis of Property Received in Liquidations

26 CFR 1.334-1: Basis of property received in liquidations.

Liquidation of subsidiary's subsidiary; basis of assets received. A wholly-owned subsidiary distributed to its parent all of its wholly-owned subsidiary's stock, the basis of which was greater than its fair market value. The distribution was followed immediately by a complete liquidation described in section 332(b) of the Code and occurring within 12 months of the parent's acquisition of the subsidiary. **Held**, the stock distribution was a purchase of the stock by the parent within the meaning of section 334(b)(3) and the parent's basis for the assets received in the liquidation is determined, pursuant to section 334(b)(2) by reference to its adjusted basis in the stock of the liquidated subsidiary.

Rev. Rul. 74-211

Advice has been requested whether, under the circumstances described below, the basis of assets received upon

complete liquidation of a subsidiary under section 332 of the Internal Revenue Code of 1954 is determined by reference to section 334(b)(1) or section 334(b)(2).

In 1970, *S* corporation, a manufacturer and distributor of musical instruments, purchased all the outstanding stock of *T* corporation, engaged in the piano repairing business, for 45*x* dollars.

On December 1, 1973, *P* corporation purchased all the outstanding stock of *S* for cash. Thus, *P* owned 100 percent of the stock of *S* and *S* owned 100 percent of the stock of *T*. On December 31, 1973 *S* distributed all the *T* stock to *P*. Immediately before the distribution, the adjusted basis of the *T* stock in the hands of *S* was 45*x* dollars, and the fair market value was 40*x* dollars. Immediately upon receipt of the *T* stock, *P*, pursuant to a plan of liquidation, completely liquidated *T* within the meaning of section 332(b) of the Code.

The specific question presented is whether the acquisition of the *T* stock by *P* is a purchase of such stock within the meaning of section 334(b)(3) of the Code, thus permitting *P* to determine the basis of the assets received upon the liquidation of *T* under the provisions of section 334(b)(2).

The basis of the assets received by a corporation upon the liquidation of another corporation within the meaning of section 332(b) of the Code is generally a carryover basis under section 334(b)(1). However, an exception to this general rule is contained in section 334(b)(2), which provides that the basis of assets so received in complete liquidation will be determined with reference to the adjusted basis of the parent corporation in the stock of the liquidated subsidiary, provided that the requirements of section 334(b)(2) are met. One of such requirements, contained in section 334(b)(2)(B), is that a specified percentage of all of the stock of the subsidiary be acquired by purchase during a specified 12-month period. Purchase is defined in section 334(b)(3) which provides, in part, as follows:

> (3) Purchase defined.—For purposes of paragraph (2)(B), the term 'purchase' means any acquisition of stock, but only if—
>
> (A) the basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, . . .
>
> (B) the stock is not acquired in an exchange to which section 351 applies,
>
> (C) the stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock.
>
> Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2)(B), the term 'purchase' also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence).

Since the *T* stock was not acquired by *P* in an exchange to which section 351 of the Code applies, such acquisition is not excluded from the term "purchase" by section 334(b)(3)(B).

P acquired the *T* stock from a person (*S*) the ownership of whose stock (*S*'s ownership of *T* stock) would be attributable to the person acquiring such stock (*P*) within the meaning of section 318(a)(2)(C). Thus, the acquisition by *P* of the *T* stock from a related party (*S*) violates the purchase rules of section 334(b)(3)(C). However, the last sentence of section 334(b)(3) provides that section 334(b)(3)(C) will not preclude an otherwise qualifying purchase where the stock of the related corporation (*S*) is acquired by purchase, within the meaning of section 334(b)(3), within the same 12-month period that the acquiring person (*P*) acquired stock of the subsidiary corporation (*T*). Since *P* acquired control of the related corporation *S* for cash within the same 12-month period that *P* acquired all of the stock of the liquidated corporation, *T*, section 334(b)(3)(C) does not preclude the acquisition of the stock from qualifying as a purchase. See section 1.334-1(c)(7) of the Income Tax Regulations.

Section 334(b)(3)(A) of the Code precludes an acquisition of stock from qualifying as a purchase if the basis of the stock in the hands of the distributee is determined in whole or part by reference to the adjusted basis of stock in the hands of the person from whom the stock was acquired. In the instant case, the distribution of the *T* stock by *S* to *P* was a distribution of property subject to the provisions of section 301. The basis of the *T* stock received by *P*, as determined under section 301(d)(2), is the lesser of its fair market value (40*x* dollars) or its adjusted basis in the hands of S immediately before the distribution (45*x* dollars). Therefore, the basis of the *T* stock to *P* is its fair market value of 40*x* dollars. Consequently, *P's* basis in the *T* stock is determined by reference to its fair market value, rather than by reference to the adjusted basis of the stock in the hands of the person from whom acquired, (*S*).

Accordingly, since the *T* stock was acquired by *P* by purchase within the meaning of section 334(b)(3) of the Code and the other requirements of section 334(b)(2) are met, the basis of the *T* assets in the hands of *P* is determined under section 334(b)(2) by reference to the adjusted basis of the *T* stock in the hands of *P* (40*x* dollars).

If, in the instant case, the fair market value of the *T* stock had been 50*x* dollars and its adjusted basis in the hands of *S* was 45*x* dollars immediately before the distribution, the acquisition of the *T* stock by *P* (by distribution from *S*) would not be a purchase of the stock within the meaning of section 334(b)(3) of the Code, by reason of section 334(b)(3)(A), since the basis of the *T* stock in the hands of *P* would be determined, pursuant to section 301(d)(2), by reference to the adjusted basis

of such stock in the hands of *S*. Therefore, upon the liquidation of *T* the basis of its assets in the hands of *P* would be a carryover basis under section 334(b)(1).

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26 CFR 1.334-1: Basis of property received in liquidations.

Liquidation of subsidiary; stock acquired through exercise of option. Factual situations in which an acquiring corporation obtained an option from individual shareholders of the acquired corporation to purchase their stock illustrate the starting date of the two-year period during which a plan of liquidation under section 332 of the Code must be adopted to qualify for the provisions of section 334 (b)(2), regarding the basis of assets received in the liquidation.

Rev. Rul. 74-295

Advice has been requested whether, in each of the situations described below, the basis provisions of section 334 (b)(2) of the Internal Revenue Code of 1954 will apply to a liquidation under section 332, of a subsidiary whose stock was acquired by the parent corporation, in whole or in part, through the exercise of an option.

Section 334(b)(2) of the Code provides, in pertinent part, that the basis of property distributed to a parent corporation, in complete liquidation of a subsidiary under the provisions of section 332, will be the adjusted basis of the stock with respect to which the distribution was made, provided: (1) the parent owns at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock, except nonvoting stock which is limited and preferred as to dividends; (2) the parent acquired the requisite 80 percent stock ownership by purchase, as defined in section 334(b)(3), during a 12-month period beginning with the date of the first qualifying purchase; and (3) the distribution of the property is pursuant to a plan of liquidation adopted not more than two years after the date of the purchase of the requisite 80 percent stock ownership.

Section 1.334-1(c)(3)(i) of the Income Tax Regulations provides, in pertinent part, that where the parent acquires the requisite 80 percent stock ownership in a series of purchases within a 12-month period, the two year period within which the parent must adopt the plan of liquidation begins on the day following the date of the specific purchase, within such 12-month period, which resulted in the parent acquiring the requisite 80 percent stock ownership in the subsidiary.

Section 334(b)(3)(C) of the Code, in pertinent part, defines a purchase to exclude stock acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock. Section 318(a)(4) provides that if any person has an option to acquire stock, such stock shall be considered as being owned by such person.

Section 1.334-1(c)(6)(iii) of the regulations provides that if a corporation acquires stock pursuant to an option to buy such stock from a person who, without regard to such option, is not a person the ownership of whose stock would be attributable to the acquiring corporation under section 318 (a) of the Code, then such stock will be considered to have been purchased on the date the acquiring corporation acquired the option providing the option is exercised on or before the last day of a 12 month period beginning on the day of the earliest purchase of stock (including stock subject to such option) used in determining the applicability of section 334(b)(2). For this purpose, the stock with respect to which the option was exercised will be deemed to have been purchased on the date the option was acquired. Unless section 1.334-1(c)(6)(iii) applies, a corporation holding an option to purchase more than 20 percent of the stock of another corporation cannot "purchase" the requisite 80 percent stock ownership of that corporation.

The application of the above provisions is illustrated by the situations described below. In each situation, the acquiring corporation acquired an option from individual shareholders of the acquired corporation to purchase their stock in the acquired corporation for a fair market value cash consideration. Without regard to the option, the stock ownership of these former shareholders of the acquired corporation was not, under section 318(a) of the Code, attributed to the acquiring corporation.

Situation 1

On June 1, 1969, *X* corporation acquired an option to purchase 100 percent of the stock of *Y* corporation which *X* exercised on April 1, 1970. On September 1, 1971, *X* adopted a plan for the complete liquidation of *Y*. Since *X* exercised the option within the 12-month purchase period referred to in section 1.334-1(c)(6)(iii) of the regulations, the date the option was acquired, June 1, 1969, is considered the date of the purchase of 100 percent of the *Y* stock. Since the plan of liquidation was adopted more than two years after this date, the provisions of section 334(b)(2) of the Code will not apply to the liquidation. See section 334(b)(1) in regard to basis of the assets received on liquidation of *Y*.

Situation 2

On June 1, 1969, *R* corporation acquired an option to purchase 100 percent of the stock of *S* corporation which *R* exercised on April 1, 1970. On May 1, 1971, *R* adopted a plan for the complete liquidation of *S*. Since *R* exercised the option within the 12-month purchase period, referred to in section 1.334-1(c)(6)(iii) of the regulations, the date the option was acquired, June 1, 1969, is con-

sidered the date of the purchase of 100 percent of the *S* stock. Since the plan of liquidation was adopted not more than two years after this date, the provisions of section 334(b)(2) of the Code will apply to the liquidation.

Situation 3

On June 1, 1969, *M* corporation acquired an option to purchase 100 percent of the stock of *N* corporation which *M* exercised on July 1, 1970. On August 1, 1970, *M* adopted a plan for the complete liquidation of *N*. Since *M* did not exercise the option within the 12-month purchase period referred to in section 1.334-1(c)(6)(iii) of the regulations, the date the option was exercised, July 1, 1970, is considered the date on which *M* acquired 100 percent of the *N* stock. *M* thus acquired 100 percent of the *N* stock from a person the ownership of whose stock is attributed to *M* under the provisions of section 318(a)(4) of the Code. Accordingly, the acquisition is not a purchase as defined in section 334(b)(3) and the provisions of section 334(b)(2) will not apply to the liquidation even though the plan of liquidation was adopted not more than two years after the requisite 80 percent stock ownership was acquired. See section 334(b)(1) in regard to basis of the assets received on liquidation of *N*.

Situation 4

On June 1, 1969, *Q* corporation acquired an option to purchase 40 percent of the stock of *V* corporation which *Q* exercised on April 1, 1970. On May 15, 1970, *Q* made a purchase of an additional 45 percent of the stock of *V* and on May 30, 1970, *Q* purchased the remaining stock of *V* (15 percent). *Q* then adopted a plan for the complete liquidation of *V* on April 1, 1972. The provisions of section 334(b)(2) of the Code will apply to the liquidation, since (1) *Q* exercised the option within the 12-month purchase period referred to in section 1.334-1(c)(6)(iii) of the regulations, June 1, 1969, is considered the date on which *Q* made a purchase of 40 percent of the stock of *V*, (2) *Q* acquired the requisite 80 percent stock ownership on May 15, 1970, in a second purchase (both purchases being within a 12 month period), and (3) *Q* adopted a plan of liquidation not more than two years after May 16, 1970, in accordance with section 1.334-1(c)(3)(i).

Situation 5

On June 1, 1969, *T* corporation acquired an option to purchase 19 percent of the stock of *V* corporation which *T* exercised on July 1, 1970. On April 1, 1971, *T* made a purchase of the remaining stock of *V* (81 percent), and on March 1, 1973, *T* adopted a plan for the complete liquidation of *V*. Since *T* did not exercise the option within the 12-month purchase period referred to in section 1.334-1(c)(6)(iii) of the regulations, the date the option was exercised, July 1, 1970, is considered the date on which *T* acquired 19 percent of the *V* stock. Under the provisions of section 334(b)(3) of the Code, the acquisition of this 19 percent interest was not a purchase since the acquisition was from a person the ownership of whose stock is attributable to *T* under section 318(a)(4). However, since *T* subsequently acquired the requisite 80 percent stock ownership in a purchase on April 1, 1971, and adopted a plan of liquidation not more than two years after this date, the provisions of section 334(b)(2) will apply to the liquidation.

Situation 6

On June 1, 1969, *Z* corporation acquired an option to purchase 100 percent of the stock of *W* corporation, within 15 months. The option was allowed to lapse on September 1, 1970. On January 1, 1972, *Z* made a purchase of 100 percent of the *W* stock and on May 1, 1973, *Z* adopted a plan for the complete liquidation of *W*. The option having lapsed without being exercised, the acquisition of 100 percent of the *W* stock on January 1, 1972 was a purchase of the requisite 80 percent stock ownership. Since the plan of liquidation was adopted not more than two years after the date of the purchase, the provisions of section 334(b)(2) of the Code will apply to the liquidation.

Situation 7

On June 1, 1969, *O* corporation made a purchase of 79 percent of the stock of *P* corporation. On May 1, 1970, *O* acquired an option, to purchase the remaining 21 percent stock interest in *P*, which *O* exercised on July 1, 1970, and on August 1, 1970, *O* adopted a plan for the complete liquidation of *P*. Since *O* did not exercise the option within the 12-month purchase period beginning on June 1, 1969, the day of the earliest purchase used in determining the applicability of section 334(b)(2) of the Code, July 1, 1970, the date the option was exercised is considered the date on which *O* acquired 21 percent of the *P* stock. Under the provisions of section 334(b)(3), *O* is thus considered to have acquired the 21 percent interest from a person the ownership of whose stock is attributed to *O* under section 318(a)(4) even though the option was exercised two months after it was acquired. Accordingly, since the requisite 80 percent stock ownership was not acquired by purchase during the 12-month purchase period referred to in section 1.334-1(c)(6)(iii) of the regulations, the provisions of section 334(b)(2) will not apply to the liquidation. See section 334(b)(1) in regard to basis of the assets received on liquidation of *P*.

Subpart B. Effects on Corporations

Section 337.—Gain or Loss on Sales or Exchanges in Connection With Certain Liquidations

26 CFR 1.337-3: Property defined.

Liquidation; portion of sale price

allocated to covenant not to compete. The nonrecognition provisions of section 337 of the Code do not apply to the amount received on the sale of its business by a liquidating corporation for the portion of the sale price specifically allocated to a covenant not to compete that was separately bargained for and clearly severable from goodwill.

Rev. Rul. 74-29

Advice has been requested regarding the application of section 337 of the Internal Revenue Code of 1954 to a sale of property by a liquidating corporation where a portion of the sales price is specifically allocated to a covenant not to compete.

Y corporation was engaged in the vending machine business. *Y*, following the adoption of a plan of complete liquidation by its shareholders, entered into an arm's length agreement with *A*, an individual, whereby *Y*, in consideration of $100*x*, agreed (1) to sell property, as defined in section 337(b) of the Code, to *A*, and (2) not to compete with *A* in the vending machine business for a stated period of time within a limited geographic area. The covenant not to compete had independent significance other than merely assuring the effective transfer of the goodwill of the *Y* business. The agreement between *Y* and *A* specifically allocated the amount of $10*x* (of the total consideration of $100*x*) to the covenant not to compete and this amount represented the value of the covenant.

Section 337 of the Code provides, in pertinent part, that, as a general rule, no gain or loss will be recognized to a corporation from the sale or exchange by it of property, as defined in section 337(b), within the 12-month period following the adoption by the corporation of a plan of complete liquidation provided all of the assets of the corporation, less assets retained to meet claims, are distributed to the shareholders within such 12-month period.

An amount received by the seller of a going business in consideration for a covenant not to compete, which is separately bargained for and clearly severable from the goodwill of the business in that it has independent significance, is ordinary income to the seller. See *Ullman v. Commissioner*, 264 F.2d 305 (2d Cir. 1958). Such payment is not gain realized from the sale of property, as defined in section 337(b) of the Code, and is thus not subject to the nonrecognition provisions of section 337. See *Harvey Radio Laboratories, Inc. v. Commissioner*, 31 CCH Tax Ct. Mem. 333 (1972), *aff'd*, 470 F.2d 118 (1st Cir. 1972).

Accordingly, the $10*x* received by *Y*, in payment for the covenant not to compete, is not subject to the nonrecognition provisions of section 337 of the Code and is ordinary income to *Y*.

Subpart D. Definition

Section 346.—Partial Liquidation Defined

26 CFR 1.346-1; Partial liquidation.

Partial liquidation; contraction of business. The change in a corporation's business operation from a full-line department store to that of a discount apparel store by eliminating departments and most forms of credit, and changing the type of merchandise sold, which resulted in a large reduction in floor space, employees, inventory, fixed assets, accounts receivable, and sales constituted a genuine contraction of the business of the corporation and a pro rata distribution to its shareholders in redemption of part of their stock qualifies as a partial liquidation under section 346(a)(2) of the Code; Rev. Rul. 60-322 distinguished.

Rev. Rul. 74-296

Advice has been requested whether a distribution, under the circumstances described below, qualifies as a distribution in partial liquidation under section 346(a)(2) of the Internal Revenue Code of 1954.

X corporation operated a full line department store, which offered a comprehensive selection of brand merchandise and a number of services, and also offered a variety of credit arrangements. In 1971 two new shopping center complexes opened in the vicinity of *X*'s store which adversely affected sales. Pursuant to a plan adopted in 1972 *X* changed its operation from that of a large department store to a small discount apparel store operation by eliminating 33 of the 40 departments, changing the type of merchandise sold, and eliminating most forms of credit. As a result of the change, leased floor space was reduced by 85 percent; accounts receivable dropped from 570*x* dollars to 10*x* dollars; inventory related to the discontinued departments was disposed of through a series of sales; the number of employees was reduced from approximately 275 persons to about 20 persons; sales declined from about 4,000*x* dollars to about 600*x* dollars per year; and fixed assets (display counters and cash registers) related to the discontinued departments were disposed of for their salvage value which totaled less than 1*x* dollars.

The disposition of the inventory and the collection of the accounts receivable related to the discontinued departments resulted in the realization of approximately 800*x* dollars in cash after the payment of all liabilities related to the discontinued departments. Early in 1973 *X* distributed 600*x* dollars in cash to its shareholders, pro rata, in redemption of a part of its outstanding common stock. *X* had paid regular dividends on its stock for many years prior to the distribution. There was no intention to expand the business of *X* except through internal growth of the discount operations.

Section 346(a)(2) of the Code provides, in part, that a distribution shall be treated as in partial liquidation of a corporation if it is not essentially equivalent to a dividend, is in redemption of a part of the stock of the corporation pursuant to a plan, and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year.

Section 1.346-1(a) of the Income Tax Regulations provides that a distribution which will qualify as a distribution in partial liquidation of a corporation under section 346(a)(2) of the Code is one which results from a genuine contraction of the corporate business.

Rev. Rul. 60-232, 1960-2 C.B. 115, holds that, in a contraction qualifying pursuant to section 346(a)(2) of the Code, the qualifying amounts distributed will include not only the net proceeds derived from the sale of operating assets, or the operating assets themselves, but also includes that portion of the working capital (including cash) reasonably attributable to the business activity terminated.

Rev. Rul. 60-322, 1960-2 C.B. 118, holds that a distribution did not result from a genuine contraction where a corporation, due to a steady decline in demand for its products, distributed cash to its shareholders, in redemption for part of their stock, that was realized from the sale of portfolio bonds and excess inventories, which it had decided to gradually sell off because of a decline in the demand for the inventory. The corporation did not change the activities or operation of its business, but simply reduced its inventory to reflect the decline in the demand for that inventory.

The instant case is distinguishable from Rev. Rul. 60-322 in that X discontinued most of the activities and operation of its business, and then changed the nature of its remaining business. Furthermore, there was no sale of investment property.

Accordingly, the distribution of $600x$ dollars to X's shareholders in exchange for a portion of their shares in X resulted from a genuine contraction of X's business and, therefore, qualifies as a partial liquidation under section 346(a)(2) of the Code.

Rev. Rul. 60-322 is distinguished.

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26 CFR 1.346-1: Partial liquidation.

Whether a distribution in partial liquidation defined in section 346(a)(1) of the Internal Revenue Code of 1954 is subject to the provisions of section 483 of the Code. See Rev. Rul. 74-89, page 125.

Part III.—Corporate Organizations and Reorganizations
Subpart B. Effects on Shareholders and Security Holders

Section 354.—Exchanges of Stock and Securities in Certain Reorganizations

26 CFR 1.354-1: Exchanges of stock and securities in certain reorganizations.

Whether recapture of investment credit due to early disposition of section 38 property in a section 368(a)(1)(D) reorganization is required where transferee corporation does not receive substantially all of the assets of transferor as required by section 354. See Rev. Rul. 74-101, page 7.

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26 CFR 1.354-1: Exchanges of stock and securities in certain reorganizations.

Whether the acquisition of all of the assets of a personal holding company by a regulated investment company constitutes a reorganization within the meaning of section 368(a)(1)(C) of the Code. See Rev. Rul. 74-155, page 86.

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26 CFR 1.354-1: Exchanges of stock and securities in certain reorganizations.

Whether the exchange of a portion of the common stock of a corporation for newly issued preferred stock constitutes a reorganization within the meaning of section 368(a)(1)(E) of the Code. See Rev. Rul. 74-269, page 87.

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26 CFR 1.354-1: Exchanges of stock and securities in certain reorganizations.

Whether gain or loss is recognized to policyholder-members of a tax-exempt fraternal beneficiary society upon exchange of their proprietary interests in the society for stock in a newly formed taxable mutual life insurance company. See Rev. Rul. 74-277, page 88.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355-1: Distribution of stock and securities of controlled corporation.

Spin-off; active trade or business requirement. A parent corporation not engaged in the active conduct of a trade or business, wishing to distribute to its shareholders all of the stock of a wholly-owned subsidiary corporation in a transaction meeting the requirements of section 355 of the Code, may satisfy the active trade or business requirements of section 355(b) by liquidating another wholly-owned subsidiary that meets such requirements and acquiring the subsidiary's business in a transaction in which no gain or loss is recognized.

Rev. Rul. 74-79

Advice has been requested whether, under the circumstances described below, a corporation is engaged in the active conduct of a trade or business for purposes of section 355(b) of the Internal Revenue Code of 1954.

Corporation X has owned all of the stock of corporations M and N for over five years. M and N have each been engaged during this time in the active conduct of a business, M in the steel manufacturing business and N in the motor common carrier business. The stock of corporations O and P was acquired by X four years ago in a transaction in which gain was recognized. O has been engaged in the active conduct of a newspaper publication business for the preceding five years and P has been engaged in the active conduct of an automobile parts manufacturing business for the preceding five years. X has never directly engaged in any business activity and has no assets other than the stock of M, N, O, and P. The stock of M, N, O, and P are of approximately equal value.

X, for valid business reasons, wished

to distribute all of the stock of *N* to the *X* shareholders in a transaction meeting the requirements of section 355 of the Code. However, such a distribution would not qualify under section 355(a) because the active business requirements of section 355(b) could not be satisfied. Under section 355(b)(1)(A) the distributing corporation, *X*, must itself be engaged after the distribution in the active conduct of a trade or business as that term is defined in section 355(b)(2). Under section 355(b)(2)(A) a corporation is treated as engaged in the active conduct of a trade or business only if it is directly engaged in the active conduct of a business or substantially all of its assets consists of stock and securities of corporations controlled by it which are so engaged. *X* is not directly engaged in the active conduct of any business and after a distribution of *N* stock, two-thirds of its assets would consist of stock of controlled corporations *O* and *P* which are not treated as engaged in the active conduct of a trade or business because control of these corporations was acquired within the five-year period ending on the date of distribution in a taxable transaction. See section 355(b)(2)(D). Furthermore, *X* would not qualify under section 355(b)(1)(B) (relating to a distributing corporation that has no assets other than stock in the controlled corporations that are engaged immediately after the distribution in the active conduct of a trade or business) because *X* owns stock, before the distribution, of three corporations, *M*, *O*, and *P*, which are not the controlled corporations, that is, corporations whose stock is to be distributed.

Therefore, *X*, with the intent of meeting the active trade or business requirements of section 355(b)(1)(A) of the Code by itself being directly engaged in the active conduct of a trade or business, liquidated *M* in a transaction in which no gain or loss was recognized to *X* or *M* pursuant to the provisions of sections 332 and 336, respectively. Immediately thereafter, *X* distributed all of the stock of *N* to the shareholders of *X*. At the time of the distribution *X* had no plan to sell or otherwise dispose of the assets of the business formerly conducted by *M*. *X* continued to engage in the active conduct of the steel manufacturing business acquired upon the complete liquidation of *M*.

Section 355(a)(1) of the Code provides for the nonrecognition of gain or loss to shareholders upon the distribution of the stock of a controlled corporation where, among other things, the requirements of section 355(b) are satisfied. For this purpose, section 368(c) defines the term "control" to mean ownership of at least 80 percent of the voting stock and 80 percent of the nonvoting stock of a corporation.

Section 355(b)(1)(A) of the Code requires that both the distributing and controlled corporation each be engaged immediately after the distribution in the active conduct of a trade or business.

Section 355(b)(2) of the Code defines those circumstances under which a corporation will be treated as engaged in the active conduct of a trade or business for purposes of section 355(b)(1). Section 355(b)(2) requires, in pertinent part, that the trade or business must have been conducted for at least a five-year period ending on the date of distribution and must not have been acquired during such period in a transaction in which gain or loss was recognized in whole or in part.

Although the business of *M*, which *M* had conducted for the five-year period, was acquired by *X* within such five-year period, it was not acquired in a transaction in which gain or loss was recognized. Accordingly, *X* is engaged immediately after the distribution in the active conduct of a trade or business within the meaning of section 355(b)(1)(A) of the Code.

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26 CFR 1.355-1: Distribution of stock and securities of controlled corporation.

Whether recapture of investment credit is required due to early disposition of section 38 property in a divisive reorganization under section 355 where such property is transferred from existing corporation to two newly formed corporations. See Rev. Rul. 74-101, page 7.

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26 CFR 1.355-4: Active conduct of a trade or business.

Controlled corporations; stock distribution; active trade or business. A corporation purchased all of the stock of another corporation in 1969 in a transaction in which gain or loss was recognized. In 1971 the acquired corporation distributed the stock of its wholly-owned subsidiary whose stock it had acquired in 1965 to the acquiring corporation which, in 1972, distributed that stock to its shareholders. Each of the corporations involved had been actively engaged in a trade or business since 1960. **Held,** the distribution by the acquired corporation of the stock of its wholly-owned subsidiary meets the requirements of section 355(b)(2)(D) of the Code; however, the distribution of the stock by the acquiring corporation to its shareholders does not satisfy those requirements.

Rev. Rul. 74-5

Advice has been requested whether the transactions described below satisfy the active trade or business requirements of section 355(b) of the Internal Revenue Code of 1954.

All the outstanding stock of *P* corporation is owned by individual shareholders. In 1969 *P* acquired for cash all the outstanding stock of *X* corporation from *T* corporation, an unrelated party, in a transaction in which gain or loss was recognized to *T*. The assets of *X* include all the outstanding

stock of *Y* corporation. *X* has owned all the *Y* stock since 1965. In 1971 *X* distributed all the *Y* stock to *P*. In 1972 *P* distributed all its *Y* stock to the *P* shareholders. *P*, *X*, and *Y* have each conducted an active trade or business since 1960.

Section 355 of the code provides for the distribution without recognition of gain or loss to the shareholders of the stock of a corporation controlled by the distributing corporation. For such treatment, section 355(b)(1)(A) requires that both the distributing corporation and the controlled corporation be engaged immediately after the distribution in the active conduct of a trade or business. Section 355(b)(2)(A), in defining an active trade or business, requires that the distributing corporation and the controlled corporation each be engaged in the active conduct of a trade or business, or hold as substantially all of its assets, stock and securities of a corporation controlled by it (immediately after the distribution) which is so engaged. Section 355(b)(2)(B) provides that such trade or business must have been actively conducted throughout the five-year period ending on the date of the distribution. Section 355(b)(2)(C) provides that the trade or business must not have been acquired within the period described in section 355(b)(2)(B) in a transaction in which gain or loss was recognized in whole or in part.

Section 355(b)(2)(D) of the code provides further that control of a corporation, which at the time of acquisition of control was conducting an active trade or business, must not have been acquired directly (or through one or more corporations) by "another corporation" within the five-year period described in section 355(b)(2)(B), or if so acquired by "another corporation" within such period, such control must not have been acquired by reason of transactions in which gain or loss was recognized in whole or in part, or acquired by reason of such transactions combined with acquisitions before the beginning of such period.

The purpose of section 355(b)(2)(D) of the code is to prevent a distributing corporation from accumulating excess funds to purchase the stock of a corporation having an active business and immediately distributing such stock to its shareholders. See *H.R. Rep. No. 2543*, 83rd Cong., 2d Sess. 37 (1954). Thus where control is acquired by the distributing corporation in a transaction in which gain or loss is recognized, the distributing corporation cannot distribute the stock of the controlled corporation within the five-year period and qualify under section 355.

The requirements of sections 355(b)(2)(A), (B), and (C) of the code are met with regard to both the distribution by *X* of the *Y* stock to *P* and the distribution by *P* of the *Y* stock to the *P* shareholders. The question presented is whether the requirements of section 355(b)(2)(D) have been met with regard to each of the distributions since *P* acquired control of *X* directly and *Y* indirectly within the five-year period prior to the distributions in a transaction in which gain or loss was recognized.

The distribution by *X* of the *Y* stock to *P* satisfies the requirements of section 355(b)(2)(D) of the code even though *P* ("another corporation") acquired control of *X* directly and *Y* indirectly within the five-year period prior to distribution in a transaction in which gain or loss was recognized. The purchase of the *X* stock by *P* within the five-year period is not the type of transaction to which section 355(b)(2)(d) is directed since *P* is merely the shareholder receiving the distributions and not the distributing or controlled corporation. In the distribution of the *Y* stock to *P* it is impossible for *P* to pass accumulated excess funds through another corporation to *P* shareholders. Thus in this transaction the abuse that section 355(b)(2)(D) was designed to prevent is not present and the section has no application to the acquisition of control of *X*, and indirectly of *Y*, by *P*.

However, the distribution by *P* of the *Y* stock to the *P* shareholders does not satisfy the requirements of section 355(b)(2)(D) of the code since the business of the controlled corporation, *Y*, was indirectly acquired by the distributing corporation, *P*, through another corporation, *X*, during the five-year period ending on the date of the distribution in a transaction in which gain or loss was recognized.

Section 356.—Receipt of Additional Consideration

26 CFR 1.356-5: Transactions involving gift or compensation.

Whether the exchange of a portion of the common stock of a corporation for newly issued preferred stock constitutes a transaction described in section 354 of the Code. See Rev. Rul. 74-269, page 87.

Section 358.—Basis to Distributees

26 CFR 1.358-1: Basis to distributees.

Whether the exchange of a portion of the common stock of a corporation for newly issued preferred stock constitutes a reorganization within the meaning of section 368(a)(1)(E) of the Code. See Rev. Rul. 74-269, page 87.

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26 CFR 1.358-1: Basis to distributees.

Basis of policyholder-members upon exchange of their proprietary interests in a fraternal beneficiary society for stock of a newly formed mutual life insurance company. See Rev. Rul. 74-277, page 88.

Subpart C. Effects on Corporations

Section 361.—Nonrecognition of Gain or Loss To Corporations

26 CFR 1.361-1: Nonrecognition of gain or loss to corporations.

Whether gain or loss is recognized under section 361(a) upon transfer of substantially all of the assets of a tax-exempt fraternal beneficiary society to a newly formed mutual life insurance company in exchange for the new company's stock. See Rev. Rul. 74-277, page 88.

Subpart D. Special Rules; Definitions

Section 367.—Foreign Corporations

26 CFR 1.367-1: Foreign corporations.
(Also Section 368; 1.368-2.)

Reorganization; merger into foreign corporation's domestic subsidiary; advance ruling. The merger of an unrelated domestic corporation into the wholly-owned domestic subsidiary of a foreign corporation through an exchange of the parent corporation's stock, meeting the business purpose and continuity requirements of section 368(a)(1)(A) of the Code, qualifies as a reorganization by reason of the application of section 368(a)(2)(D). However, for the nonrecognition of gain provisions of sections 354 and 361 to apply, an advance ruling under section 367 is necessary.

Rev. Rul. 74-297

Advice has geen requested whether section 367 of the Internal Revenue Code of 1954 is applicable to the transaction described below which depends on whether the transaction qualifies as a reorganization under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(D).

Corporation *S*, a wholly owned subsidiary of corporation *P*, desires to acquire all of the assets of corporation *X*, an unrelated corporation. *P* is incorporated under the laws of a foreign country. *S* and *X* are incorporated under the laws of State *A*. It is proposed that the acquisition will be accomplished by merging *X* into *S*, pursuant to the laws of State *A*, with the *X* shareholders exchanging their *X* stock for *P* stock. No stock of *S* will be used in the transaction. In the merger, *S* will receive all of the assets of *X* and will assume all of *X*'s liabilities.

Section 367(a) of the Code provides, in part, that in determining the extent to which gain will be recognized in the case of exchanges described in sections 354 or 361, a foreign corporation will not be considered as a corporation unless before the exchanges are consummated a ruling has been issued by the Internal Revenue Service that the transaction is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

Section 368(a)(1)(A) of the Code defines the term "reorganization" to mean a statutory merger or consolidation.

Section 368(a)(2)(D) of the Code provides that the acquisition by one corporation, in exchange for stock of a corporation ("controlling corporation") which is in control of the acquiring corporation, of substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation will not disqualify a transaction under section 368(a)(1)(A) if (i) such transaction would have qualified under section 368(a)(1)(A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction.

Section 368(b) of the Code provides, in part, that in the case of a reorganization qualifying under section 368(a)(1)(A) by reason of section 368(a)(2)(D), the term "a party to a reorganization" includes the controlling corporation referred to in section 368(a)(2)(D).

Section 354(a)(1) of the Code provides, in part, that no gain or loss will be recognized if stock in a corporation a party to a reorganization is, in pursuance of the plan of reorganization, exchanged solely for stock in such corporation or in another corporation a party to the reorganization.

Section 361(a) of the Code provides that no gain or loss will be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock in another corporation a party to the reorganization.

The test of section 368(a)(2)(D) of the Code of whether the transaction would have qualified under section 368(a)(1)(A) if the merger had been into the controlling corporation means that the general requirements of a reorganization under section 368(a)(1)(A) (such as business purpose, continuity of business enterprise, and continuity of interest) must be met in addition to the special requirements of section 368(a)(2)(D). Under this test, it is not relevant whether the merger into the controlling corporation could have been effected pursuant to state or Federal corporation law. See *S. Rep. No. 1653,* 90th Cong., 2d Sess. (1968), 1968-2 C.B. 849, 850.

In the instant case, the proposed transaction meets the requirements of a reorganization under section 368(a)(1)(A) of the Code such as business purpose, continuity of business enterprise, and continuity of interest. In addition, the transaction meets the special requirements of section 368(a)(2)(D). Therefore, the transaction qualifies as a reorganization under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(D).

However, in order for *P*, a foreign corporation, to be considered a corporation and, therefore, a party to the reorganization for purposes of having the nonrecognition of gain provisions of sections 354 and 361 of the Code apply to the transaction, it is necessary, pursuant to section 367, that a ruling be obtained prior to the transaction that the exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

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26 CFR 1.367-1: Foreign corporations.

Whether section 1248 of the Code applies to a situation in which a domestic corporation surrenders its stock in a foreign corporation for stock resulting from an amalgamation of the foreign corpora-

tion and its wholly-owned subsidiary, without the domestic corporation obtaining "clearance" under secton 367. See Rev. Rul. 74-106, page 237.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges. (Also Section 301; 1.301-1.)

Reorganization; stock for stock exchange; partial distribution of assets. The acquisition by a corporation, pursuant to a plan of reorganization, of all the outstanding stock of an unrelated corporation solely in exchange for stock representing 20 percent of its voting stock after the transaction qualifies as a reorganization under section 368(a)(1)(B) of the Code; a distribution, pursuant to the plan of reorganization, by the acquired corporation to the acquiring corporation of appreciated investment assets representing 30 percent in value of the acquired corporation's assets is a distribution to which section 301 applies.

Rev. Rul. 74-35

Advice has been requested as to the Federal income tax consequences of the acquisition by one corporation, solely for shares of its voting stock, of all of the outstanding stock of another corporation, followed by a distribution by the acquired corporation of a part of its assets under the circumstances described below.

X and *Y* were unrelated corporations, each of which was engaged in a separate business. Pursuant to a plan of reorganization and for valid business reasons, *Y* acquired all of the outstanding stock of *X* solely in exchange for 10,000 shares of voting common stock of *Y*, representing 20 percent of the *Y* stock outstanding after the transaction. As part of the plan, *X* then distributed to *Y*, its sole shareholder, appreciated investment assets (not constituting an active trade or business within the meaning of sections 346 and 355 of the Internal Revenue Code of 1954) amounting to 30 percent in value of the *X* assets.

At issue is whether the principle set forth in *Kimbell-Diamond Milling Co.*, 14 T.C. 74 (1950), *aff'd per curiam* 187 F.2d 718 (5th Cir. 1950), *cert. denied* 342 U.S. 827 (1951) properly should be invoked when *Y*, pursuant to the overall plan, acquired direct ownership of some, but not all, of *X*'s assets. If this principle does apply, the transaction will be recast for Federal income purposes into (1) a constructive sale by *X* to *Y* of the assets "distributed" in exchange for an amount of the *Y* stock received of equivalent value, followed by a constructive taxable distribution of such stock by *X* to its shareholders, and (2) a concurrent exchange by the *X* shareholders of their *X* stock solely for the remainder of the *Y* stock qualifying as a reorganization under section 368(a)(1)(B).

Section 368(a)(1)(B) of the Code provides, in pertinent part, that the term "reorganization" means the acquisition by one corporation, in exchange solely for shares of its voting stock, of the outstanding stock of another corporation if, immediately after the transaction, the acquiring corporation has control of such other corporation. Under section 368(c), "control" means ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

In *Kimbell-Diamond Milling Co.* and Rev. Rul. 67-274, 1967-2 C.B. 141, one corporation acquired all of the stock of another corporation pursuant to a prearranged plan the essential nature of which was the acquisition of the assets of that corporation by immediately liquidating it. In each, effect was given to the intent, purpose and result of this plan such that the acquiring corporation was treated as if it had actually acquired assets rather than stock. Although Rev. Rul. 67-274 makes no reference to *Kimbell-Diamond,* the holding that the initial acquisition of stock is to be disregarded as transitory and that the transaction is to be treated as an acquisition of assets represents an application of the *Kimbell-Diamond* principle. Under that principle, whenever a corporation acquires all the stock of another corporation pursuant to a prearranged plan to liquidate that corporation in order to acquire its assets, the transaction is treated, as to the acquiring corporation, as an acquisition of assets.

The *Kimbell-Diamond* principle, as illustrated by Rev. Rul. 67-274, does not support a recast of a portion of a transaction, such as in the instant case, because *Y* does not acquire substantially all the property of *X*. *Y* continues its stock interest in *X*, which retains all of its operating assets and 70 percent in value of all the assets it owned prior to the transaction.

Accordingly, the acquisition by *Y*, in exchange solely for its voting stock, of the outstanding stock of *X* qualifies as a reorganization within the meaning of section 368(a)(1)(B) of the Code. No gain or loss is recognized to the *X* shareholders upon the exchange of their stock for the *Y* stock under section 354(a), nor to *Y* upon receipt of the *X* stock in exchange for the *Y* stock under section 1032(a). The distribution of assets by *X* to *Y* is a distribution of property under section 301.

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26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Whether requests for rulings will be considered under section 368 of the Code with regard to the acquisition by an investment company of the stock or assets of another investment company. See Rev. Proc. 74-10, page 420.

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26 CFR 1.368-2: Definition of terms. (Also Section 302; 1.302-1.)

Reorganization; cash for frac-

tional shares of stock. Payment of cash in lieu of fractional shares of stock in a reorganization qualifying under section 368(a)(1)(F) of the Code to mechanically round off the fractions resulting from the exchange, and not as a separately bargained-for consideration, will be tested under section 302 as a distribution in redemption of the fractional share interests.

Rev. Rul. 74-36

Advice has been requested concerning the tax treatment of cash received by shareholders in lieu of fractional shares of stock in a reorganization defined in section 368(a)(1)(F) of the Internal Revenue Code of 1954.

Rev. Rul. 66-365, 1966-2 C.B. 116, holds that the "solely for voting stock" requirement contained in sections 368 (a)(1)(B) and (C) of the Code will not be violated where a cash payment made by the acquiring corporation to the shareholders of the acquired corporation is in lieu of fractional interests and represents a mere mechanical rounding off of the fractions in the exchange rather than separately bargained-for consideration. That Revenue Ruling also holds that, in a transaction qualifying under section 368(a)(1)(A), (C) (by reason of section 368(a)(2)(B)), or (D), if the cash paid by the acquiring corporation represents separately bargained-for consideration it will be treated as the receipt of "boot" under sections 356(a) and 361(b).

In addition, Rev. Rul. 66-365 holds that where such a cash payment is in lieu of fractional interests and is not in the nature of bargained-for consideration, it will be treated as a distribution in full payment in exchange for the fractional share under section 302(a) of the Code provided the payment is not essentially equivalent to a dividend.

Rev. Rul. 69-34, 1969-1 C.B. 105, extended the application of Rev. Rul. 66-365 to cash payments accompanying a reorganization qualifying under section 368(a)(1)(E) of the Code relating to recapitalizations.

The tests set forth in Rev. Rul. 66-365 (namely, where the cash paid represents merely a mechanical rounding off of the fractions in the exchange, and is not a separately bargained-for consideration) will also be applied to cash payments accompanying a reorganization qualifying under section 368(a)(1)(F) of the Code relating to a mere change in identity, form, or place of organization. If these criteria are satisfied, the cash payments will be tested under section 302 of the Code relating to distributions in redemption of stock. However, if these criteria are not satisfied, the cash payments will be treated either as the receipt of "boot" under section 356(a) or as distributions to which section 301 applies, depending upon all the facts and circumstances involved. See section 1.301-1(1) of the Income Tax Regulations.

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26 CFR 1.368-2: Definition of terms. (Also Section 354; 1.354-1.)

Reorganizations; regulated investment company acquiring personal holding company. The exchange by a regulated investment company of its stock for all the assets of a personal holding company engaged in purchasing, selling, and managing securities in its portfolio, under a plan in which the acquired corporation distributed the stock to its shareholders and dissolved, constitutes a reorganization within the meaning of section 368(a)(1)(C) of the Code.

Rev. Rul. 74-155

Advice has been requested whether the acquisition of all of the assets of a personal holding company by a regulated investment company under the circumstances described below constitutes a reorganization within the meaning of section 368(a)(1)(C) of the Internal Revenue Code of 1954.

X corporation is an investment company which, for a number of years, has qualified and elected to be taxed as a regulated investment company under the provisions of sections 851 through 855 of the Code. The assets of *X* are invested in the stock of various corporations in a wide range of industries. *X* engages in the business of purchasing, selling and managing its investment assets on a continuous basis.

Y corporation is a personal holding company as defined in section 542 of the Code. *Y* has been engaged, for a number of years, in purchasing, selling, and managing securities in its portfolio. The percentage of outstanding stock *X* and *Y* each held in corporations in different industries varied.

X, pursuant to a plan, acquired all of the assets of *Y* in exchange solely for *X* voting stock. *Y* distributed the *X* stock to its shareholders and dissolved. The purpose of the transaction was to enable *X* to acquire the securities of *Y*, without incurring the costs of brokerage commissions, and thereby achieve further diversification of its investments, and to enable *Y* to acquire the management know-how of *X* for its investments and greater diversification for its shareholders of the investment assets underlying their stockholdings.

No prior transfers of property to *X* or *Y* were made under section 351 of the Code in contemplation of the transaction described above. See section 1.351-1(c)(5) of the Income Tax Regulations.

Section 368(a)(1)(C) of the Code, in pertinent part, provides that the term "reorganization" means the acquisition by one corporation in exchange solely for all or part of its voting stock of substantially all of the properties of another corporation.

Section 1.368-1(b) of the regulations provides, in part, that requisite to a reorganization under the Code are continuity of the business enterprise under modified corporate form and a

continuity of interest therein on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the reorganization.

Section 1.368-2(g) of the regulations provides, in part, that the transaction embraced in a plan must not only come within the specific language of section 368(a) of the Code, but the readjustments involved in the exchanges effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization.

Based upon the facts stated above, the "business purpose" for effecting the transaction meets the requirements of section 1.368-2(g) of the regulations. Furthermore, there is continuity of the business enterprise of *Y* by *X* and a continuing interest in *X* by the former *Y* shareholders through their ownership of *X* stock thus satisfying the requirements of section 1.368-1(b).

Accordingly, the acquisition by *X* of all of the assets of *Y* qualifies as a reorganization within the meaning of section 368(a)(1)(C) of the Code. No gain or loss will be recognized to the shareholders of *Y* upon the exchange of their shares of *Y* for shares of *X* as provided for in section 354.

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26 CFR 1.368-2: Definition of terms. (Also Sections 354, 356, 358; 1.354-1, 1.356-5, 1.358-1.)

Recapitalization; new preferred stock for part of common. In accordance with a corporation's plan of recapitalization, an exchange of newly issued preferred stock for all the common stock held by its majority shareholder constitutes a reorganization within the meaning of section 368(a)(1)(E) of the Code and no gain will be recognized provided the fair market value of the preferred stock equals that of the common; however, if the fair market value of either stock exceeds the other, the difference must be treated as having been used for whatever purpose the facts indicate. Rev. Rul. 54-13 superseded.

Rev. Rul. 74-269

Advice has been requested whether the situation described below constitutes a recapitalization and, therefore, a reorganization under section 368(a)(1)(E) of the Internal Revenue Code of 1954.

A, the founder of *X* corporation, owns 50 of *X*'s outstanding 100 shares of common stock. *B* and *C*, *A*'s sons, each owns 25 shares. In anticipation of *A*'s retirement and pursuant to a plan of recapitalization, *X* proposes to exchange shares of newly issued $100 par value six percent cumulative nonvoting preferred stock for all of *A*'s common stock. *B* and *C* will not participate in the exchange. The terms of the preferred stock provides that on liquidation, the preferred shareholder will receive the par value of his shares plus accrued dividends. The book value per share of *X* common stock was calculated to be $10*x*, or a total book value of $500*x* for the 50 shares held by *A*.

Pursuant to the plan, *A* will exchange all of his *X* common stock with a book value of $500*x* for five shares of new *X* preferred stock with a par value of $500*x*.

Section 368(a)(1) of the Code provides in subparagraph (E) that a recapitalization constitutes a "reorganization." Section 354(a)(1) provides, in part, that no gain or loss will be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation. Section 358 provides, in effect, that in an exchange to which section 354 applies, the basis of the stock permitted to be received pursuant to the 354 exchange will be the same as that of the stock exchanged therefor. Section 356(f) provides that for transactions described in section 354, but which result in a gift or have the effect of the payment of compensation, the appropriate sections of the Code will apply.

In the exchange of stock described above, the parties contend that the fair market value of the preferred stock is equal to the fair market value of the common stock exchanged therefor. As support for this contention, the parties use the book value of the common stock and par value of the preferred stock.

The fair market value of stock is a factual determination and is not necessarily the book value or par value of the stock. However, to the extent that the fair market value of the preferred stock received in the instant case is found, in fact, to be equal to the fair market value of the common stock exchanged therefor, the transaction will constitute an exchange pursuant to a reorganization within the meaning of section 368(a)(1)(E) of the Code.

Accordingly, the exchange of stock described above will constitute a reorganization within the meaning of section 368(a)(1)(E) of the Code and no gain or loss will be recognized to *A* under section 354 on the exchange of those shares of his common stock which are equal in value to the value of the shares of the preferred stock which are received in exchange therefor. Under section 358 the basis of the preferred stock received by *A* in the exchange will be the same as the basis of those shares of the common stock which are considered exchanged under section 354. However, if *A* receives shares of preferred stock having a fair market value in excess of the fair market value of the common stock surrendered, or surrenders shares of common stock having a fair market value in excess of the fair market value of the preferred stock received, the amount representing such excess will be treated as having been used to make gifts, pay compensation, satisfy obligations of any kind, or for whatever purpose the facts indi-

cate. The reorganization will not diminish the accumulated earnings and profits of *X* corporation available for the subsequent distribution of dividends within the meaning of section 316.

Rev. Rul. 54-13, 1954-1 C.B. 109, is hereby superseded, since the position set forth therein is restated under the current law in this Revenue Ruling.

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26 CFR 1.368-2: Definition of terms.

Whether the conversion pursuant to State law of a fraternal beneficiary society into a mutual life insurance company by a transfer of all assets and liabilities, including outstanding insurance policies is a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 74-277, this page.

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26 CFR 1.368-2: Definition of terms.

Whether a transaction qualifies as a reorganization under section 368(a)(1)(A) of the Code by reason of the application of section (a)(2)(D), and whether section 367 is applicable to the transaction if it does so qualify. See Rev. Rul. 74-297, page 84.

Part V.—Carryovers

Section 381.—Carryovers in Certain Corporate Acquisitions

26 CFR 1.381(a)-1; General rule relating to carryovers in certain corporate acquisitions.
(Also 1.381(b)-1.)
(Also Sections 354, 358, 361, 368, 1032; 1.354-1, 1.358-1, 1.361-1, 1.368-2, 1.1032-1.)

Reorganization; fraternal beneficiary society converted to mutual life company. The conversion of an exempt fraternal beneficiary society to a taxable mutual life insurance company, under a plan of reorganization and provisions of State law, whereby the society transferred all of its assets to the company which assumed all of the society's liabilities, including its outstanding insurance policies, and the policyholders continued to possess their contractual rights and proprietary interests qualifies as a section 368(a)(1)(D) reorganization. No gain or loss will be recognized to the society, the company, or the policyholders; each policyholder will have a zero basis in his interest in the company; and the earnings and profits of the society will carry over to the company.

Rev. Rul. 74-277

Advice has been requested as to the Federal income tax consequences of the transfer of assets and assumption of liabilities under circumstances below.

Corporation *X* is a fraternal beneficiary society operating under the lodge system for the exclusive benefit of its members and is engaged in providing life insurance benefits and coverage for its members. It is qualified as a tax-exempt organization under section 501(c)(8) of the Internal Revenue Code of 1954.

Pursuant to a plan of reorganization and the provisions of State law authorizing the conversion of a fraternal beneficiary society into a mutual life insurance company, Corporation *X* on July 1, 1972, transferred all of its assets to Corporation *Y* a newly organized mutual life insurance company. *Y* assumed all of the liabilities of *X*, including all liabilities under the outstanding insurance policies issued by *X*. Corporation *Y* is a life insurance company within the meaning of section 801 of the Code and is subject to tax under section 802.

Approximately five percent of the policyholders of Corporation *X* elected to cancel their membership certificates and insurance policies and did not participate in the transaction. Such policyholders received a refund of their unearned dues (premiums), including any nonforfeiture value.

By operation of state law the policyholders of *X* occupied a dual legal relationship to the corporation: (1) as members of a membership corporation they had proprietary interests, and (2) as policyholders they possessed the contractual rights provided for in their contracts. Similarly, those policyholders of *X* who participated in the above-described transaction acquired proprietary interests in *Y* (a mutual insurance company), and as policyholders they continued to possess the contractual rights provided for in the contracts. See Rev. Rul. 71-233, 1971-1 C.B. 113.

The premiums paid by each policyholder of *X* represented payments for the cost of insurance and an investment in his contract, but such premium payments were not an investment in the assets of *X*. The policyholders' proprietary interests in the assets of *X* arise solely by virtue of their insurance contracts with *X*. Therefore, the basis of each policyholder's proprietary interest in *X* is zero.

The adjusted basis of the assets of *X* transferred to *Y* exceeded the sum of the *X* liabilities assumed by *Y* plus the *X* liabilities to which the property was subject. The assets of *X* transferred to *Y* represent more than ninety percent of the fair market value of the net assets and seventy percent of the fair market value of the gross assets held by *X* immediately prior to the transfer.

Section 368(a)(1)(D) of the Code defines a "reorganization" in part, as a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355 or 356.

Section 354(a) of the Code provides that no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation

or in another corporation a party to the reorganization.

Section 354(b) of the Code provides that subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D) unless "substantially all of the assets of the transferor" are acquired by the transferee.

Section 358 of the Code provides, in part, that the basis of the property permitted to be received in certain exchanges shall be the same as that of the property exchanged with certain required adjustments.

Section 361(a) of the Code provides that no gain or loss will be recognized if a corporation that is a party to a reorganization exchanges property, in pursuance of the plan of reorganization solely for stock or securities in another corporation, a party to the reorganization.

Section 381 of the Code provides that in the case of the acquisition of the assets of a corporation by another corporation, in a transaction described therein, the acquiring corporation shall succeed and take into account, as of the close of the day of distribution or transfer, the items described in section 381(c) of the distributor or transferor corporation, subject to certain conditions and limitations specified in section 381(b) and 381(c).

In the instant case, since "immediately after the transfer" the proprietors (policyholders) of X were in control of Y, and since "substantially all of the assets" of X were transferred to Y, the transaction qualifies as a reorganization under section 368(a)(1)(D) of the Code.

Based solely on the foregoing, certain of the Federal income tax consequences are as follows:

(1) No gain or loss will be recognized to either X or Y (parties to the reorganization pursuant to section 368(b) of the Code) because of the application of sections 361(a) and 1032(a).

(2) No gain or loss will be recognized to the policyholder-members of X upon the exchange of their proprietary interests in X for proprietary interests in Y pursuant to section 354(a)(1) of the Code.

(3) In accordance with section 358(a) of the Code each policyholder will have a zero basis in his proprietary interest in Y since the basis of his proprietary interest exchanged was zero.

(4) Since the instant transaction is one to which section 381(c) of the Code applies, the accumulated earnings and profits of X will carry over and be added to the earnings and profits of Y. See section 381(c)(2).

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26 CFR 1.381(a)-1: General rule relating to carryovers in certain corporate acquisitions.

Whether exception to recapture of investment credit allowed for transactions to which section 381(a) applies is applicable where substantially all of the transferor's assets are not acquired by either one of the transferee corporations involved. See Rev. Rul. 74-101, page 7.

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26 CFR 1.381(b)-1: Operating rules applicable to carryovers in certain corporate acquisitions.

Whether accumulated earnings and profits of a tax-exempt fraternal beneficiary society carry over and are added to earnings and profits of a newly formed taxable mutual life insurance company in a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 74-277, page 88.

Subchapter D. Deferred Compensation, etc. Part I.—Pension, Profit-sharing, Stock Bonus Plans, etc.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Profit-sharing plan; withdrawal of employee contributions. The provision in an employees' profit-sharing plan that permits participants to withdraw at any time their required and optional contributions to which employer contributions are geared could reasonably be expected to result in the manipulation of the formula allocating employer's contributions, and the plan will not qualify under section 401(a) of the Code; Rev. Rul. 72-275 modified.

Rev. Rul. 74-55 [1]

Further consideration has been given to Rev. Rul. 72-275, 1972-1 C.B. 109, relating to whether a profit-sharing plan qualifies under section 401(a) of the Internal Revenue Code of 1954 if it contains the provisions described below.

In accordance with the plan, each participant must contribute an amount each month equal to two percent of his current compensation. A participant may make additional contributions each month in an amount equal to one, two, or three percent of his compensation. The employer contributes each month for each participant, out of profits, an amount equal to the participant's required and optional contributions. A participant may withdraw all or any part of his own contributions at any time without penalty and without affecting the employer contributions and earnings allocated to his account. A participant's share of employer contributions and trust earnings may be withdrawn, however, only upon termination of the participant's employment.

Rev. Rul. 72-275 states that optional employee contributions to which the employer contributions are geared are part of the funds accumulated under the plan within the meaning of section 1.401-1(b)(1)(ii) of the Income Tax Regulations. That Revenue Ruling states further that allowing employer contributions to be allocated on the basis of employee contributions that may be withdrawn immediately after they are made would permit manipulation of the allocation and contravene the requirement of section

[1] Also released as Technical Information Release No. 1270, dated January 10, 1974.

1.401-1(b)(1)(ii) for a definite predetermined allocation formula. That Revenue Ruling accordingly holds that the plan does not qualify under section 401(a) of the Code.

Section 1.401-1(b)(1)(ii) of the regulations provides that a profit-sharing plan must provide a definite predetermined formula for allocating the contributions made to the plan among the participants and for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment. Rev. Rul. 71-295, 1971-2 C.B. 184, holds that the term "fixed number of years" means at least two years.

Although it is recognized that employee contributions are funds accumulated under the plan for certain purposes, the term "funds accumulated under the plan", as used in section 1.401-1(b)(1)(ii) of the regulations, does not include employee contributions. The employee contributions under this plan are, therefore, not a part of the funds accumulated under the plan within the meaning of that provision.

Allowing employer contributions to be allocated on the basis of employee contributions that may be withdrawn immediately after they are made, however, could reasonably be expected to result in manipulation of the allocation and contravention of the definite predetermined allocation formula requirement of section 1.401-1(b)(1)(ii) of the regulations. In general, a profit-sharing plan containing a withdrawal provision that can reasonably be expected to result in the manipulation of the allocation in contravention of the requirement of section 1.401-1(b)(1)(ii), that a profit-sharing plan must provide a definite predetermined formula for allocating the contributions made to the plan among participants, does not satisfy the qualification requirements of section 401(a) of the Code.

Accordingly, the plan does not qualify under section 401(a) of the Code since the withdrawal provision can reasonably be expected to result in the manipulation of the allocation.

Rev. Rul. 72-275 is hereby modified to remove therefrom the statement that the employee contributions are a part of the funds accumulated under the plan within the meaning of section 1.401-1(b)(1)(ii) of the regulations.

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26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.

Profit-sharing plan; withdrawal of employee contributions. The provision in an employees' profit-sharing plan that permits participants to withdraw their own contributions prior to termination of their employment, thereby suspending contributions to the trust accounts of those employees for six months, imposes a substantial limitation on the right of participants to withdraw their own contributions and the plan may qualify under section 401(a) of the Code; Rev. Rul. 72-367 modified.

Rev. Rul. 74-56 [1]

Advice has been requested whether, under the circumstances described below, a profit-sharing plan may qualify under section 401(a) of the Internal Revenue Code of 1954.

The plan provides that each participant may make contributions each month in any amount up to six percent of his earnings for that month. Under the plan, the employer is to contribute each month, out of its current or accumulated earnings or profits, an amount equal to the total amounts contributed by the participants, and these contributions are to be allocated to each participant's account in proportion to his own contributions. The plan further provides that a participant may withdraw his own contributions to the trust under the plan at any time, but, if he makes such a withdrawal, his right to make future contributions to the trust is suspended for six months. No employee or employer contributions may ever be made with respect to any such six-month period of suspension.

Rev. Rul. 72-367, 1972-2 C.B. 219, involves a profit-sharing plan that requires each participant to contribute each month an amount equal to two percent of his earnings for the month. The plan also provides that each participant may make additional contributions each month in any amount up to four percent of his earnings for the month. Under the plan, the employer is to contribute each month, out of its current or accumulated earnings or profits, an amount equal to the total amounts contributed by the participants. The plan further provides that a participant may withdraw his own contributions to the trust, plus the increments earned thereon, at any time. Upon any such withdrawal made prior to the time the participant terminates his employment, however, he forfeits the employer contributions, plus the increments earned thereon, that were geared to the withdrawn employee contributions.

Rev. Rul. 72-367 states that optional employee contributions to which employer contributions are geared are a part of the funds accumulated under the plan within the meaning of section 1.401-1(b)(1)(ii) of the Income Tax Regulations. It states further that the willingness of a participant to forfeit the geared employer contributions in order to withdraw his own contributions is evidence of financial need within the meaning of Rev. Rul. 56-693, 1956-2 C.B. 282. It accordingly holds that the withdrawal provision does not cause the plan to fail to qualify under section 401(a) of the Code.

Section 1.401-1(b)(1)(ii) of the regulations provides that a profit-sharing plan must provide a definite pre-

[1] Also released as Technical Information Release No. 1270, dated January 10, 1974.

determined formula for allocating the contributions made to the plan among prior occurrence of some event such after a fixed number of years, the at- the funds accumulated under the plan tainment of a stated age, or upon the the participants and for distributing as layoff, illness, disability, retirement, death, or severance of employment.

Rev. Rul. 74-55, page 89, this Bulletin, modifying Rev. Rul. 72-275, 1972-1 C.B. 109, concludes that the term "funds accumulated under the plan", as used in section 1.401-1(b)(1)(ii) of the regulations, does not include employee contributions. It also concludes that a profit-sharing plan containing a withdrawal provision that could reasonably be expected to result in the manipulation of the allocation in contravention of the definite predetermined allocation formula requirement of section 1.401-1(b)(1)(ii) will not qualify under section 401(a) of the Code.

The withdrawal provision in this plan imposes a substantial limitation on the right of a participant to withdraw his own contributions. The withdrawal provision, therefore, cannot reasonably be expected to result in the manipulation of the allocation in contravention of the definite predetermined allocation formula requirement of section 1.401-1(b)(1)(ii) of the regulations.

Likewise, the withdrawal provision included in the plan underlying Rev. Rul. 72-367 imposes a substantial limitation on the right of a participant to withdraw his own contributions and, therefore, cannot reasonably be expected to result in the manipulation of the allocation in contravention of the definite predetermined allocation formula requirement of section 1.401-1(b)(1)(ii) of the regulations.

Accordingly, neither the withdrawal provision in this plan nor the one in the plan underlying Rev. Rul. 72-367 will cause either of the respective plans to fail to qualify under section 401(a) of the Code.

Rev. Rul. 72-367 is hereby modified to remove therefrom the premise that employee contributions are a part of the funds accumulated under the plan within the meaning of section 1.401-1(b)(1)(ii) of the regulations, and the premise that the willingness of a participant to forfeit geared employer contributions is evidence of financial need within the meaning of Rev. Rul. 56–693.

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26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Distribution to employee on transfer of job location. A noncontributory money purchase pension plan that permits distribution to be made to participants when they are transferred to job locations outside the area covered by the plan, and for that reason become ineligible to participate in the plan, does not qualify under section 401(a) of the Code; Rev. Rul. 56-213 modified.

Rev. Rul. 74-254

Advice has been requested whether a plan, containing the provision described below, qualifies as a pension plan under section 401(a) of the Internal Revenue Code of 1954.

An employer established a noncontributory money purchase plan that permits distributions to be made to participants, to the extent their rights have vested, when they are transferred to job locations outside the area covered by the plan and, for that reason, become ineligible to participate in the plan. These partipicants are not considered to have terminated their service upon transfer and have no control as to the time and place of transfer.

Section 401(a) of the Code prescribes the requirements which must be met for qualification of a pension, profit-sharing, or stock bonus plan.

Section 1.401-1(b)(1)(i) of the Income Tax Regulations provides that a pension plan, within the meaning of section 401(a) of the Code, is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. The regulations provide further, however, that a plan is not a pension plan if it provides for the payment of benefits not customarily included in a pension plan such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses, except as described in section 401(h).

Disability and death benefits, although incidental to the primary purpose of providing benefits after normal retirement, are essentially a form of "retirement" benefits, since they are payable upon severance or termination of employment. Contingencies such as layoff, sickness, and accident generally do not involve a termination of employment, and payments for such contingencies from a qualified pension plan are prohibited by section 1.401-1(b)(1)(i) of the regulations.

Revenue Ruling 56-693, 1956-2 C.B. 282, as modified by Rev. Rul. 60-323, 1960-2 C.B. 148, holds that a pension plan fails to meet the requirements for qualification under section 401(a) of the Code if it permits employees to withdraw prior to normal retirement any part of the funds accumulated on their behalf which consist of employer contributions or increments thereon prior to the severance of employment or the termination of the plan. That Revenue Ruling deals with a situation in which withdrawals are at the option of, or subject to the control of, the employee and does not deal with the case in which an employee is being dropped from participation in the plan under conditions beyond his control.

In Revenue Ruling 56-213, 1956-1 C.B. 194, employees were dropped from participation under a qualified employees' retirement plan if they no longer met the minimum work period

requirements or if they terminated their employment, and their vested interests under the plan could then be paid as an immediate annuity or cash settlement. Furthermore, such employees were later reinstated as participants in the plan upon meeting the minimum work period requirements or being reemployed. The Revenue Ruling holds that the qualification of the plan will not be adversely affected provided the terms of the plan are uniformly applied and the full actuarial equivalent of the amount already vested in the participant is deducted from the amount of pension or other settlement to be paid under the plan as a result of the service rendered after the reinstatement of the participants.

The primary holding in Rev. Rul. 56-213 deals with the conditions under which employees may be reinstated as participants in a qualified plan where they have received a distribution under the plan. However, the circumstances that rendered the employee ineligible to continue his participation in the plan were similar to those in this case and, as in this case, were beyond his control.

In this case, as well as in the plan underlying Rev. Rul. 56-213, the payment of an annuity or lump-sum distribution from employer contributions or increments thereon when an employee ceases his plan participation but continues his employment, is analogous to payments for contingencies such as layoff, sickness, and accident and does not satisfy the requirements of section 1.401-1(b)(1)(i) of the regulations. Therefore, a pension plan does not qualify if it permits distributions prior to normal retirement and prior to termination of employment or termination of the plan, and this requirement does not depend on whether withdrawals of employer contributions are at the discretion of the employee.

Accordingly, this plan does not qualify as a pension plan under section 401(a) of the Code since it permits distributions to be made to participants prior to normal retirement and prior to their termination of employment or the termination of the plan.

Rev. Rul. 56-213, 1956-1 C.B. 194, is hereby modified to remove therefrom the holding that the qualification of a pension plan is not adversely affected where it provides that a participant may receive his vested account balance in the form of an immediate annuity or cash settlement upon becoming ineligible to participate in the plan prior to his terminating employment or the plan being terminated.

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26 CFR 1.401-3: Requirements as to coverage.
(Also Section 403; 1.403(b)-1.)

Exempt organization's annuity plan; elective participation. An exempt organization's pension plan will not fail to qualify under section 401 of the Code merely because participation is limited to employees electing to have the employer purchase on their behalf the annuities described in section 403 (b).

Rev. Rul. 74-96

Advice has been requested whether a pension plan may qualify under section 401 of the Internal Revenue Code of 1954 if participation thereunder is limited in accordance with the circumstances described below.

The pension plan was established by an organization that is exempt from Federal income tax under section 501(c)(3) of the Code. It provides that participation thereunder shall be available to all employees of the employer who have elected to participate in an existing annuity purchase plan which meets the requirements of section 403(b). No employee contributions are made under the pension plan.

The employer's annuity purchase program is available to all employees. Under this program, the employee who desires to have an annuity contract purchased on his behalf must agree to a salary reduction of three percent of his total compensation. The amount subject to the salary reduction agreement is then applied by the employer toward the purchase for the employee of an annuity contract that meets the requirements of section 403 (b) of the Code.

Section 401(a) of the Code provides that a plan may qualify if it meets the requirements of that section. Section 401(a)(3) provides that a plan will meet the coverage requirements if it (1) covers a percentage of the employer's employees at least as great as the percentage prescribed in section 401(a)(3)(A), or (2) covers such employees as constitute a classification set up by the employer and found not to be discriminatory in favor of employees who are officers, shareholders, supervisors, or highly compensated.

Section 401(a)(5) of the Code sets out certain classifications of employees that will not in themselves be considered discriminatory. However, those so designated are not intended to be exclusive. Thus, plans may qualify even though coverage thereunder is limited to employees who have either reached a designated age or have been employed for a designated number of years, or who have been employed in certain designated departments or are in other classifications, provided the effect of covering only such employees does not discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated. See section 1.401-3(d) of the Income Tax Regulations.

The effect of limiting participation in this plan to those employees who have elected to participate in the annuity program is to create a classification, for coverage purposes, that is not specifically designated in section

401(a)(5) of the Code or section 1.401-3(d) of the regulations. However, the classification is not inherently discriminatory. Whether it is acceptable under section 401(a)(3)(B) depends upon whether its effect is to discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated.

Accordingly, this plan will not fail to qualify under section 401 of the Code merely because participation thereunder is limited to employees who are participating in the annuity purchase program.

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26 CFR 1.401-3: Requirements as to coverage.

Coverage; exclusion of hourly-paid employees. A pension plan, the eligibility provisions of which result in covering two salaried shareholder-employees to the exclusion of four hourly-paid employees earning substantially more compensation than one shareholder and only slightly less than the other, discriminates in favor of the shareholders and does not satisfy the requirements of section 401(a)(3)(B) of the Code.

Rev. Rul. 74-141

Advice has been requested whether, under the circumstances described below, the pension plan of a corporate employer satisfies the coverage requirements of section 401(a)(3)(B) of the Internal Revenue Code of 1954.

An employer established a pension plan under which participation is limited to salaried employees with at least five years of service. The employer has six employees, two of whom are salaried and participate in the plan. Each of the participants owns 50 percent of the outstanding stock of the company. Their annual salaries are $20,000 and $12,000 respectively. The four excluded employees have been employed for more than five years, but are ineligible to participate because they are paid on an hourly basis. Each earns approximately $18,000 per year.

Section 401(a)(3)(B) of the Code provides that a plan may qualify under section 401(a), if the coverage classification set up by the employer does not discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated.

The non-discrimination requirement of section 401(a)(3)(B) of the Code was not intended to permit the qualification of plans which favor the higher paid or stock-holding employees, as against the lower-paid or non-stock-holding employees. See *H.R. Rep. No. 2333,* 77th Cong. 2d Sess. 50 (1942), 1942-2 C.B. 372, 413.

In this case, the eligibility provisions of the plan result in covering the two shareholder-employees, to the exclusion of all other employees. Although each of the excluded employees earns substantially more than the lowest compensated shareholder and only slightly less than the highest compensated shareholder, the plan discriminates in favor of the shareholder group, as against non-stock-holding employees.

Accordingly, this plan does not satisfy the requirements of section 401(a)(3)(B) of the Code.

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26 CFR 1.401-3: Requirements as to coverage.

Coverage; discrimination; middle compensation ranges. A pension plan to provide benefits for all full-time salaried and clerical employees that covers seven of the corporation's 80 employees, including four shareholders, but fails to cover any employees in the middle compensation ranges, and covers only nominal numbers of low-paid employees, does not satisfy the coverage requirements of section 401(a)(3)(B) of the Code; Rev. Rul. 70-200 distinguished.

Rev. Rul. 74-255

Advice has been requested whether the pension plan described below satisfies the coverage requirements of section 401(a)(3)(B) of the Internal Revenue Code of 1954.

A corporation established a pension plan for the benefit of all full-time salaried and clerical employees. Coverage under the plan is as follows:

Schedule of Employees

Annual Range of Compensation	*Participants*	*Excluded Employees*
Over $25,000	4 (all shareholders)	
$20,001 — $25,000		3
$15,001 — $20,000		12
$13,001 — $15,000		13
$11,001 — $13,000		10
$ 9,001 — $11,000		20
$ 7,001 — $ 9,000		15
$ 5,001 — $ 7,000	3	
	7	73

Section 401(a)(3)(B) of the Code provides that a plan intended to qualify under section 401(a) may, in lieu of meeting the percentage requirements of section 401(a)(3)(A), benefit such employees as qualify under a classification set up by the employer and found by the Secretary of the Treasury or his delegate not to be discriminatory in favor of employees who are officers, shareholders, supervisors, or highly compensated.

Section 401(a)(5) of the Code provides that a plan will not be con-

sidered discriminatory within the meaning of paragraphs (3)(B) or (4) of section 401(a) merely because it is limited to salaried or clerical employees. Conversely, such a classification is not automatically nondiscriminatory. All of the surrounding circumstances and attendant facts must be taken into account in determining whether the classification is discriminatory. See section 1.401-1(b)(3) of the Income Tax Regulations.

The percentage of total employees covered and the percentage of employees in whose favor discrimination is prohibited in relation to total employees participating under a plan are not the sole factors in determining whether a classification meets the nondiscriminatory coverage requirements. See Rev. Rul. 68-244, 1968-1 C.B. 158. However, a plan will fail to qualify if the limitation of coverage to salaried or clerical employees results in covering primarily employees who are officers, shareholders, supervisors or highly compensated, to the exclusion of lower-paid, hourly-rated employees. See Rev. Rul. 66-14, 1966-1 C.B. 75.

In this case, only seven out of 80 total employees participate in the pension plan. Four of the seven participants are shareholders of the employer corporation and therefore fall within the group enumerated in section 401(a)(3)(B) of the Code. The above schedule of employees shows that the plan does not cover employees in all compensation ranges. There are no additional facts indicating that coverage under this plan does not discriminate in favor of the employees enumerated in section 401(a)(3)(B). The employer's classification results in covering primarily employees in whose favor discrimination is prohibited when viewed in light of these facts and circumstances.

Accordingly, this plan does not satisfy the coverage requirements of section 401(a)(3)(B) of the Code.

This case, like Rev. Rul. 74-256, below, is distinguishable from Rev. Rul. 70-200, 1970-1 C.B. 101, which holds that the coverage requirements of section 401(a)(3)(B) of the Code were satisfied where 22 of the 40 plan participants were officers, shareholders or supervisors. There, a greater proportion of the employer's total work force was covered by the plan than is covered by the plan in this case. Moreover, the compensation of nearly all of the participants described in Rev. Rul. 70-200 was substantially the same as that of the excluded employees and the plan covered employees in all compensation ranges, with those in the middle and lower compensation ranges being covered in more than nominal numbers.

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26 CFR 1.401-3: Requirements as to coverage.

Coverage; discrimination; hourly-paid employees. A profit-sharing plan to provide benefits for all full-time salaried and clerical employees with at least three years service, that covers only eight of the employer's 63 employees, five of whom are highly compensated (including two officer-shareholders), three of whom are in the lowest-paid category and none of whom are in the compensation ranges in between, does not satisfy the coverage requirements of section 401(a)(3)(B) of the Code; Rev. Rul. 70-200 distinguished.

Rev. Rul. 74-256

Advice has been requested whether the profit-sharing plan described below satisfies the coverage requirements of section 401(a)(3)(B) of the Internal Revenue Code of 1954.

An employer established a profit-sharing plan that provides benefits for all its full-time salaried and clerical employees with three years of service. The employer has 63 full-time employees each of whom has completed at least three years of service. However, only eight of those employees are participants in the plan. The remaining 55 are ineligible to participate because they are paid on an hourly basis.

The eight participating employees include two who are officer-shareholders. The compensation for each group of full-time employees is set out below.

Group	*Compensation Range*	*Total Employees*	*Excluded Employees*	*Participants*
1	Above $25,000	2		2*
2	$20,001 — $25,000	1		1
3	$15,001 — $20,000			
4	$12,501 — $15,000	2		2
5	$10,001 — $12,500	3	3	
6	$ 9,001 — $10,000	16	16	
7	$ 8,001 — $ 9,000	18	18	
8	$ 7,001 — $ 8,000	5	5	
9	$ 6,001 — $ 7,000	9	9	
10	$ 5,001 — $ 6,000			
11	$ 5,000 and below	7	4	3
Total		63	55	8

* Officer-shareholders

A plan intended to qualify under section 401(a) of the Code must cover (1) a number of employees that is at least equal to that determined under the percentage provisions of section 401(a)(3)(A), or (2) such employees who qualify under a nondiscriminatory classification within the

purview of section 401(a)(3)(B). The latter provision states that a plan may qualify if it benefits a classification of employees that is found not to discriminate in favor of employees who are officers, shareholders, supervisors, or highly compensated. Thus, a plan that does not satisfy the percentage tests may still satisfy the coverage requirements if the classification of employees actually covered does not result in prohibited discrimination. The classification must be nondiscriminatory both on its face and in actual operation. See section 1.401-1(b)(3) of the Income Tax Regulations.

Under section 401(a)(5) of the Code, a plan that is limited to salaried or clerical employees is not necessarily discriminatory within the meaning of section 401(a)(3)(B). See Rev. Rul. 66-12, 1966-1 C.B. 72. Conversely, such a classification is not automatically nondiscriminatory. See Rev. Rul. 66-13, 1966-1 C.B. 73. All of the surrounding circumstances and attendant facts must be taken into account in determining whether the classification is nondiscriminatory. See section 1.401-1(b)(3) of the regulations.

Coverage under the plan in the instant case does not meet the minimum percentage requirement of section 401(a)(3)(A) of the Code. Therefore, if the coverage requirements are to be met, the classification of participants must not discriminate in favor of employees enumerated in section 401(a)(3)(B).

In this case only eight out of 63 employees participate in the profit-sharing plan. Two of the eight participants are officer-shareholders. Three of the eight participants are highly compensated in relation to the excluded employees. See Rev. Rul. 69-398, 1969-2 C.B. 59. The above schedule of employees shows that the plan does not cover employees in all compensation ranges. There are no additional facts indicating that coverage under this plan does not discriminate in favor of members of the employees enumerated in section 401(a)(3)(B) of the Code. The employer's classification results in covering primarily employees in whose favor discrimination is prohibited when viewed in light of these facts and circumstances.

Accordingly, the profit-sharing plan in this case does not satisfy the coverage requirements of section 401(a)(3) of the Code.

This case, like Rev. Rul. 74-255, page 93, this Bulletin, is distinguishable from Rev. Rul. 70-200, 1970-1 C.B. 101, which holds that the coverage requirements of section 401(a)(3)(B) of the Code were satisfied where 22 of the 40 plan participants were members of the group in whose favor discrimination is prohibited. In that case, unlike this case, the compensation of nearly all the participants was substantially the same as that of the excluded employees, and the plan covered employees in all compensation ranges, with those in the middle and lower compensation ranges being covered in more than nominal numbers. Also, in Rev. Rul. 70-200, a greater proportion of the employer's total work force was covered by the plan than that covered in this case.

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26 CFR 1.401-4: Discrimination as to contributions or benefits.

Benefits funding method. A pension plan designed to provide each participant a retirement benefit of 60 percent of his career average compensation does not fail to qualify under section 401(a) of the Code merely because the shareholder's greater age and nearness to retirement at the time the plan is established result in more than 90 percent of the contributions being used to fund his benefits.

Rev. Rul. 74-142

Advice has been requested whether, under the circumstances described below, the method of funding the pension benefits prevents the pension plan from qualifying under section 401(a) of the Internal Revenue Code of 1954.

A professional service corporation established a pension plan for the benefit of all its employees. The plan provides a retirement benefit of 60 percent of the career average compensation of each participant and all benefits are fully vested when accrued. A participant's normal retirement date is the later of his 65th birthday or the date on which he has 10 years of participation in the plan. The restrictions of section 1.401-4(c) of the Income Tax Regulations were incorporated in the plan. At the inception of the plan the shareholder-employee was 60 years of age and the only other employee was 52 years of age.

Because of this difference in ages and the differences in their compensation, 90 percent of the contributions are applied to fund the benefits of the shareholder-employee. The shareholder-employee's total compensation, including contributions to the pension plan, did not exceed reasonable compensation.

Section 401(a) of the Code provides for the qualification of a pension plan that meets the requirements of that section. Under that section a qualified plan is one in which there is no discrimination in contributions or benefits in favor of employees who are officers, shareholders, supervisors, or highly compensated. However, section 401(a)(5) provides that a plan shall not be considered discriminatory within the meaning of section 401(a)(3)(B) or (a)(4) merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees.

Section 1.401-1(b)(2) of the regulations provides that the term "plan" implies a permanent, as distinguished from a temporary, program. Thus, al-

though the employer may reserve the right to change or terminate the plan, and to discontinue contributions thereunder, the abandonment of a plan for any reason other than business necessity within a few years after it has taken effect will be evidence that the plan from its inception was not a bona fide program for the exclusive benefit of employees in general. Especially will this be true if, for example, a pension plan is abandoned soon after pensions have been fully funded for persons in favor of whom discrimination is prohibited under section 401(a) of the Code. The permanency of the plan will be indicated by all of the surrounding facts and circumstances. See also section 2.02 of Rev. Rul. 69-25, 1969-1 C.B. 113.

Section 3.01 of Rev. Rul. 69-25 states that there is a presumption that a newly established plan is being established in good faith as a permanent program, unless there is clear evidence to the contrary in the facts and circumstances surrounding the adoption of the plan. Therefore, Rev. Rul. 69-25 states that, in most cases, the issue of intended permanence is resolved in favor of the taxpayer at the time of the adoption of the plan.

Section 401(a)(4) of the Code does not require a ceiling or similar limitation on the proportion of the total contributions or benefits that may be provided for a shareholder-employee if the benefits to be provided bear a uniform relationship to compensation and the plan is not otherwise discriminatory. See Rev. Rul. 71-255, 1971-1 C.B. 125, which holds that a plan is not discriminatory merely because the benefits thereunder are based on current compensation, 80 percent of which is paid to a shareholder-employee.

In this case, although benefits for each employee will equal 60 percent of his career average compensation, the shareholder-employee's benefit will normally be funded over a period of ten years whereas the common-law employee's benefit will be funded over a period of 13 years. For that reason alone, the annual contributions necessary to fund the benefits for the shareholder-employee will be greater as a percentage of his compensation than the annual contributions necessary to fund the benefits for the common-law employee. However, this difference alone is not sufficient to overcome the presumption that the plan is being established in good faith as a permanent program under which the benefits ultimately provided to all participants will be nondiscriminatory.

Accordingly, under the circumstances, the method of funding the pension benefits in this case does not prevent the plan from qualifying under section 401(a) of the Code.

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26 CFR 1.401-4: Discrimination as to contributions or benefits.

Discrimination; comparability of contributions. Differences in vesting are not considered in comparing contributions to two plans of an employer, considered as a unit, to determine whether the contribution requirements of section 401(a)(4) of the Code are satisfied; Rev. Rul. 71-503 revoked.

Rev. Rul. 74-165

The Internal Revenue Service has reconsidered its position in Revenue Ruling 71-503, 1971-2 C.B. 206, and considered an additional situation concerning differences in vesting when contributions are used to demonstrate whether two plans are comparable.

Situation 1. In Revenue Ruling 71-503, an employer established a fixed benefit—fixed contribution pension plan pursuant to a collective bargaining agreement for its relatively low paid hourly employees, and a profit-sharing plan for its salaried employees, each of whom was highly compensated within the meaning of section 401(a)(3)(B) of the Internal Revenue Code of 1954. The profit-sharing plan, in order to qualify under section 401(a) of the Code, had to be comparable with the pension plan. The salaried plan provided immediate vesting of all contributions. The hourly plan provided vesting of contributions only upon attainment of normal retirement age. Identical contributions as a percentage of annual compensation were required to be made to both plans, except that contributions to the profit-sharing plan were required to be made out of profits. Although not stated in Revenue Ruling 71-503, the benefits in and the rate of contributions to the hourly plan were fixed only for the duration of the collective-bargaining agreement then in effect and were subject to renegotiation upon expiration of the contract. Revenue Ruling 71-503 states that contributions that are nonforfeitable when made are more beneficial to participants than contributions in which the participants' interest will be subject to forfeiture over an extended period of time. Revenue Ruling 71-503 then holds that the profit-sharing plan does not meet the requirements of section 401(a)(4).

Situation 2. An employer established, effective January 1, 1970, a fully and immediately vested money purchase pension plan requiring annual employer contributions of 5% of annual compensation on behalf of its salaried employees, each of whom was highly compensated within the meaning of section 401(a)(3)(B) and (4) of the Code. The employer also established, effective January 1, 1970, a money purchase pension plan for its hourly paid employees requiring annual employer contributions of 7% of annual compensation, less forfeitures. The hourly plan provided less favorable vesting than the salaried plan. In 1970 the employer contributed 7% of annual compensation to the hourly plan. In 1970, turnover in the hourly plan produced forfeitures which subsequently reduced the employer contribution in 1971 to 5.2% of annual compensation. In 1971, turnover in

the hourly plan further reduced the employer contribution in 1972 to 4.8% of annual compensation.

The salaried plans in *situations 1 and 2* do not satisfy the coverage requirements of section 401(a)(3) of the Code and, therefore, standing alone, cannot qualify. However, both plans in each situation, taken as a unit, satisfy such requirements. See section 4.401-3(f) of the Income Tax Regulations.

The specific question to be considered in each situation is whether the salaried plan is comparable to the hourly plan. This Revenue Ruling deals only with the comparability of contributions.

Section 401(a)(4) of the Code requires that either benefits or contributions must not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

When two plans are considered as a unit, section 401(a)(4) of the Code will be satisfied if the plan not containing members of the prohibited group (the "lower" plan) is at least comparable to the plan containing members of the prohibited group (the "higher" plan).

Vesting applies to benefits, not contributions. It is therefore inappropriate, for purposes of comparability, to consider vesting when comparing contributions.

Since the contribution rate, as a percentage of compensation, is identical for both plans in *situation 1* for the duration of the collective bargaining agreement, the profit-sharing plan did satisfy the requirements of section 401(a)(4) of the Code for such period. Furthermore, the profit-sharing plan would continue to qualify as long as the rate of contribution as a percentage of compensation to the collectively-bargained plan does not fall below the rate of contribution actually made to the profit sharing plan.

In *situation 2* the salaried plan satisfied the requirements of section 401(a)(4) of the Code in 1970 and 1971 since the rate of contribution to the hourly plan for those years was not less than the rate of contribution to the salaried plan. Furthermore, the salaried plan would fail to satisfy the requirements of section 401(a)(4) in 1972 since the rate of contribution (4.8% of annual compensation) to the hourly plan is less than the rate of contribution (5% of annual compensation) to the salaried plan, unless the contribution rates can be demonstrated to be nondiscriminatory after imputing a value to the employer's contributions to social security. See Revenue Ruling 70-580, 1970-2 C.B. 90.

Revenue Ruling 71-503 is hereby revoked.

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26 CFR 1.401-4: Discrimination as to contributions or benefits.

Discrimination; comparability of benefits. Differences in vesting are not discriminatory per se in comparing the benefits of two or more plans of an employer, considered as a unit, to determine whether the benefits satisfy the requirements of section 401(a)(4) of the Code. Acceptable methods for adjusting for the value of vesting in company benefits are provided. Rev. Rul. 65-266 revoked.

Rev. Rul. 74-166

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is (1) to reconsider the position taken in Rev. Rul. 65-266, 1965-2 C.B. 138, and (2) to provide acceptable methods for comparing the benefits of two or more plans which have different vesting schedules.

SEC. 2. BACKGROUND.

.01 Section 401(a)(3) of the Internal Revenue Code of 1954 specifies certain coverage requirements that must be satisfied in order for a plan to qualify. Section 1.401-3(f) of the Income Tax Regulations permits a plan, that does not satisfy the coverage requirements of section 401(a)(3) of the Code standing alone, to qualify under section 401(a) if the employer designates several trusts, or a trust or trusts and an annuity plan or plans, to be considered as a unit, and such unit satisfies the requirements of sections 401(a)(3) and 401(a)(4). Section 401(a)(4) provides that contributions or benefits shall not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

02. In Rev. Rul. 65-266, an employer established a pension plan, with full and immediate vesting, covering individuals on whose behalf discrimination is prohibited by section 401(a)(4) of the Code (the "higher plan"). The employer also established a pension plan, with less than full and immediate vesting, covering the rank-and-file employees (the "lower plan").

The higher plan, standing alone, did not satisfy the coverage requirements of section 401(a)(3) of the Code nor the nondiscrimination requirements of section 401(a)(4). The two plans considered by Rev. Rul. 65-266, taken together, satisfied the coverage requirements of section 401(a)(3)

The question considered by Rev. Rul. 65-266 is whether benefits provided by the two plans taken together satisfy the requirements of section 401(a)(4) of the Code, since the higher plan provides better vesting.

Rev. Rul. 65-266 holds, under the given fact situation, that the benefit requirement of secion 401(a)(4) of the Code is not satisfied since vested benefits are more valuable than nonvested benefits and the higher plan provides better vesting. That holding does not consider the value of all of

the respective benefits provided by the two plans.

SEC. 3. CONCLUSION.

The Internal Revenue Service now holds that differences in vesting are not discriminatory per se and that such differences should be taken into consideration for purposes of comparing the benefits provided under two or more plans with unlike vesting provisions. This conclusion also is consistent with the conclusion reached by the court in the following cases: *United States v. Hall,* 398 F.2d 383 (8th Cir. 1968) and *Loper Sheet Metal, Inc.,* 53 T.C. 385 (1969).

SEC. 4. METHODS OF COMPARING BENEFITS

01. Section 401(a)(4) of the Code requires, assuming benefits rather than contributions are being tested, that benefits must not discriminate in favor of members of the prohibited group. In comparing the benefits provided under two plans, the total benefits provided for any member of the prohibited group in the higher plan must not exceed in value, stated as a percentage of compensation, the total benefits provided for participants in the lower plan. Vested benefits are more valuable than an equal amount of non-vested benefits. If the higher plan provides greater vesting than the lower plan, benefits under the higher plan must be adjusted upward in relation to benefits under the lower plan, for purposes of computing their value stated as a percentage of compensation, to reflect differences in vesting. Various methods may be used to reflect differences in vesting where the higher plan provides better vesting than the lower plan.

02. One acceptable method of adjusting the value of benefits to reflect differences in vesting is to adjust upward, for comparison purposes, the value of benefits payable to any given member of the prohibited group participating in the higher plan. Such adjustment in the value of benefits should reflect the difference applicable to such participant between the vesting actually provided in the higher plan and the vesting that would be provided in such plan if the vesting provisions in the lower plan were applied to the higher plan.

Under this method, the "average vesting" for each member of the prohibited group participating in the higher plan is determined as the average of the percentage of the accrued benefit vested for each year of plan participation for such participating member, such average being taken over the 25-year period commencing with the date of such participating member's initial plan participation. The "average vesting' under the lower plan is similarly determined with respect to such participating member by assuming that the vesting provisions in the lower plan apply to each such participating member in the higher plan. For purposes of applying these guidelines, eligibility for early, normal or deferred retirement is considered to be equivalent to 100 percent vesting, and years after those dates will be included in the 25-year period if it extends beyond such dates. The value of the benefits for each such participant, stated as a percentage of compensation, is then increased by a factor equal to 50 percent of the difference in average vesting, if the average vesting under the higher plan is greater than the average vesting under the lower plan.

03. Another acceptable method of adjusting the value of benefits to reflect differences in vesting is to adjust, for any participant in a given plan, the value of the benefits provided under that plan by the value of the vesting provided under that plan applicable to the given participant.

Under this method, average vesting is determined for each member of the prohibited group participating in the higher plan in the same manner as in the first method, but based solely on the vesting provisions of the higher plan. Average vesting is similarly determined for each participant in the lower plan based on the vesting provisions of the lower plan. If, for any two individuals being compared, the average vesting of the participant in the prohibited group in the higher plan exceeds the average vesting of the participant in the lower plan, then the value of the benefits provided for the participant in the higher plan is increased by 50 percent of his average vesting in the higher plan, and the value of the benefits provided for the participant in the lower plan is increased by 50 percent of his average vesting in the lower plan.

04. Either of the above-described methods may be used to reflect differences in vesting for the purpose of comparing benefits provided under the higher plan with benefits provided under a lower plan in any instance where the average vesting for members of the prohibited group in the higher plan exceeds such vesting in the lower plan. Neither of these methods may be used, however, in adjusting for more favorable vesting in a lower plan.

SEC. 5. EXAMPLES.

01. *Example of Application of First Method:* The higher plan covering only salaried employees of the employer provides a vesting schedule of 10 percent of the accrued benefit after completion of the first year's service, increasing 10 percent after completion of each subsequent year's service until attaining 100 percent vesting after completion of ten years' service. The lower plan, covering rank-and-file hourly workers covered by a union-negotiated collective-bargaining agreement, provides no vesting for each of the first ten years' service, but 100 percent vesting thereafter. Normal retirement age of both plans is age 65. The hourly plan contains no members of the prohibited group. The salaried plan, on its effective date, covers three members of the prohibited group (A, B & C). The vesting adjustment un-

der the first method described above is illustrated below:

Employee	Age at Hire	Age at Effective Date
A	40	52
B	30	32
C	57	57

Employee A has 12 years of service on the effective date of the plan. Since employee A has already completed ten years of service, he would have 100 percent vesting under the vesting provisions of either the higher or lower plan throughout his entire period of participation in the higher plan. Therefore, no adjustment to the value of benefits provided employee A is made under this method to reflect differences in vesting.

Employee B is 20 percent vested the first year of participation under the plan (since he has two years of service), 30 percent the second year, and so forth until he is 100 percent vested at the beginning of the ninth year of participation under the plan. The average vesting applicable to employee B is

$$\frac{20\% + 30\% + 40\% + 50\% + 60\% + 70\% + 80\% + 90\% + (17 \times 100\%)}{25 \text{ (years)}} = 85.6\%.$$

Under the lower plan's provisions, employee B would have 0 percent vesting for each of his first eight years of participation plus 100 percent vesting for each subsequent year. This average vesting is

$$\frac{(8 \times 0\%) + (17 \times 100\%)}{25 \text{ (years)}} = 68\%.$$

The difference between the two vesting schedules, as it applies to employee B, is 17.6 percent (85.6% — 68%). The value of B's benefit for purposes of comparison is, therefore, under this method, equivalent to the value of a benefit 8.8 percent (50% of 17.6%) greater than the benefit specified in the plan.

Employee C has 0 percent vesting the first year, 10 percent vesting the second year, increasing to 70 percent vesting in the eighth year, and 100 percent vesting thereafter since he will then have reached his normal retirement age (age 65). His average vesting in the higher plan is

$$\frac{0\% + 10\% + 20\% + 30\% + 40\% + 50\% + 60\% + 70\% + (17 \times 100\%)}{25 \text{ (years)}} = 79.2\%.$$

Under the lower plan's vesting provisions, employee C would have no vesting until normal retirement and 100 percent vesting thereafter. This average vesting is

$$\frac{(8 \times 0\%) + (17 \times 100\%)}{25 \text{ (years)}} = 68\%.$$

The difference in vesting, as it applies to Employee C is, therefore, 11.2 percent (79.2% — 68%). The value of C's benefit for purposes of comparison is, therefore, under this method, equivalent to the value of a benefit 5.6 percent (50% of 11.2%) greater than the benefit specified in the plan.

02. *Example of Application of Second Method*: The higher plan covering only salaried employees of the employer provides a vesting schedule of 10 percent of the accrued benefit after completion of the first year's service, increasing 10 percent after completion of each subsequent year's service until attaining 100 percent vesting after completion of 10 years' service. The lower plan, covering rank-and-file hourly workers covered by a union-negotiated collective-bargaining agreement, provides a vesting schedule of 5 percent of the accrued benefit after completion of the first year's service, increasing 5 percent after completion of each subsequent year's service until attaining 100 percent vesting after completion of 20 years' service. The salaried plan, on its effective date, covers one employee in the prohibited group (Employee A) who has 2 years' completed service. The hourly plan has two employees (Employee B and Employee C) with 3 and 15 years' completed service, respectively. All three employees have at least 25 years participation remaining before eligibility for early or normal retirement under their respective plans. The vesting adjustment under the second method described above is illustrated below:

Employee A in the higher plan has 2 years' completed service. His average vesting is therefore

$$\frac{20\% + 30\% + 40\% + 50\% + 60\% + 70\% + 80\% + 90\% + (17 \times 100\%)}{25 \text{ (years)}} = 85.6\%.$$

Employee B in the lower plan has 3 years' completed service. His average vesting is, therefore

$$\frac{15\% + 20\% + 25\% + 30\% + 35\% + 40\% + 45\% + 50\% + 55\% + 60\% + 65\% + 70\% + 75\% + 80\% + 85\% + 90\% + 95\% + (8 \times 100\%)}{25 \text{ (years)}} = 69.4\%.$$

Employee C in the lower plan has 15 years' service. His average vesting is

$$\frac{75\% + 80\% + 85\% + 90\% + 95\% + (20 \times 100\%)}{25 \text{ (years)}} = 97.0\%.$$

In the present case, the value of A's benefit must be compared separately with B's and C's. Since A's average vesting is greater than B's, the value of A's benefit for the purpose of comparison with B should be increased by 42.8 percent (50% of 85.6%) and the value of B's benefit should be increased by 34.7 percent (50% of 69.4%). Since A's average vesting is less than C's, the value of neither of their benefits should be adjusted when A's benefit is compared to C's.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Rev. Rul. 65-266 is hereby revoked.

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Early retirement benefits paid under "social security option." Amounts received by a participant of a qualified plan who retires before age 62, in accordance with the terms of a so-called "social security option" providing a larger monthly pension before he commences to receive benefits under the Social Security Act, do not represent insurance benefit payments made under the Act and are includible in the participant's gross income.

Rev. Rul. 74-143

Advice has been requested whether, under the circumstances described below, the amounts paid to a participant under a qualified plan in accordance with a "social security option" are includible in the employee's gross income under section 402(a)(1) of the Internal Revenue Code of 1954.

The employee retired at age 55 and immediately began to receive monthly pension payments from the exempt trust forming part of the plan, to which he had made no contributions. The payments were made in accordance with the terms of a so-called social security option contained in the plan. Under the option a participant who retires before age 62 receives a payment of a larger monthly pension before he commences to receive Social Security benefits and a smaller pension after he commences to receive such benefits, thus leveling off the two combined benefits.

Section 402(a)(1) of the Code provides that the amount actually distributed or made available to any distributee under an exempt employees' trust will be taxable to him in the year in which so distributed or made available under section 72 (relating to annuities).

The insurance benefits payments made to individuals under the provisions of section 202 of Title II of the Social Security Act are not includible in the gross income of the recipients. See Rev. Rul. 70-217, 1970-1 C.B. 12.

Amounts received by the employee in this case under the social security option represent distributions from a qualified plan and are not insurance benefit payments made under the provisions of section 202 of Title II of the Social Security Act.

Accordingly, such amounts are includible in the employee's gross income under section 402(a)(1) of the Code.

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26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Additional retirement benefits resulting from three years and one month of service performed by a retired Federal employee during a period of reemployment. See Rev. Rul. 74-107, page 28.

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Additional retirement benefits resulting from five years additional service performed by a retired Federal employee during a period of reemployment. See Rev. Rul. 74-138, page 29.

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26 CFR 1.402(b)-1: Treatment of beneficiary of a trust not exempt under section 501(a).

Taxability of a beneficiary on distributions from a non-exempt employees' trust. See Rev. Rul. 74-299, page 154.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

Modified endowment contract purchased by exempt organization for an employee. A modified endowment policy with an annuity rider purchased by a section 501(c)(3) organization for one of its employees, providing a preretirement death benefit with an actuarially indicated value (based on comparative premiums of the policies) of less than that of a typical retirement income policy, meets the incidental death benefit limitation and may be treated as an annuity contract for purposes of section 403(b) of the Code.

Rev. Rul. 74-115

Advice has been requested whether the insurance contract described below may be treated as an annuity contract for purposes of section 403(b) of the Internal Revenue Code of 1954.

An organization, exempt from Federal income tax under section 501(c)(3) of the Code, purchased a modified endowment policy with an annuity rider for one of its employees. Each

unit of the contract provides for (1) an endowment policy with a face amount of 500x dollars and a maturity value at age 65 of 500x dollars, and (2) a deferred retirement annuity with a maturity value at age 65 of 1,240*x* dollars. Based on the total maturity value of 1,740*x* dollars, a settlement option could be selected providing a male employee, age 65, with a monthly retirement income of 11*x* dollars for ten years certain and life thereafter.

Section 403(b) of the Code provides that, if the conditions set forth therein are met, amounts contributed by an employer that is exempt from Federal income taxes under section 501(c)(3), to purchase an annuity for an employee, shall be excluded from the employee's gross income to the extent that such amounts do not exceed his applicable exclusion allowance.

Section 1.403(b)-1(c)(3) of the Income Tax Regulations provides that an individual contract issued after December 31, 1962, which provides incidental life insurance protection may be purchased as an annuity contract.

Rev. Rul. 61-121, 1961-2 C.B. 65, holds that preretirement death benefits under a pension plan may be regarded as incidental if such benefits do not exceed those that would be payable had they been funded under typical retirement income contracts providing a death benefit prior to retirement equal to the greater of 100 times the anticipated monthly lifetime pension or the accumulated reserve. Furthermore, in accordance with Rev. Rul. 70-611, 1970-2 C.B. 89, life insurance protection under a pension plan is within "incidental limits" where the cost does not exceed 25 percent of the total cost.

Both the "100 to 1" and "25 percent" rules stem from *Raymond J. Moore v. Commissioner,* 45 B.T.A. 1073 (1941), *acq.,* 1944 C.B. 20, which held that the retirement income policies, under which the pension benefits were funded, provided incidental life insurance protection. In that case, the initial life insurance protection equalled 100 times the monthly annuity and the cost of pure life insurance protection varied according to the age at issue, but in every case was less than 25 percent of the total premiums. In this regard, see Rev. Rul. 66-143, 1966-1 C.B. 79.

Although Rev. Ruls. 66-143, 61-121, and 70-611 involve the qualification of plans under section 401(a) of the Code, the principles set forth therein, including the principles derived from the *Moore* case, are equally applicable in determining whether the life insurance protection under an individual contract is "incidental" for purposes of section 1.403(b)-1(c)(3) of the regulations.

In this case, actuarial computations reveal that during most policy years, the death benefit under the combination endowment policy is substantially smaller than the death benefit under a typical retirement income policy providing the same retirement benefit, but is slightly larger during some later policy years. However, a comparison of premium rates under each of these policies (computed on the basis of the same actuarial assumptions) discloses that at all ages the net level premiums under the endowment policy are smaller than the net level premiums under the retirement income contract. This indicates that the value of the preretirement death benefit under the endowment contract is less than the value of such benefit under a typical retirement income policy and, therefore, the endowment contract meets the incidental death benefit limitation of section 1.403(b)-1(c)(3) of the regulations.

Accordingly, under the specific facts in this case, the insurance contract may be treated as an annuity contract for purposes of section 403(b) of the Code.

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26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

Limitation of participation under pension plan to employees who have elected to have the employer purchase section 403(b) annuities on their behalf. See Rev. Rul. 74-96, page 92.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation under a Deferred-Payment Plan

26 CFR 1.404(e)-1: Contributions on behalf of a self-employed individual to or under a pension, annuity, or profit-sharing plan meeting the requirements of section 401; application of section 404(a)(8), (9), and (10) and section 404(e) and (f). (Also Section 1402; 1.1402(c)-1.)

Contributions; fee-basis public official. Contributions to a retirement plan are not deductible under section 404(e) of the Code by a public official who is compensated solely on a fee basis and has social security coverage under an agreement between the State and the Secretary of Health, Education, and Welfare.

Rev. Rul. 74-225

Advice has been requested whether contributions made under the circumstances described below are deductible under section 404(e) of the Internal Revenue Code of 1954.

A is a public official who is compensated solely on a fee basis. The fees *A* receives are covered by an agreement between the State and the Secretary of Health, Education, and Welfare, pursuant to section 218 of the Social Security Act, as amended.

A is covered under a retirement plan which permits him to obtain retirement benefits for the fee services he performs provided he makes certain contributions under the plan. Pursuant to the terms of the plan, *A* contributed $4,000 on December 31, 1972.

Section 404(e) of the Code provides for a limited deduction under

section 404(a) of contributions made to qualified plans on behalf of individuals who are employees within the meaning of section 401(c)(1). Under section 401(c)(1), this includes individuals who have net earnings from self-employment, defined in section 1402(a) as gross income derived by an individual from a trade or business carried on by him.

However, section 1402(c)(1) of the Code provides that the term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall not include the performance of the functions of public office, other than the functions of a public office of a State or political subdivision thereof with respect to fees received in any period in which the functions are performed in a position compensated solely on a fee basis and in which such functions are *not* covered under an agreement entered into by such State and the Secretary of Health, Education, and Welfare, pursuant to section 218 of the Social Security Act.

Although *A* is compensated solely on a fee basis, his services are covered under an agreement entered into by the State and the Secretary of Health, Education, and Welfare, pursuant to section 218 of the Social Security Act. Therefore, such services do not qualify as a trade or business and the fees paid to *A* do not qualify as net earnings from self-employment. Hence *A* is not an employee under the meaning of section 401(c)(1) for purposes of section 404(e).

Accordingly, the contributions made by *A* under the retirement plan are not deductible under section 404(e) of the Code.

Part II.—Certain Stock Options

Section 421.—General Rules

26 CFR 1.421-8: General rules.

Whether a disposition of stock occurred for purposes of section 422(a)(1) of the Code. See Rev. Rul. 74-267, this page.

Section 422.—Qualified Stock Options

26 CFR 1.422-1: Qualified stock options—general rules.
(Also Sections 421, 425; 1.421-8, 1.425-1.)

Employee stock option; disposition. The exchange of stock by a shareholder, purchased under a qualified stock option plan, for cash prior to the expiration of the required three-year holding period is a disposition for purposes of section 422(a)(1) of the Code notwithstanding that the exchange occurred due to a reorganization and plan of liquidation that the majority of shareholders approved with the shareholder dissenting. The Service will not follow the decision in **Brown** that a disposition can result only from a voluntary affirmative act of the shareholder.

Rev. Rul. 74-267

Advice has been requested whether a disposition of stock occurred for purposes of section 422(a)(1) of the Internal Revenue Code under the circumstances described below.

In June 1973, corporation *X* granted an option to purchase shares of its common stock to the taxpayer who was one of its employees. The option in all respects satisfied the qualified stock option requirements of section 422(b) of the Code.

A few months after the taxpayer exercised his stock option, the board of directors of corporation *X*, following negotiations with corporation *Y*, approved a plan whereby *Y* would purchase all the assets of *X*. Corporation *X* then would be liquidated, and its shareholders would receive cash in exchange for their shares of *X* common stock. The majority of the shareholders, with the taxpayer dissenting, approved the plan. In October 1973, the taxpayer exchanged his shares for cash.

Section 421(a) of the Code provides, in part, that if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) are met, that, with exceptions not here pertinent, no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share.

Section 422(a)(1) of the Code provides that generally section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if no disposition of such share is made by such individual within the 3-year period beginning on the day after the day of the transfer of such share.

Under section 1.421-8(b) of the Income Tax Regulations the disposition of a share of stock, acquired by the exercise of a statutory option before the expiration of the applicable holding period as determined under section 422(a)(1) of the Code makes section 421 inapplicable to the transfer of such share. The income attributable to such transfer shall be treated by the individual as income received in the taxable year in which such disposition occurs.

Section 422(c)(5) of the Code provides, in general, that a transfer of a share of option stock by an insolvent individual to a trustee or similar fiduciary under the Bankruptcy Act or other insolvency proceeding does not constitute a "disposition of such share" for purposes of section 422(a)(1).

Section 425(c)(1) of the Code provides, in part, that the term "disposition" includes a sale, exchange, gift, or a transfer of legal title, but does not include (A) a transfer from a decedent to an estate or a transfer by bequest or inheritance; (B) an exchange to which section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies; or (C) a mere pledge or hypothecation.

Sections 422(c)(5) and 425(c) of the Code provide the only examples of sales, exchanges, gifts, and transfers

of legal title that do not constitute "dispositions" for purposes of section 422(a)(1). In view of the fact that the Code specifically sets forth these exceptions in precise terms, they are exhaustive to the exclusion of all others.

In the instant case, the taxpayer exchanged his stock for cash in a complete liquidation of *X*. Under section 331(a) of the Code, the amounts distributed in complete liquidation of a corporation are treated as in full payment in exchange for the stock. Exchanges governed by section 331 are not described in sections 422(c)(5) or 425(c)(1).

Accordingly, the exchange of the option shares for cash within three years of the date the option was exercised was a disposition for purposes of section 422 (a)(1), and therefore, section 421(a) of the Code does not apply with respect to the transfer of the option stock to the taxpayer.

The fact that the taxpayer voted against the reorganization and liquidation and sought to retain his option stock is not relevant for purposes of section 422(a)(1) of the Code.

The Service will not follow the decision in *Brown v. United States*, 427 F. 2d 57 (9th Cir. 1970), in which the court held that a disqualifying disposition within the meaning of the predecessor of section 422(a)(1) of the Code can result only from a voluntary, affirmative act of the stockholder. This interpretation is inconsistent with the statutory language of sections 422(c)(5) and 425(c)(1) which gives no indication that the reasons or the circumstances surrounding a disposition are to be considered in determining whether the three-year holding period requirement has been satisfied.

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26 CFR 1.422-2: Qualified stock options defined.

Employee stock option; expiration. A qualified employee stock option that is exercisable for a maximum period of five years from the date of grant will be considered outstanding for purposes of sections 422(b)(5) and 422(c)(2) of the Code until it is exercised in full or expires by lapse of time at the end of its five-year term notwithstanding a provision accelerating the expiration date in the event of the optionee's termination of employment.

Rev. Rul. 74-88

Advice has been requested concerning the time of expiration of qualified stock options under the circumstances described below.

A corporation granted a stock option to an employee pursuant to its qualified stock option plan under section 422(b) of the Internal Revenue Code of 1954. The terms of the option provided that it was exercisable for a maximum period of five years from the date of grant so long as the optionee was employed by the corporation. However, in the event of the optionee's termination of employment prior to the expiration of five years, the terms of the option provided for an acceleration of the option expiration date and required that it be exercised within two months of the employment termination. A later qualified option granted to the employee at a lower price than the first option contained the same maximum five-year exercise period, and, by its terms was not exercisable until the first option was no longer outstanding within the meaning of section 422(c)(2). The terms of the latter option contained a provision similar to the first option with respect to its exercise in the event of termination of employment, except that exercise was required within two months and ten days of employment termination.

Section 422(b)(5) of the Code provides that a qualified stock option (new option) is one granted to an individual that by its terms may not be exercised while there is outstanding any qualified or restricted stock option that was granted, before the granting of the new option, to such individual to purchase stock in his employer corporation or in a corporation that, at the time of the granting of such option, is a parent or subsidiary corporation of the employer corporation, or in a predecessor corporation of any such corporations. Under section 422(c)(6) of the Code and the Regulations thereunder the requirement of section 422(b)(5) shall be considered to be met if the new option and all outstanding options referred to in section 422(b)(5) are to purchase the same class of stock in the same corporation and the option price of the new option is equal to or greater than that of the old option(s). See section 1.422-2(f)(1)(ii) of the Income Tax Regulations.

Section 422(c)(2) of the Code provides that, for purposes of section 422(b)(5) of the Code, any qualified stock option granted after December 31, 1963, shall be treated as outstanding until such option is exercised in full or expires by reason of lapse of time.

Section 1.422-2(f)(3)(i) of the regulations provides, in part, that if any portion of such an option is not exercised, such portion will be treated as outstanding until the expiration of the maximum period for which such portion, according to the terms of the option when granted, could have been exercised under any circumstances.

Accordingly, in the instant case, since the options granted are by their terms exercisable for a period of five years from the date of grant if the optionee's employment does not terminate, any unexercised portions of the options will expire by reason of the lapse of time no sooner than the expiration of their five-year periods, which are the maximum periods for which such options could have been exercised under any circumstances as provided by section 1.422-2(f)(3)(i) of the regulations. Consequently, the first option granted in this case will be

considered as outstanding for purposes of sections 422(b)(5) and 422(c)(2) of the Code until it is exercised in full or expires by reason of the lapse of time at the end of its five-year term. Therefore, the second option may not be exercised until the first option is exercised in full, or expires by reason of the lapse of its five-year term.

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26 CFR 1.422-2: Qualified stock options defined.

Employee stock options; qualified and nonstatutory options simultaneously granted. The granting of a nonstatutory option to purchase 4 percent of a corporation's outstanding stock at the same time that another option, intended to be a qualified stock option, is granted for the purchase of 5 percent of the outstanding stock by an employee who owned no other shares of the corporation's stock will not adversely effect the latter option if it otherwise meets the requirements of section 422(b) of the Code; Rev. Rul. 73-26 distinguished.

Rev. Rul. 74-128

Advice has been requested whether a stock option which otherwise qualifies as a qualified stock option as defined in section 422(b) of the Internal Revenue Code of 1954 meets the requirements of section 422(b)(7) of the Code under the circumstances described below.

A corporation having an equity capital of $3,000,000 granted to one of its employees a stock option (stock option 1) that satisfied the requirements of paragraphs (1) through (6) of section 422(b) of the Code. The number of shares that the employee was entitled to purchase under the option was equal to 5 percent of the total combined voting power or value of all classes of stock of the corporation. The employee did not own stock of the corporation, or of a parent or a subsidiary of the corporation either directly, or indirectly by attribution under section 425(d). Also, prior to the granting of the option, the employee did not own any other options to acquire stock of the corporation, or of a parent or subsidiary of the corporation.

Simultaneously with the granting of stock option 1, the corporation also granted to the employee a nonstatutory stock option (stock option 2) for the purchase of an additional number of shares equal to 4 percent of its outstanding stock. This option was not exercisable until stock option 1 had been exercised in full or had expired.

Under the limitations of section 422(b)(7) of the Code, a stock option that otherwise meets the requirements of section 422(b), is a qualified stock option only if the optionee, immediately after the option is granted, does not own stock possessing more than 5 percent of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation, with exceptions not here pertinent.

Section 422(c)(3)(C) of the Code and section 1.422-2(h)(1)(i) of the Income Tax Regulations provide, in part, that, for purposes of section 422(b)(7), stock that an individual may purchase under outstanding options (whether or not such options qualify for the special tax treatment afforded by section 421(a)) shall be treated as stock owned by the individual. An option is outstanding for purposes of section 422(b)(7) and 422(c)(3) although under its terms it may be exercised only in installments or after the expiration of a fixed period of time.

Section 1.422-2(h)(2) of the regulations provides, in part, that if an individual is granted an option which permits him to purchase stock in excess of the limitation of section 422(b)(7) of the Code, such option shall be treated as meeting the requirement of that section to the extent that such individual could, if the option were exercised in full at the time of grant, purchase stock under such option without exceeding such limitation. If shares in excess of the number allowable under section 422(b)(7) are transferred to the individual under an option, such shares will not be treated as transferred pursuant to the exercise of a qualified stock option, irrespective of whether the stock ownership of the individual at the time of such transfer exceeds the limitation of section 422(b)(7). The shares purchased under an option described in this subparagraph which will be treated as shares transferred pursuant to the exercise of a qualified stock option will be the first shares acquired under the option.

Thus, in the instant case, if the corporation had granted the employee a single option for the purchase of shares equal to 9 percent of its outstanding stock, and if that option had otherwise satisfied the requirements of section 422 of the Code, then, under the foregoing regulations, such option, to the extent that it would permit the purchase of shares equal to 5 percent of the corporation's stock would have been treated as a qualified stock option, and the remaining portion of the option would have been considered as a nonqualified stock option. Therefore, the simultaneous granting of the two options as the corporation did in this case produced the same result (assuming that stock option 1 is actually exercised in full) as that that would have occurred if the corporation had granted only one option for the purchase of shares equal to 9 percent of its outstanding stock.

Accordingly, it is held that stock option 1 in the instant case satisfied the requirements of section 422(b)(7) of the Code, and is not adversely affected by the simultaneous grant of the nonqualified stock option. Stock option 1 is therefore a qualified stock option within the meaning of section 422(b). The plan in the instant case is distinguishable from the "tandem" stock options considered in Rev. Rul.

73-26, 1973-1 C.B. 204, which holds, in part, that an option is inconsistent with the purpose of section 422 of the Code and thus does not qualify if it is part of an arrangement that gives the optionee any rights to purchase stock as an alternative of the right to buy stock under terms and conditions that satisfy the requirements of section 422. A "tandem" stock option plan is a plan under which the exercise of one option reduces the number of shares for which the other option can be exercised. Because of this offset feature, the granting of a purported qualified stock option in tandem with a nonstatutory option is considered as providing the optionee with, in substance, a single option with alternative purchase terms on a given quantity of the employer's stock. Thus, under Rev. Rul. 73-26 the nonstatutory alternative precludes any part of the plan from qualifying under section 422.

In the instant case, the nonstatutory stock option has been granted in addition to the qualified stock option rather than as an alternative. Although the nonstatutory option is not exercisable until the qualified stock option has been exercised in full or has expired, the options have no tandem feature but are, instead, separate and distinct. See Rev. Rul. 73-359, 1973-2 C.B. 148, concerning the granting of statutory and nonstatutory stock options. Accordingly, the two options are not viewed as a single option with alternative purchase terms, and the fact that the nonstatutory option is exercisable for a period beyond that permitted by section 422(b)(3) of the Code will not prevent the qualified stock option from satisfying the requirement of that section.

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26 CFR 1.422-2: Qualified stock options defined.
(Also Section 425; 1.425-1.)

Employee stock options; economic stabilization. Stock options granted under a qualified plan in which the aggregate number of shares to be issued was reduced to comply with the economic stabilization program are considered outstanding, under section 422(c)(2) of the Code, only as to the reduced number of shares. The use of a formula provided in the stock option agreements to reduce the number of shares proportionate to the reduction in the aggregate number of shares to be issued is not a modification of the options under section 425(h).

Rev. Rul. 74-144

In 1972 a corporation adopted a qualified stock option plan within the meaning of section 422(b) of the Internal Revenue Code of 1954 and secured shareholder approval of the plan within twelve months of its adoption. The plan provided for an aggregate of $100x$ shares to be issued under options and designated certain key executive employees of the corporation as the persons eligible to receive such options. The aggregate of $100x$ shares covered by the option agreements was subject to possible reduction if necessitated by application of the regulations promulgated under the Economic Stabilization Act of 1970. This possibility was provided for in the stock option agreements. The stock option agreements satisfied the requirements of section 422(b) of the Code.

Subsequent to the granting of all of the above stock options in 1972, a decision was issued by the Executive Director of the Pay Board to the effect that the total number of shares that could be the subject of qualified stock options granted by the corporation during 1972 was $95x$ shares.

As a result of this decision, the number of shares covered by the 1972 option agreements was proportionately reduced to ensure compliance with the Economic Stabilization regulations. This reduction was accomplished in accordance with the stock option agreements through the application of a formula which ensured that the number of shares in each employee's agreement was reduced by the same percentage and that the aggregate number of shares after the reduction was within the prescribed limit.

Section 422(c)(2)(B) of the Code provides that, for purposes of section 422(b)(5) (which provides that a qualified stock option by its terms must not be exercisable while there are previously granted qualified stock options outstanding), any qualified stock options granted after December 31, 1963, shall be treated as outstanding until such option is exercised in full or expires by reason of the lapse of time.

Section 425(h)(1) of the Code provides, in part, that if the terms of any option to purchase stock are modified, extended, or renewed, such modification, extension, or renewal shall be considered as the granting of a new option.

Section 425(h)(3) of the Code provides, in part, that the term "modification" means any change in the terms of the option which gives the employee additional benefits under the option.

Held, the options granted during 1972, in the instant case, will be considered outstanding (within the meaning of section 422(c)(2) of the Code) only with respect to that number of shares subject to each option agreement after reduction in the number of such shares as required by the Pay Board and as provided for in the option agreements.

Held further, the use of the formula provided in the option agreements to proportionately reduce the number of shares subject to the options was not a modification of the terms of the options within the meaning of section 425(h) of the Code. See Rev. Rul. 64-230, 1964-2 C.B. 118.

Section 425.—Definitions and Special Rules

26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

Qualified stock options; community property State; stock transferred to wife's estate. In California both the employee husband and nonemployee wife qualify for the benefits of section 421(a)(1) of the Code with respect to stock purchased by the husband pursuant to the exercise of a qualified stock option. Thus, after the wife's death the transfer of one-half of the shares to her estate is not a "disposition" within the meaning of section 425(c)(1); Rev. Rul. 68-408 clarified.

Rev. Rul. 74-68

Advice has been requested whether, under the circumstances described below, the transfer to an estate of stock purchased by the decendent's husband pursuant to the exercise of a qualified stock option is a "disposition" within the meaning of section 425(c)(1) of the Internal Revenue Code of 1954.

Pursuant to the husband's exercise of a qualified stock option granted him by *X*, his employer corporation, 10,000 shares of *X* stock were transferred to him on June 1, 1971. The husband and his wife were lifelong residents and domiciliaries of California, a community property state, and community property funds were used by the husband to purchase the *X* stock. Under California law the *X* stock was community property and the wife's estate became the owner of 5,000 shares of the *X* stock upon the wife's death in 1972. The wife had never been an employee of *X* or of any parent or subsidiary thereof, and thus could not have been granted a qualified stock option to purchase *X* stock.

Section 421(a)(1) of the Code provides, in part, that if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) are met, no income shall result at the time of the transfer of such share to the individual.

Section 422(a) of the Code provides, in part, that section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if no disposition of such share is made by the individual within the 3-year period beginning on the day after the day of the transfer of such share.

Under section 425(c)(1) of the Code the term "disposition" includes a sale, exchange, gift, or a transfer of legal title, but does not include a transfer from a decedent to an estate or a transfer by bequest or inheritance.

Section 5105 of the California Civil Code (West 1970) provides that the respective interests of the husband and wife in community property are present, existing, and equal interests.

On several previous occasions the Internal Revenue Service has considered the application of the Federal income tax laws to taxpayers domiciled in community property states. Thus, although section 105 of the Code provides an exclusion for certain amounts received by employees under accident and health plans, Rev. Rul. 59-159, 1959-1 C.B. 26, allows a nonemployee wife and her employee husband domiciled in a community property state to each exclude one-half of the excludable amount received by the husband. The basis for this conclusion is that the character of community income is established by the circumstances under which it is earned and that such character is not changed by the community property laws.

Similarly, Rev. Rul. 55-246, 1955-1 C.B. 92, holds that if a husband satisfies the requirements of section 911 of the Code with respect to presence in a foreign country and receives income that is excludable, the wife's share of such income is excludable on her separate return even though she remains at their marital domicile in a community property state.

Accordingly, in the instant case it is held that since the husband qualified for the benefits of section 421(a)(1) of the Code with respect to the qualified stock option granted him to purchase *X* stock, his wife also qualified for such benefits even though she could not have been granted a qualified stock option to purchase *X* stock. Thus, the wife is a "decedent" for purposes of section 425(c)(1), and the transfer of the 5,000 shares of *X* stock to her estate is a transfer from a decedent to an estate and is not a "disposition" within the meaning of section 425(c)(1).

Rev. Rul. 68-408, 1968-2 C.B. 193, concludes that in a community property state the registration of option stock in the names of both spouses is not a disposition within the meaning of section 425(c)(1) of the Code. The basis for this conclusion is that since the stock is community property, the registration merely describes the legal ownership of the stock under state law. The holding of the present Revenue Ruling that in a community property state a nonemployee spouse qualifies for the benefits of section 421(a)(1) if her employee spouse qualifies furnishes additional rationale for the position taken in Rev. Rul. 68-408. Thus, Rev. Rul. 68-408 is clarified to include the holding of this Revenue Ruling as additional support for its conclusion.

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26 CFR 1.425-1: Definitions and special rules applicable to statutory options. (Also Section 1036; 1.1036-1.)

Disposition of option stock; transfer to blind trust. A corporate executive who resigned to accept a five-year government assignment and transferred stock, which had been acquired less than three years previously under a qualified stock option, to an irrevocable trust whose trustees had the power to sell or exchange trust property and

who were not permitted to furnish him any information about the trust, made a "transfer of legal title" constituting a disposition under section 425(c) of the Code and the income attributable to the transfer must be treated as income received in the year the disposition occurred.

Rev. Rul. 74-243

Advice has been requested whether a disposition of stock occurred under section 425(c) of the Internal Revenue Code of 1954 under the circumstances described below.

The taxpayer was a corporate executive and acquired stock in the corporation pursuant to his exercise of qualified stock options under section 422 of the Code. A few months after his acquisition of this stock, the taxpayer resigned from employment as a corporate executive to accept a five-year assignment in government service. In order to remove himself completely from participation in, or knowledge of, certain of his financial affairs during the period of his government service, the taxpayer transferred the above stock and other property to an irrevocable trust, the term of which was to last until his separation from government service, or his death, whichever occurred first.

Under the terms of the trust agreement, the trustees were required to pay monthly from the trust net income and, to the extent necessary from principal, such amounts of money as the taxpayer would request in writing from time to time. To effect the taxpayer's insulation from the administration of the trust, the trustees were given broad powers to manage all the property in the trust, including the power to exchange or sell the trust property, and were not permitted to furnish, directly or indirectly, any information to the taxpayer about the trust assets, any changes therein, any distributions made in kind, or any liabilities assumed or discharged.

The trust agreement provided that upon termination of the trust the trustees would deliver the entire principal and any accumulated income to the taxpayer.

Section 422(a) of the Code provides, in part, that in general, section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if no disposition of such share is made by the employee within the three-year period beginning on the day after the day of the transfer of such share and if at all times during the period beginning with the date of the granting of the option and ending on the day three months before the date of such exercise, the individual was an employee of either the corporation granting the option or a subsidiary thereof. Section 421(a)(1) provides, with an exception not involved here, that if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) are met, no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share.

Under section 1.421-8(b) of the Income Tax Regulations, the disposition of a share of stock, acquired by the exercise of a statutory option before the expiration of the applicable holding period makes section 421 of the Code inapplicable to the transfer of such share. The income attributable to such transfer shall be treated by the individual as income received in the taxable year in which such disposition occurs.

Section 425(c) of the Code provides that the term "disposition" includes a sale, exchange, gift, or a transfer of legal title, but does not include an exchange to which section 1036 applies.

Section 1036 of the Code states that no gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

In Rev. Rul. 57-451, 1957-2 C.B. 295, it is noted that for purposes of section 1036 of the Code, a "simultaneous delivery is not essential to an exchange." The transferee, however, must be under an obligation to replace transferred shares with shares of the same kind and amount. In the instant case, the trustee to whom the stockholder transferred the stock was under no such obligation. Thus, the transaction is not an exchange within the meaning of section 1036.

The phrase "transfer of legal title" is not defined in either section 425 of the Code or in the regulations under that section. However, the phrase has been frequently considered in connection with Federal and State stock transfer taxation, and, in the absence of a definition of "transfer of legal title" in section 425, the construction placed upon the phrase by courts in the area of stock transfer taxes has been relied upon. Rev. Rul. 57-451.

In *Selected American Shares, Inc. v. United States,* 196 F. 2d 473 (7th Cir. 1952) the court viewed a mere custodian of stock as the alter ego of the true owner and as taking no legal title to stock deposited with it for safekeeping where the stock, accompanied by a blank assignment, was not reissued in the custodian's name so as to necessitate a retransfer by the custodian in the event of a subsequent sale by the true owner.

On the basis of the foregoing, Rev. Rul. 57-451 held that where certificates representing shares of stock received by an optionee under a restricted stock option are endorsed or assigned in blank by such optionee and are deposited with a custodian, such as a bank or trust company or a broker, under a written agreement between the parties providing that such stock is to be held or disposed of by such custodian for, and subject at all

times to the instructions of, the optionee, who remains the registered owner of such certificates on the books of the corporation, such deposit is not a "disposition" of the stock.

However, in the instant case, when the taxpayer transferred the stock to the trust, it was not a transfer of the stock to a mere custodian but was a transfer of legal title in the stock to the trustee. The trustee acquired the power to sell the stock, and so long as the trustee holds the stock in trust he may transfer by sale all the incidents of ownership in the stock to a third party.

Accordingly, a disposition of the taxpayer's stock occurred within the meaning of section 425(c) of the Code at the time the taxpayer transferred his stock to the trust, and the income attributable to such transfer is treated as income received in the taxable year in which the disposition occurred.

Compare Rev. Rul. 73-30, 1973-1 C.B. 207, where the delivery of option stock to an agent with a power-of-attorney for the period of a taxpayer's government service is held not to be a disposition under section 425(c) of the Code.

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26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

Divorce dividing stock acquired under statutory option; community property. No "disposition" within the meaning of section 425(c)(1) of the Code is made when stock purchased by a husband with community property funds through the exercise of a qualified stock option is divided equally between the spouses pursuant to a judgment of a California court in a divorce action.

Rev. Rul. 74-278

Advice has been requested whether, under the circumstances described below, the division of stock purchased pursuant to the exercise of a qualified stock option is a "disposition" within the meaning of section 425(c)(1) of the Internal Revenue Code of 1954.

Pursuant to the husband's exercise of a qualified stock option granted him by his employer corporation, 2,000 shares of the corporation's stock were transferred to him on September 1, 1971. The husband and his wife were residents and domiciliaries of California, a community property state, and the stock was purchased with community property funds. Since the wife had never been an employee of the corporation or of any parent or subsidiary thereof, she could not have been granted a qualified stock option to purchase its stock.

In 1973 a California court entered a final judgment dissolving the marriage of the parties and dividing their community property equally between them. The above stock, which was community property under California law, was part of the property so divided.

Section 421(a)(1) of the Code provides, in part, that if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) are met, no income shall result at the time of the transfer of such share to the individual.

Section 422(a) of the Code provides, in part, that section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if no disposition of such share is made by the individual within the 3-year period beginning on the day after the day of the transfer of such share.

Under section 425(c)(1) of the Code the term "disposition" includes a sale, exchange, gift, or a transfer of legal title.

Section 5105 of the California Civil Code (West 1970) provides that the respective interests of the husband and wife in community property are present, existing, and equal interests.

Rev. Rul. 68-408, 1968-2 C.B. 193, concludes that in a community property state the registration of option stock in the names of both spouses is not a disposition within the meaning of section 425(c)(1) of the Code. The basis for this conclusion is that since the stock is community property, the registration merely describes the legal ownership of the stock under State law.

Rev. Rul. 74-68, page 106, which holds that the transfer of one-half of certain qualified stock option shares purchased with community funds to the nonemployee spouse's estate is not a disposition for purposes of section 425(c)(1), furnishes additional rationale for the conclusion reached in Rev. Rul. 68-408. Rev. Rul. 74-68 also holds that if the husband qualifies for the benefits of section 421(a)(1) with respect to a qualified stock option, his wife also qualifies for such benefits even though, as a nonemployee, she could not have been granted the qualified option.

Accordingly, in the instant case it is held that since the wife qualifies for the benefits of section 421(a)(1) of the Code with respect to the option stock, the equal division of the 2,000 shares pursuant to the judgment of the court is not a "disposition" of such shares within the meaning of section 425(c)(1).

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26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

Whether a "modification" occurred when the aggregate number of shares subject to qualified stock options was reduced in accordance with a decision of the Executive Director of the Pay Board pursuant to the regulations under the Economic Stabilization Act of 1970. See Rev. Rul. 74-144, page 105.

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26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

Whether a disposition of stock occurred for purposes of section 422(a)(1) of the Code. See Rev. Rul. 74-267, page 102.

Subchapter E. Accounting Periods and Methods of Accounting
Part II.—Methods of Accounting
Subpart A.—Methods of Accounting in General

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.
(Also Sections 451, 481; 1.451-3, 1.481-1.)

Completed contract method of accounting; cost-plus-fixed-fee contracts. The income from cost-plus-fixed-fee contracts of a corporation engaged in the construction of ships requiring at least three years to complete may be reported on the completed contract method of accounting; I.T. 3459 revoked.

Rev. Rul. 74-129

A corporate taxpayer is engaged in the construction of ships which require at least three taxable years to complete. The contracts entered into by the taxpayer are cost-plus-fixed-fee contracts providing for reimbursement of the contractor at certain intervals for its expenditures as well as specified fixed fee. All parts constructed and materials on account of which payments have been made vest in the purchaser as soon as the contractor is reimbursed for its expenditure.

Held, the reporting of cost-plus-fixed-fee contracts on the completed contract method of accounting is an acceptable method of accounting for Federal income tax purposes. I.T. 3459, 1941-1 C.B. 236, holding that income from cost-plus-fixed-fee contracts must be reported on the accrual method of accounting, is hereby revoked.

A taxpayer wishing to change its method of accounting for cost-plus-fixed-fee contracts to the completed contract method must obtain the approval of the Commissioner in accordance with the provisions of section 446 of the Internal Revenue Code of 1954 and section 1.446-1(e) of the Income Tax Regulations, including Rev. Proc. 70-27, 1970-2 C.B. 509.

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26 CFR 1.446-1: General rule for methods of accounting.

Change of accounting method; bank with trust department using different method. A national bank using a hybrid method of accounting for its commercial banking activities and the cash method for its trust department that is required by Federal regulations to be operated separately may be granted permission to change its method of accounting to the accrual method and continue using the cash method for its trust department.

Rev. Rul. 74-270

Advice has been requested whether permission to change the method of accounting will be granted, pursuant to section 446(e) of the Internal Revenue Code of 1954, under the circumstances described below.

The taxpayer, a national bank, keeps its books and records and files its Federal income tax returns using a hybrid method of accounting for its commercial banking activities. It keeps its books and records and files its Federal income tax returns using the cash receipts and disbursements method with respect to its trust department. The trust department, as required by Federal statute, is operated separately having its own management, offices, and employees. The business of the trust department is basically different from the commercial banking activities. The cash receipts and disbursements method of accounting clearly reflects taxable income of the trust department.

The taxpayer timely requested permission to change its method of accounting for its commercial banking activities, for Federal income tax purposes, from the hybrid method to the accrual method and to continue to employ the cash receipts and disbursements method for its trust department. If such permission is granted, taxpayer will continue to maintain a complete and separate set of books and records for its trust department. Further, if the requested change is approved there will be no creation or shifting of profits or losses between the trust department and the commercial banking activities so that the taxpayer's income is not clearly reflected.

Section 446(e) of the Code provides that a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary of the Treasury or his delegate.

Section 1.446-1(e)(2)(i) of the Income Tax Regulations provides, in part, that a taxpayer may not compute his taxable income under a method of accounting different from that previously used by him unless the consent of the Commissioner is secured.

Section 1.446-1(e)(3) of the regulations provides, in part, that permission to change a taxpayer's method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected.

Section 481 of the Code and the regulations thereunder prescribe the rules to be followed in computing taxable income in cases where the taxable income of the taxpayer is computed under a method of accounting different from that under which the taxable income was previously computed. Certain adjustments that are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted shall be taken into account in computing the taxable income for the taxable year of the change.

Section 1.446-1(d) of the regulations provides, in general, that where

a taxpayer has two or more separate and distinct trades or businesses a different method of accounting may be used for each trade or business, provided the method used for each trade or business clearly reflects the income of that particular trade or business. However, no trade or business will be considered separate and distinct for purposes of this paragraph unless a complete and separable set of books and records is kept for such trade or business. Further, that if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer will not be considered to be separate and distinct.

The right to operate a trust department is granted by the Comptroller of the Currency pursuant to law. Under such law all national banks exercising fiduciary powers are required to segregate their general assets from assets held in any fiduciary capacity and to keep separate books and records. The banking activities and fiduciary functions must be operated separately and the separate identity of the trust department must be preserved. The activities of a trust department of a national bank are governed by regulations under the law. The trust activities differ basically from the banking business in that banking is a mercantile business which consists of receiving deposits, making collections and loans, discounting commercial paper, and issuing notes. The trust business is a personal service business consisting of acting as trustee, executor or administrator, registering stocks and bonds, guarding estates, and acting in other fiduciary capacities. The trust department has its own management, staff of employees, and office space.

Accordingly, under the foregoing circumstances the taxpayer will be permitted to use different methods of accounting for its commercial banking activities and its trust department for Federal income tax purposes. Further, permission will be granted by the Commissioner to change its method of accounting for its commercial banking activities, for Federal income tax purposes, from the hybrid method to the accrual method provided that the taxpayer and the Commissioner of Internal Revenue agree to the terms, conditions, and adjustments under which the change will be effected.

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26 CFR 1.446-1: General rule for methods of accounting.
(Also Section 471; 1.471-1.)

Accounting method; optometrist. An optometrist who maintains a supply of eyeglasses and frames for sale and display purposes and who includes in their sale price an amount for services must use inventories pursuant to the provisions of section 471 of the Code and therefore the proper method of accounting is the accrual rather than the cash method.

Rev. Rul. 74-279

The taxpayer is engaged in business as an optometrist. He has consistently used the cash receipts and disbursement method of accounting for reporting income. The taxpayer purchases and maintains a supply of eyeglasses and frames that are sold in the ordinary course of his business. Some of the eyeglasses and frames are used as samples for display purposes and are also held for sale. The sales price charged by the taxpayer includes the price of the eyeglasses and frames as well as the amount charged for the various services provided.

Section 1.471-1 of the Income Tax Regulations provides, in part, that in order to reflect income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. Section 1.446-1(c)(2)(i) of the regulations provides, in part, that in any case where it is necessary to use an inventory, the accrual method of accounting must be used with regard to purchases and sales.

In *Wilkinson-Beane, Inc.*, 38 P-H Tax Ct. Mem. 477 (1969), aff'd, 420 F. 2d 352 (1st Cir. 1970), the United States Tax Court sustained the Commissioner's determination that a funeral director was required to compute taxable income on the accrual method of accounting. The Court found that caskets were purchased for sale and were sold as merchandise, thus requiring the use of inventories. The requirement to use inventories, in turn, required the use of the accrual method of accounting, notwithstanding the fact that the taxpayer was also in the business of providing valuable professional services in connection with the sales of the caskets.

In the instant case, although the taxpayer provides various services there is also a substantial amount of merchandise sold.

Held, in order to reflect income correctly in the instant case, it is necessary for the taxpayer to use inventories pursuant to the provisions of section 471 of the Internal Revenue Code of 1954. Therefore, the accrual method of accounting is the proper method under the circumstances. However, any change in the taxpayer's present method of accounting is a change in method of accounting subject to the provisions of sections 446 and 481 of the Code and the regulations thereunder.

See Rev. Rul. 73-485, 1973-2 C.B. 150, which holds similarly with respect to a domestic corporation that fabricates and fits artificial limbs and orthopedic braces to physically handicapped persons in addition to providing various services to such persons.

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26 CFR 1.446-1: General rule for methods of accounting.

Change in method of accounting for

nventory costing. See Rev. Proc. 74-9, page 420.

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26 CFR 1.446-1: General rule for methods of accounting.

Procedures for changing certain methods of computing depreciation. See Rev. Proc. 74-11, page 420.

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26 CFR 1.446-1: General rule for methods of accounting.

Whether interest on convertible bonds is accruable and deductible in a taxable year that ends between interest payment dates where such interest is not payable upon the conversion of the bonds to stock. See Rev. Rul. 74-127, page 47.

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26 CFR 1.446-1: General rule for methods of accounting.

Whether a taxpayer may retroactively change the method of depreciation that was used for the original filed tax return. See Rev. Rul. 74-154, page 59.

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26 CFR 1.446-1: General rule for methods of accounting.

Treatment by landlord of real estate taxes payable by tenant in year subsequent to year in which landlord's real estate tax liability is determined. See Rev. Rul. 74-244, page 118.

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26 CFR 1.446-1: General rule for methods of accounting.

Proper method of accounting that should be used by a cash basis bank with respect to its bond department. See Rev. Rul. 74-280, page 121.

Subpart B. Taxable Year for Which Items of Gross Income Included

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Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.
(Also Section 856; 1.856-1.)

Real estate investment trust; forfeited good-faith deposit. Good-faith deposits that, pursuant to an agreement between an accrual method real estate investment trust and an investment counseling company, are paid by loan applicants to the counseling company, deposited in a separate bank account, and eventually refunded to them unless forfeited to the trust, are includible in the trust's gross income only in the year that forfeiture of a particular deposit occurs.

Rev. Rul. 74-130

Advice has been requested concerning the taxable year of inclusion in gross income of amounts received by a real estate investment trust under the circumstances described below.

A real estate investment trust, as defined in section 856 of the Internal Revenue Code of 1954, invests in construction loans and land development loans. The trust, which uses the accrual method of accounting, entered into an agreement with a corporation, an investment counseling company, which provided that the corporation would investigate and evaluate the applications of prospective borrowers. The trust required that a good-faith deposit accompany an application and that such deposit be placed with the corporation to assure performance by the applicant in the event the loan was approved. Pursuant to the agreement, the corporation placed the good-faith deposit in a separate bank account in which no other funds were deposited.

The agreement that accompanied the good-faith deposit provided that the sum deposited was a deposit against the expenses of the corporation in investigating and evaluating the application of the borrower. In the event that no commitment to loan the funds was made by the trust, or a commitment was issued and the loan was taken up within the time specified in the commitment, the deposit was refunded in full. However, if the commitment was made but not taken up by the prospective borrower, or if it was determined that a material fact was omitted from the application, or if there was a material misrepresentation by the borrower, the amount of the deposit was forfeited by the borrower. Upon forfeiture the amount of the deposit was paid to the trust by the corporation.

The specific question presented is whether a good-faith deposit is includible in the gross income of the trust prior to forfeiture by the borrower.

Section 451(a) of the Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations provides, in part, that gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

In the instant case the trust does not receive the good-faith deposits as its own, subject to its unfettered control, unless and until there is a forefeiture by the depositor.

Accordingly, it is held in the instant case that the amount of the good-faith deposit is includible in the gross income of the trust only in the taxable year that a forfeiture of a particular deposit occurs.

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26 CFR 1.451-1: General rule for taxable year of inclusion.

Inclusion by mortgage participation certificate holders in mortgage pool guaranteed by Federal Home Loan Mortgage Corporation on "cash" or accrual method of accounting of their pro rata share of mortgage interest and other items of income. See Rev. Rul. 74-221, page 365.

26 CFR 1.451-1: General year for taxable year of inclusion.

Time for inclusion in income of real estate taxes payable by tenant on behalf of landlord when tax liability is determined in one year and taxes are payable in subsequent year. See Rev. Rul. 74-244, page 118.

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26 CFR 1.451-2: Constructive receipt of income.

Interest: Uniformed Services Savings Deposits Program. Interest on a Uniformed Services Savings Deposits Program account with a balance of less than $10,000 is subject to substantial restrictions on withdrawal and is not includible in gross income until actually received or made available to the serviceman, whichever is earlier; interest on an account that has reached and maintained a balance of $10,000 may be withdrawn quarterly and is includible in gross income; Rev. Rul. 67-450 modified.

Rev. Rul. 74-37

The Internal Revenue Service has been asked to further explain the proper income tax treatment of interest on a savings account of a serviceman for purpoies of section 451 of the Internal Revenue Code of 1954 where an account was established under the Uniformed Services Savings Deposits Program.

Rev. Rul. 67-450, 1967-2 C.B. 174, holds that interest on such savings accounts is includible in the serviceman's gross income in the taxable year in which such interest is actually received or "made available" to him, whichever is earlier. Further, interest is "made available" to the serviceman at the time of his permanent return to the United States or its possessions.

Section 1035, title 10, United States Code, as amended, provides that under joint regulations prescribed by the Secretaries concerned, a member of the armed forces who is on permanent duty assignment outside the United States or its possessions may deposit during that tour of duty certain amounts under the Program. Normally the amount upon which the prescribed interest of 10 percent may be paid is limited to $10,000; however, in the case of a serviceman in a missing status such limitation has been removed to the extent of deposits made on or after September 1, 1966.

The joint regulations of the Secretaries concerned are published in the Department of Defense Military Pay and Allowances Entitlements Manual. Section 70807 of these regulations provides, in part, that: (1) withdrawals may be made in an emergency only when the health or welfare of a member or his dependent would be jeopardized if the withdrawal were not granted; (2) with regard to members in a missing status, withdrawals may be made when directed by the Secretary concerned or his designee when deemed in the best interest of the member, his dependents, or the Government; and (3) in situations where a member's principal and interest on deposit reaches $10,000, any interest accruing in the account subsequent to that time which causes the $10,000 total to be exceeded, may be withdrawn quarterly at the member's request.

Section 451(a) of the Internal Revenue Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-2(a) of the Income Tax Regulations provides, in part, that income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. This section of the regulations further provides that income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Under the facts presented, a serviceman on permanent duty assignment outside the United States or its possessions, whose account has not reached $10,000, is subject to substantial restrictions and control regarding withdrawals from the account. Accordingly, interest accruing during that time is not made available to him and is not includible in his gross income until made available to him. However, since interest accruing in the account subsequent to the time a member's principal and interest on deposit reaches $10,000 and which causes the $10,000 total to be exceeded may be withdrawn quarterly at the member's request, such interest is at that time includible in his gross income because it is "available" to him within the meaning of section 1.451-2(a) of the regulations. Further, the treatment of interest accruing in an account of a serviceman in a missing status results in the same tax treatment as interest accruing in an account of a member of the armed forces not in a missing status.

Rev. Rul. 67-450 is hereby modified to the extent that once an account reaches and is maintained at $10,000, interest accruing in the account thereafter may be withdrawn quarterly at the member's request and therefore is made available to him at that time.

In the case of a member of the armed forces who dies while serving in a combat zone, the interest accruing in the account will be treated in accordance with section 692 of the Code and the regulations applicable thereto.

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26 CFR 1.451-3: Long-term contracts.

Whether a contractor engaged in the construction of ships may report income on the completed contract method of accounting with respect to cost-plus-fixed-fee contracts. See Rev. Rul. 74-129, page 109.

26 CFR 1.451-4: Accounting for redemption of trading stamps and coupons.

Trading coupons issued by gambling casino; redemption; time of deduction. An accrual-method gambling casino that issues to winning patrons its own coupons which are redeemable for cash in the casino, or for merchandise from local merchants who are reimbursed by the casino, may not currently deduct estimated costs based on anticipated redemptions as provided by section 1.451-4 of the regulations.

Rev. Rul. 74-69

Advice has been requested whether the method of currently deducting estimated costs based on anticipated redemptions of trading stamps and coupons, as provided by section 1.451-4 of the Income Tax Regulations, is applicable under the circumstances described below.

The taxpayer, a domestic corporation using an accrual method of accounting, operates gaming machines and other games of chance. Patrons who win at these games are paid in cash along with coupons issued by the taxpayer. Redemption booths are maintained on the taxpayer's premises where the coupons may be redeemed for cash. The coupons may also be redeemed for merchandise from local participating merchants who are subsequently reimbursed by the taxpayer when the coupons are presented for redemption.

Section 1.451-4 of the regulations provides that an accrual method taxpayer issuing trading stamps or premium coupons with sales should deduct from gross receipts an amount equal to the cost to the taxpayer of merchandise, cash, and other property used for redemption in a taxable year, plus a reserve for future redemptions.

Since the taxpayer issues the stamps as prizes to winning patrons and not with sales, it cannot avail itself of section 1.451-4 of the regulations to account for the redemption of its coupons. Further, with respect to those coupons presented to the taxpayer by customers for redemption in cash, the taxpayer may deduct the cost of such redemptions when cash is actually paid to the customers. With respect to those coupons redeemed for merchandise, the costs are deductible when the taxpayer becomes liable to pay the participating merchant for the merchandise used to redeem the coupons.

Any change by the taxpayer from its present method of accounting for the redemption of its coupons is a change in method of accounting subject to the provisions of sections 446 and 481 of the Internal Revenue Code of 1954 and regulations thereunder.

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26 CFR 1.451-6: Election to include crop insurance proceeds in gross income in the taxable year following the taxable year of destruction.

Crop insurance proceeds; election to defer reporting. A cash-method taxpayer who receives crop insurance proceeds in the same calendar year his grain crops were damaged and who establishes that more than 50 percent of the crop income would have been reported in the following year under his normal business practice is entitled to elect under section 451(d) of the Code to include the proceeds in income in the following year, but he may not allocate the proceeds between the two years. A mere disclosure on the return that insurance proceeds are being deferred is not a proper election under regulations section 1.451-6(b)(1).

Rev. Rul. 74-145

Advice has been requested concerning the election under section 451(d) of the Internal Revenue Code of 1954 to defer the reporting of insurance proceeds received as a result of the destruction or damage to crops under the circumstances described below.

The taxpayer operates a grain farm and uses the cash receipts and disbursements method of accounting and files his return on the basis of a calendar year. During 1971 the taxpayer received the following amounts of insurance proceeds for the destruction and damage to his crops by hail in that year: wheat $35x$ dollars, barley $25x$ dollars, and oats $10x$ dollars. In filing his return for 1971, the taxpayer included only $20x$ dollars of the insurance proceeds in gross income. The taxpayer did not file the statement required by section 1.451-6(b)(1) of the Income Tax Regulations to defer reporting of the insurance proceeds. However, he did disclose on his return that the balance of the insurance proceeds was income being deferred.

The normal business practice of the taxpayer is to secure a loan from the Commodity Credit Corporation on part of his crop in the fall of the year in which the crop is harvested, and then secure an additional loan, as needed, on the balance of the crop after the end of that year. The loans are closed in the following year by delivering the grain covered by the loan to the grain elevator which directly pays the Commodity Credit Corporation the amount of the loans, and remits any excess to the taxpayer. Under his method of accounting the taxpayer has consistently reported as income for any taxable year: (1) the amount of any loans made during the taxable year, and (2) any amounts received from the grain elevator. It was established that under his method of accounting more than 50 percent of the income from the crops destroyed in 1971 would have been reported in 1972, that is, when an additional loan was secured or when the grain was delivered to the grain elevator.

The specific questions presented are (1) is the taxpayer entitled to make the election under section 451(d) if he establishes that a substantial portion of the income from the crops would have been reported in the following taxable year; (2) may the insurance proceeds be allocated between

the taxable year in which received and the following taxable year; and (3) has the taxpayer made a proper election under the facts presented.

With regard to question one, section 451(d) of the Code provides, in part that, in the case of insurance proceeds received as a result of destruction or damage to crops, a taxpayer reporting on the cash receipts and disbursements method of accounting may elect to include such proceeds in income for the taxable year following the taxable year of destruction or damage, if he establishes that, under his practice, income from such crops would have been reported in a following taxable year. An election under this subsection for any taxable year shall be made at such time and in such manner as the Secretary or his delegate prescribes.

In the instant case, the taxpayer has established that under his normal business practice a substantial portion of the income from the crops destroyed in 1971 would have been reported in a following taxable year. Accordingly, it is held that he is entitled to make the election under section 451(d) of the Code.

With regard to question two, section 1.451-6(a)(2) of the regulations provides, in part, that a taxpayer who receives insurance proceeds as a result of the destruction of, or damage to, two or more specific crops, if such proceeds may, under section 451(d) of the Code or this section, be included in gross income for the taxable year following the taxable year of such destruction or damage, and if such taxpayer makes an election under section 451(d) and this section with respect to any portion of such proceeds, then such election will be deemed to cover all of such proceeds which are attributable to crops representing a single trade or business under section 446(d).

Since the insurance proceeds received in the instant case are attributable to crops representing a single trade or business, it is held that, if the taxpayer properly elects to defer reporting any portion of the insurance proceeds received in 1971, all of such proceeds must be reported in 1972.

With regard to question three, the taxpayer contends that the disclosure on his return constitutes an election under section 451(d) of the Code. Section 1.451-6(b)(1) of the regulations provides that the election to include in gross income insurance proceeds received as a result of destruction of, or damage to, the taxpayer's crops in the taxable year following the taxable year of such destruction or damage shall be made by means of a statement attached to the taxpayer's return (or an amended return) for the taxable year of destruction or damage. The statement shall include the name and address of the taxpayer (or his duly authorized representative), and shall set forth the following information:

(i) A declaration that the taxpayer is making an election under section 451(d) and this section;
(ii) Identification of the specific crop or crops destroyed or damaged;
(iii) A declaration that under the taxpayer's normal business practice the income derived from the crops which were destroyed or damaged would have been included in his gross income for a taxable year following the taxable year of such destruction or damage;
(iv) The cause of destruction or damage of crops and the date or dates on which such destruction or damage occurred;
(v) The total amount of payments received from insurance carriers, itemized with respect to each specific crop and with respect to the date each payment was received; and
(vi) The name(s) of the insurance carrier or carriers from whom payments were received.

The taxpayer in the instant case, did not attach to his 1971 return a statement as required by section 1.451-6(b)(1) of the regulations. The mere disclosure on his return that insurance proceeds were deferred does not constitute an election under section 451(d) of the Code. Accordingly, it is held that the taxpayer has not made a proper election under section 451(d) to defer reporting of the insurance proceeds. However, a proper election may be made by filing an amended return within the applicable period of limitations, and attaching a statement to the return showing all the above stated information required to be shown by section 1.451-6(b)(1) of the regulations. If a proper election is not made, then the entire proceeds of 70x dollars should be included in gross income for 1971.

Section 453.—Installment Method

26 CFR 1.453-2: Special rules applicable to dealers in personal property.

Installment sale; interest allocated to down payment. The interest element of the "time price differential" a dealer computes on an installment sales contract after he deducts the down payment must be added to the total sale price and allocated proportionately to the down payment for the purpose of determining profit on the sale.

Rev. Rul. 74-156

Advice has been requested whether, under circumstances described below, a taxpayer electing the installment method of accounting must take into account the "time price differential" (interest element) in determining the portion of profit on an installment sale to be immediately recognized on receipt of a down payment.

The taxpayer is engaged in the manufacture and sale of commercial vehicles and other items. It uses the accrual method of accounting. The taxpayer ordinarily receives an initial down payment from its customers. The balance is paid in installments and the time price differential is computed on this balance, added to the selling price and treated as part of the selling price for customer billing purposes. The taxpayer presently reports a portion of its gross profit as income on receipt of the down payments, but

does not report any of the time price differential at this time or otherwise concurrently take this item into account in determining gross profit.

Section 453(a) of the Internal Revenue Code of 1954 provides that a dealer in personal property may elect to use an installment method of accounting. If he does, he must report as income "that proportion of the installment payments actually received in that year which the gross profit * * * to be realized * * * bears to the total contract price."

Section 1.453-2(c)(1) of the Income Tax Regulations provides, in part, that income from sales on the installment plan of a dealer is to be computed as a portion of "the total payments received in the taxable year from sales on the installment plan."

Section 1.453-2(c)(2) of the regulations provides that carrying charges or interest is included in the total contract for purposes of computing the gross profit to be realized from the installment sales of a dealer (i) when it is determined at the time of sale and treated as part of the selling price for customer billing purposes and (ii) in the case of sales made in taxable years beginning on or after January 1, 1960, when it is added contemporaneously with the sale on the books of account of the seller to the established selling price.

Section 453(a) of the Code does not treat down payments separately from other installments. Therefore, if the words "installment payments" do not include down payments, the portion of gross profit allocated to the down payment will go untaxed entirely, a result obviously not intended.

Section 1.453-2(c) of the regulations provides in substance that down payments are to be treated the same as other payments by referring to the "total payments" received in the taxable year. "Total payments" include down payments.

In such instances, the Code and the regulations provide that carrying charges or interest are to be treated as an element of gross profit and reported proportionately as payments on the installment contract are received. Furthermore, the down payment is to be treated as any other payment under the contract. That is, a portion of the carrying charges or interest is allocable to the down payment.

Accordingly, it is held that the taxpayer must allocate a portion of the "time price differential" in the installment contract to the initial down payment received under the contract.

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26 CFR 1.453-9: Gain or loss on disposition of installment obligations.

Installment obligation disposition; notes substituted for original note. The substitution of two promissory notes, each secured by a deed of trust on a parcel of land, for the original unpaid note and deed for the total land sold is not a disposition of an installment obligation within the meaning of section 453(d) of the Code.

Rev. Rul. 74-157

Advice has been requested whether, under the circumstances described below, the substitution of two promissory notes and deeds of trust for an existing promissory note and deed of trust is a satisfaction or disposition of an installment obligation within the meaning of section 453(d) of the Internal Revenue Code of 1954.

A taxpayer sold 1,000 acres of land in 1972 for 250*x* dollars and received from the purchaser a down payment of 50*x* dollars and a promissory note for 200*x* dollars secured by a deed of trust on the property payable in installments over a period of years. The taxpayer elected to report the gain from this sale on the installment method of accounting under section 453 of the Code.

In a subsequent year, because the purchaser desired to divide the property into two parcels and to subdivide one of such parcels, the taxpayer surrendered the existing promissory note before any payments had been made in exchange for two new promissory notes secured by separate deeds of trust on the two parcels of land. The new notes are for 50*x* dollars and 150*x* dollars and are secured by deeds of trust covering 250 acres and 750 acres, respectively. The terms of the new notes are identical to those of the original note except that the amount of each payment required under the original note is apportioned between the new notes in proportion to their principal amounts.

The new deeds of trust are identical to the original deed of trust, except for an additional provision in the deed of trust covering the 750-acre parcel which permits the purchaser to obtain the release of parcels of not less than 150 acres when the principal balance of the secured note has been reduced by $200 per acre of the portion so released.

Section 453(d) of the Code provides, in part, that if an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Rev. Rul. 55-5, 1955-1 C.B. 331, concerns the sale of property on the installment basis under a land contract. That Revenue Ruling holds that the substitution of a mortgage contract for a land contract, in an amount equal to the unpaid balance of the purchase price, payable on the same terms and conditions of payment of the balance under the land contract,

results in a change in the type of security only and does not constitute a satisfaction or disposition of an installment obligation giving rise to gain or loss under section 44(d) of the Internal Revenue Code of 1939 (predecessor of section 453(d) of the 1954 Code).

Accordingly, in the instant case, it is held that the substitution of the new promissory notes and deeds of trust for the existing promissory note and deed of trust is not a satisfaction or disposition of an installment obligation within the meaning of section 453(d) of the Code.

Subpart C. Taxable Year for Which Deductions Taken

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Section 162; 1.162-1.)

Year of deduction; FICA and FUTA. The proper year for deduction by employers of taxes imposed under sections 3111 and 3301 of the FICA and FUTA, respectively, and with respect to accrual-method employers, the effect of the credit against tax provided by section 3302; Rev. Rul. 70-507 superseded.

Rev. Rul. 74-70

The purpose of this Revenue Ruling is to supersede Rev. Rul. 70-507, 1970-2 C.B. 104.[1]

Section 461 of the Code provides, in general, that the amount of any deduction or credit allowed shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(1) of the Income Tax Regulations states, in part, that under the cash receipts and disbursements method of accounting amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid. Section 1.461-1 (a)(2) of the regulations states, in part, that under the accrual method of accounting an expense is deductible for the taxable year in which all the events have occurred which determine the fact of liability and the amount thereof can be determined with reasonable accuracy.

The tax imposed on every employer by section 3111 of the Federal Insurance Contributions Act with respect to having individuals in his employ is measured by a percentage of the "wages" (exclusive of tips received by employees after 1965) paid for "employment." Liability for the tax imposed on the employer attaches at the time that the wages are actually or constructively paid unless they are deemed to be subsequently paid. See section 31.3121(a)-2 of the Employment Tax Regulations. There is no liability until such payment is made. Not until then can the tax be accrued, whether the payments are made weekly, twice a month, monthly, or on some other basis. Where a taxpayer employs the accrual method of accounting, the excise tax imposed by section 3111 of the Federal Insurance Contributions Act is deductible for the taxable year in which the wages are actually or constructively paid. Where a taxpayer employs the cash receipts and disbursements method of accounting the tax imposed by section 3111 of that Act is deductible only for the taxable year in which the tax is paid.

Section 3301 of the Federal Unemployment Tax Act imposes on every "employer" an excise tax, with respect to individuals in his employ, equal to a certain percentage of the total "wages" paid by him with respect to "employment." Under section 3302 of that Act the taxpayer may be entitled to certain credits against the tax imposed by section 3301 of that Act for any taxable year based on the amount of contributions with respect to employment during the taxable year paid by him for the taxable year with respect to the unemployment compensation law of a State and also based on the amount of contributions that he is relieved from paying to the State under such State law. The total credits allowed to a taxpayer under section 3302 of that Act shall not exceed 90 percent of the tax against which such credits are allowable. For purposes of the credit, the tax imposed by section 3301 of that Act shall be computed at the rate of 3 percent in lieu of the rate provided by section 3301 of the Act. Thus, the aggregate of the credit that is allowable to an employer for any taxable year shall not exceed 2.7 percent of the "wages" paid by the employer during the year.

The rate of tax imposed by section 3301 of that Act for the calendar year 1973 is 3.28 percent. The rate for the calendar years 1970, 1971, and 1972 is 3.2 percent.

Accordingly, for the reasons stated below, it is held that, as to a taxpayer employing the accrual method of accounting, an amount equal to at least 0.58 percent (3.28 percent less 2.7 percent) of the "wages" paid during the calendar year 1973 may be accrued if and when the employer qualifies as an "employer" as defined in section 3306(a) of that Act. Similarly, an amount equal to at least 0.5 percent (3.2 percent less 2.7 percent) of the "wages" paid during the calendar years 1970, 1971, and 1972 may be accrued.

For example, a corporation employing the accrual method of accounting is an "employer" under section 3306 (a) of the Federal Unemployment Tax Act for its fiscal year ended June 30, 1973. It has paid "wages" of 5,000x dollars during the first six months of the calendar year 1973

[1] Because of the interaction of sections 3301 and 3302, the correct maximum credit allowable shown in Rev. Rul. 70-507 should have been 84.375 percent ($\frac{2.7\%}{3.2\%} \times 100 = 84.375$) instead of 90 percent. Therefore, the computations shown in Rev. Rul. 70-507 were incorrect.

upon which its liability for the tax under section 3301 of the Act (which is, in part, contingent) is ascertained to be 164x dollars (3.28 percent of 5,000x dollars). Its contributions to the State are 135x dollars (2.7 percent of 5,000x dollars). Accordingly, it may accrue 29x dollars (0.58 percent of 5,000x dollars) as a fixed liability deductible for Federal income tax purposes in the fiscal year ended June 30, 1973, since, to that extent its liability is determined and will not be affected by subsequent events.

The remaining 135x dollar liability under section 3301 of the Act (2.7 percent of 5,000x dollars, or 164x dollars less the 29x dollars which is accruable) may not be paid at all. All of the factors essential to the calculation under section 3301 of the Act, considered alone, may be definitely determinable from time to time during the calendar year, but the fact remains that because of the credit provisions of section 3302 of the Act an amount equal to 2.7 percent of the "wages" paid may never become a liability which must be paid to the Federal Government.

As there is a State unemployment compensation law, in this case, it may be properly said that some portion of the 135x dollars (2.7 percent of 5,000x dollars) of the liability to the Federal Government under section 3301 of the Act is cancelled immediately upon its arising by the offsetting credit under section 3302 of the Act except for the fact that such entitlement arises only after the law of the State is "certified" for the taxable year 1973 as provided in section 3304 of the Act. The total remaining liability under section 3301 of the Act thus remains in suspense until action respecting certification, as required by section 3304(c) of the Act, is taken by the Secretary of Labor.

Section 3304(c) of the Act states, in part, as follows:

CERTIFICATION.—On October 31 of each taxable year the Secretary of Labor shall certify to the Secretary [of the Treasury] each State whose law he has previously approved, except that he shall not certify any State which, after reasonable notice and opportunity for hearing to the State agency, the Secretary of Labor finds has amended its law so that it no longer contains the provisions specified in subsection (a) or has with respect to the 12-month period ending on such October 31 failed to comply substantially with any such provision in such subsection * * *.

Sections 3304(a) and 3309 of the Federal Unemployment Tax Act set forth certain standards with which a State law (as written and administered) must comply in order to secure the approval of the Secretary of Labor and be certified on October 31 of each calendar taxable year. It cannot, therefore, be known prior to October 31 in each calendar year whether the particular State law is certified for that year and, as the calendar year is the taxable year, it cannot be known until October 31 of the taxable year whether the taxpayer is entitled to the credit provisions of section 3302 of the Act. Even though it is necessary for the taxpayer to make some provisions in its accounting during the course of the calendar year against the possible incidence of an actual cash liability for this 135x dollar portion of the tax computed under section 3301 of the Act, it is clearly a contingent provision.

Inasmuch as there is a distinct likelihood that, in the example, 135x dollars of the tax calculated under section 3301 of the Act will not be paid (i.e., that it will not survive as a liability which must be paid to the Federal Government) that much of the tax imposed by that section must be classified as a liability contingent upon a specific event, namely, whether the State law is in fact certified by the Secretary of Labor on October 31 of the taxable year. Only in the event that State law is not certified will the entire amount of the liability calculated under section 3301 of the Act constitute a definite and fixed liability to the Federal Government and any definite accrual of the amount of liability in excess of 29x dollars must be postponed until October 31.

For calendar years prior to 1972, however, the certification date was December 31, rather than October 31. Consequently, as to the taxable calendar years 1970 and 1971, any definite accrual of liability in excess of 0.5 percent (3.2 percent less 2.7 percent) of the "wages" paid must be postponed to December 31.

Where a taxpayer employs the cash receipts and disbursements method of accounting any such liability which arises is deductible for the taxable year during which paid.

Rev. Rul. 70-507 is hereby superseded, since the position stated therein is restated under current law in this Revenue Ruling.

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26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Section 165; 1.165-1.)

Year of deduction; payments on negotiable note; worthless stock. Amounts paid by a cash-method taxpayer on a negotiable promissory note, payable one-half of its face value in September 1970 and the remaining half in September 1971, which was issued for stock that became worthless in December 1970, are deductible as losses from the sale or exchange of a capital asset under section 165(g) of the Code in the years the payments are made rather than the year the stock became worthless; I.T. 1167 superseded.

Rev. Rul. 74-80[1]

An individual using the cash receipts and disbursements method of accounting and filing his return on a calendar year basis issued and delivered in 1970 his negotiable promissory note of 5x dollars for stock of a newly formed corporation. The terms of the note called for payment of one-half of its face value in September

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

1970 and the remaining one-half in September 1971. The note was discounted immediately. In December 1970 the stock became worthless. The taxpayer made the first payment on the note when it became due in 1970 and the second and final payment on the note at maturity in 1971. The taxpayer was not engaged in the business of buying and selling stock.

Held, the amounts paid by the taxpayer in the instant case are deductible as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset under section 165(g) of the Internal Revenue Code of 1954 in the year the taxpayer actually made the payments on the note rather than in the year that the stock became worthless. Thus, the taxpayer is entitled to a deduction under section 165(g) of the Code for payment of one-half of the face value of the note in 1970 and a deduction in 1971 for the remaining half.

I.T. 1167, I-1 C.B. 149 (1922), is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Sections 162, 446, 451; 1.162-11, 1.446-1, 1.451-1.)

Real property taxes paid by lessee as additional rent. An accrual-method lessee who is obligated to pay as additional rent the real estate taxes on the leased property which accrue on January 1, but become due and payable on June 1 of the following year when the tax bills are issued to the lessor, may not accrue the taxes as an additional rent deduction until June 1 of the year they become payable. The accrual-method lessor may deduct the real estate taxes on January 1 and include them in income on June 1 when they become due and payable by the lessee.

Rev. Rul. 74-244

Advice has been requested concerning the Federal income tax treatment of real estate taxes in the circumstances described below.

The taxpayer, a domestic corporation, leased real property for use in its business. In addition to paying the stated rent, the taxpayer, as lessee, is required to pay the real estate taxes on the leased property.

Both the lessee and the lessor use the accrual method of accounting. The lessee files its Federal income tax returns on the basis of a fiscal year ending January 31. The lessor files its Federal income tax return on the basis of the calendar year.

The laws of the State in which the property is located provide that the owner of real property on January 1 in any year shall be liable for real estate taxes of that year. The State law provides that the taxes are payable by the owner on June 1 of the following year when the tax bills are issued. Under the terms of the underlying lease, the lessee is obligated to pay the real estate taxes as additional rent on June 1 of each year when the tax bills are issued to the lessor.

The specific questions in point are:

(1) When may the lessee accrue the real estate taxes as an additional rent deduction?

(2) Whether the lessor can accrue any liability for the real estate taxes if pursuant to the terms of the lease agreement the lessee is obligated to pay all real estate taxes on the leased premises, and if so, when should the lessor include in income its real estate taxes paid by the lessee?

Pursuant to the provisions of section 1.162-11(a) of the Income Tax Regulations, the taxes paid for the landlord are additional rent and constitute a deductible item to the lessee and taxable income to the landlord. In addition, the amount of the tax is initially deductible by the landlord.

In *Consolidated-Hammer Dry Plate & Company v. Commissioner*, 409 F. 2d 1077 (7th Cir. 1969), the United States Court of Appeals held that the real estate taxes paid by the lessee, an accrual basis taxpayer, in addition to monthly rental, were not deductible in the year in which the taxes became a lien on the property, but in the subsequent year when the taxes became payable. The court interpreted the lease agreement as providing that the lessee did not become obligated to pay the real estate taxes until after the tax bill was issued and the taxes became due.

In Rev. Rul. 71-60, 1971-1 C.B. 63, the taxpayer owned real property in Illinois. Under the Illinois statutes the ownership of real property on January 1 of each year is the event that determines the liability for the property taxes and fixes the amount, although not exactly ascertainable on that date. That Revenue Ruling held, in part, that the real property taxes accrue, for Federal income tax purposes, on January 1 for each year.

Section 1.461-1(a)(2) of the regulations provides, in part, that under an accrual method of accounting, an expense is deductible for the taxable year in which all events have occurred that determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

Sections 1.446-1(c)(ii) and 1.451-1(a) of the regulations provide, in part, that under an accrual method of accounting income is includible in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

Although ownership of real property on January 1 is the event that determines the lessor's liability for the real estate taxes, in the instant case, under the terms of the lease agreement the lessee is not obligated to pay the real estate taxes until after the issuance of the tax bills when the taxes become due.

Accordingly, it is held that the lessee may not accrue the real estate taxes as additional rent until June 1 of the year in which the real estate taxes are payable, since under the terms of the lease agreement, the lessee's liability does

not become fixed within the meaning of the provisions of section 1.461-1(a)(2) of the regulations until that point in time. They are, therefore, deductible as additional rent at that time. Further, since section 1.162-11(a) of the regulations allows a tax deduction to a landlord even if the taxes are paid by a lessee, the lessor may deduct the amount of the real estate taxes on January 1 as provided in Rev. Rul. 71-60 and pursuant to section 1.461-1(a)(2) of the regulations. It is further held that pursuant to sections 1.446-1(c)(ii) and 1.451-1(a) of the regulations, the amount of the real estate taxes payable by the lessee is includible in the lessor's income when such amount became due and payable on June 1.

Any change from the lessee's or lessor's present treatment of the real estate taxes is a change in method of accounting to which the provisions of sections 446 and 481 of the Code and the regulations thereunder apply.

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26 CFR 1.461-1: General rule for taxable year of deduction.

Whether interest on convertible bonds is accruable and deductible in a taxable year that ends between interest payment dates where such interest is not payable upon the conversion of the bonds to stock. See Rev. Rul. 74-127, page 47.

Subpart D. Inventories

Section 471.—General Rule for Inventories

26 CFR 1.471-1: Need for inventories.

Inventories; "straddling" operations. Taxpayers engaged in carrying operations in commodities dealt in on organized exchanges, whose operations consist of buying a spot commodity and entering into a sales contract for its future delivery, are required to maintain inventories in order to reflect income correctly and may value their inventory actually on hand at the close of the taxable year at market value even though it may exceed cost; G.C.M. 18658 superseded.

Rev. Rul. 74-226[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in G.C.M. 18658, 1937-2 C.B. 77.

The question presented is whether taxpayers (commonly referred to as "straddlers") engaged in carrying operations in commodities dealt in on organized exchanges are entitled to inventory goods on hand at market value under the circumstances described below.

The carrying operations in question consist of buying a spot commodity and entering into a sales contract for its future delivery. Such operation is carried on only when there is a sufficient difference between the prevailing commodity price and the price for future delivery to cover all carrying charges (including storages, insurance, cost of certification of future delivery, commissions, etc.), in addition to a fair return or profit upon delivery of the spot commodity in fulfillment of the future sale contract. In the event that there is a sufficient spread between spot and future delivery prices to warrant a continuation of the carrying operation, the future sale contract is sometime disposed of by an offsetting future purchase contract and another contract is entered into for future delivery of the commodity on hand at an advance date. The carrying operations here involved are similar to operations carried on by dealers in commodities.

Section 1.471-1 of the Income Tax Regulations provides that in order to reflect income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor.

Under the regulations cited above the need for inventories is not confined to one who may technically qualify either as a dealer or manufacturer, and the purchase or sale of commodities is an income-producing factor to persons engaged in the carrying operations in question.

Accordingly, taxpayers engaged in carrying operations ("straddlers") are required to maintain inventories in order to reflect income correctly. Furthermore, since the position of these operators is similar to that of dealers in commodities they may value their inventory actually on hand at the close of the taxable year (physical inventory) at market even though it may exceed their cost. See Rev. Rul. 74-227, this page. The taxpayers in the instant case should treat the futures contracts held by them at the end of the taxable year in the manner described in Rev. Rul. 74-223, page 23, this Bulletin, relating to dealers in commodities.

G.C.M. 18658 is hereby superseded, since the position stated therein is restated under the current law in this Revenue Ruling.

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26 CFR 1.471-1: Need for inventories.

Whether under the described circumstances the accrual method of accounting is the proper method to be used by an optometrist engaged in the business of optometric services. See Rev. Rul. 74-279, page 110.

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26 CFR 1.471-1: Need for inventories.

Proper method of accounting that should be used by a cash basis bank with respect to its security activity. See Rev. Rul. 74-280, page 121.

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26 CFR 1.471-2: Valuation of inventories.

Inventories; commodities dealers. A commodities dealer may not take into account in his year end inventory purchases or sales of commodities, represented by un-

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

closed futures contracts, to which title does not pass until delivery. Transactions in futures unclosed at the end of the taxable year form no integral part of the cost of the commodities included in the dealer's physical inventory and potential gains and losses not realized within the taxable year may not be reflected. Further, the dealer may value commodities actually on hand at the close of the taxable year at market value even though it may exceed cost. A.R.M. 100 and S.M. 5693 superseded.

Rev. Rul. 74-227[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in A.R.M. 100, 3 C.B. 66 (1920), and to update and restate that portion of S.M. 5693, V-2 C.B. 20 (1926) that pertains to the valuation of inventories at market. Rev. Rul. 74-223, page 23, this Bulletin, updates and restates that portion of S.M. 5693 that pertains to the Federal income tax treatment of gains or losses arising from dealings in futures contracts.

The issues concern the proper inventory treatment for Federal income tax purposes of open futures contracts under the circumstances described below.

The taxpayer, a dealer in commodities, reports his income under an accrual method of accounting on a calendar year basis. At the close of the taxable year ending December 31, 1972, the taxpayer had on his books open futures contracts that were hedges against either forward sales or forward purchases, or against spot or cash transactions made during the taxable year. The taxpayer also had futures contracts against which there were no concurrent forward sales or forward purchases or spot or cash transactions.

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

At the close of the taxable year the taxpayer inventoried the commodities he had on hand. The commodities on hand consisted of items purchased at various times and prices. The industry practice has been to inventory each commodity at its market value at the end of the taxable year. Further, the industry has determined that because the identity of a particular commodity and its actual cost cannot be accurately determined, it is impracticable to inventory the commodity under any other method. This has been the industry practice for many years. The taxpayer has consistently used the market value method of inventory valuation for Federal income tax purposes and financial accounting purposes.

The term "hedge" means a counterbalancing transaction of a futures contract against an actual purchase or sale of a commodity or against a forward purchase or sale. It is a form of price insurance utilized in order to avoid the risk of change in the market. The term "futures contracts" means a contract to sell or purchase some fixed amount of the commodity at a future date at a fixed price. The terms "spot" or "cash" transaction mean an actual purchase or sale for the purpose of moving the commodity along from producer to consumer. It is the merchandising of the staple product. The terms "forward sales" and "forward purchases" mean valid and enforceable sales or purchase contracts into which the commodity dealer enters to sell or buy a certain amount of the commodity at a certain price for shipment by him or delivery to him at a specified future time.

The specific questions are as follows:

Question 1: May the taxpayer add to the value of his physical inventory the value, at cost or cost or market whichever is lower, of commodities purchased on futures contracts to be delivered at some future date, the title to which does not pass to the taxpayer until the commodities have been delivered to him.

Question 2: May the taxpayer deduct from the value of his physical inventory the value, at cost or cost or market whichever is lower, of all of the commodities sold on futures contracts to be delivered at some future date, the title to which does not pass to the purchaser until the date of delivery, irrespective of whether or not such commodities are in the possession of the taxpayer at the date of the contract for sale.

Question 3: May the taxpayer reflect in the value of his physical inventory the potential gains or losses not realized within the taxable year, on transactions in futures.

Question 4: Where the cost of the commodity cannot be accurately obtained, may the taxpayer use the market value at the date of the closing inventory, notwithstanding the fact that such market value may be above cost.

Section 471 of the Internal Revenue Code of 1954 provides that whenever in the opinion of the Secretary of the Treasury or his delegate the use of inventories is necessary in order to clearly determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary of the Treasury or his delegate may prescribe as conforming as nearly as may be to the best accounting practices in the trade or business and as most clearly reflecting the income.

Section 1.471-1 of the Income Tax Regulations provides, in part, that merchandise should be included in the inventory only if title thereto is vested in the taxpayer. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold (including containers) title to which has passed to the purchaser. A purchaser should include in

inventory merchandise purchased (including containers) title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected.

Section 1.471-2 of the regulations provides, in part, that section 471 of the Code provides two tests to which each inventory must conform: (1) it must conform as nearly as may be to the best accounting practices in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practices in the particular trade or business. In order clearly to reflect income, the inventory practice of the taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is in accord with sections 1.471-1 through 1.471-11.

Question (1) is specifically covered by section 1.471-1 of the regulations. Since the taxpayer did not own the commodity, but only had a contract for its purchase it cannot be properly included in his year end inventory. Title thereto was not vested in the taxpayer.

Question (2) is also specifically covered by section 1.471-1 of the regulations which provides that the seller should include in his inventory goods under contract for sale, but not yet segregated or applied to the contract, but should exclude from inventory goods sold, title to which has passed to the purchaser.

In the consideration of Question (3), it must be determined whether potential gains or losses on transactions in futures can be held to form an integral part of the cost of the commodity or commodities in which the taxpayer deals.

While the futures transactions are entered into primarily for the purpose of stabilizing the cost of such commodities sold or purchased they do not constitute one transaction. The purchase of a commodity and the sale of the futures are two entirely separate and distinct transactions, neither one of which can have any effect whatsoever upon the other. If the commodity purchased is on hand at the end of the taxable year, it forms a part of the physical inventory, and whatever potential loss or gain that may exist with respect to the simultaneous futures transaction at the date of inventory does not affect the cost of that commodity in the inventory in the slightest degree. The fact that these transactions may be simultaneous is no reason for regarding them as identical, for a commodity may be retained and the futures contract covered or closed out, or the commodity may be disposed of and the futures contract remain open, without any effect whatever upon the other transaction.

Accordingly, it is held, with respect to question (3) that transactions in futures unclosed at the end of the taxable year form no integral part of the cost of the commodity included in the taxpayer's physical inventory.

Question (4) can be answered by reviewing the industry wide practice. The practice followed by commodity dealers, of bringing all elements to market value at date of closing of the taxable year, which has been in use for many years and which conforms to the best accounting practice in the trade, is recognized as the only practical method of arriving at a true and correct result of the operation.

Accordingly, commodities actually on hand at the close of the taxable year (the physical inventory) may be valued at market. Thus, the taxpayer may value his inventory at market even though it may exceed his cost.

For the Federal income tax treatment of futures contracts held by the taxpayer at the close of his taxable year see Rev. Rul. 74-223.

A.R.M. 100 and S.M. 5693 are hereby superseded, since the positions stated therein are restated under the current law in this Revenue Ruling.

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26 CFR 1.471-5: Inventories by dealers in securities.
(Also 1.471-1.)
(Also Section 446; 1.446-1.)

Accounting method; bank dealer in securities. The bond department operated by a national bank, a dealer in securities under section 1.471-5 of the regulations, must be accounted for under the accrual method of accounting; however, the bank may continue to use the cash method for its other business provided it clearly reflects income and complete and separate books and records are maintained for each trade or business.

Rev. Rul. 74-280

Advice has been requested as to the proper method of accounting to be utilized by a bank having a bond department, under the circumstances described below.

The taxpayer, a national bank, operates a bond department and is a dealer in securities within the meaning of section 1.471-5 of the Income Tax Regulations. It uses the cash receipts and disbursements method of accounting for reporting income and expenses from its overall business, including the bond department. However, the taxpayer does not deduct the cost of securities at the time of purchase but rather it defers taking such cost into account until the securities are sold.

Section 471 of the Internal Revenue Code of 1954 provides that whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be

taken by such taxpayer on such basis as the Commissioner may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Section 1.471-1 of the regulations provides, in pertinent part, that in order to reflect taxable income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor.

Section 1.446-1(c)(2)(i) of the regulations provides, in pertinent part, that in any case in which it is necessary to use an inventory the accrual method of accounting must be used with regard to purchases and sales.

Section 1.446-1(d) of the regulations provides, in general, that where a taxpayer has two or more separate and distinct trades or businesses a different method of accounting may be used for each trade or business, provided the method used for each trade or business clearly reflects the income of that particular trade or business. However, no trade or business will be considered separate and distinct for purposes of this paragraph unless a complete and separable set of books and records is kept for such trade or business. Further, that if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer will not be considered to be separate and distinct.

Taxpayers engaged in the banking business are permitted to use the cash receipts and disbursements method with respect to their banking activities provided such method clearly reflects income. See Rev. Rul. 68-35, 1968-1 C.B. 190, and Rev. Rul. 68-83, 1968-1 C.B. 190. However, a bank, as the instant taxpayer, also may be a dealer in securities with respect to the securities activities of its bond department. See Rev. Rul. 70-563, 1970-2 C.B. 108.

The purchase and sale of securities by a dealer is an income-producing factor within the meaning of section 1.471-1 of the regulations. Thus, in order to clearly reflect income, a dealer in securities (just as a dealer in other merchandise) must maintain an inventory of his securities held for resale. See *Stern Brothers & Company*, 16 T.C. 295, 322 (1951), *acq.*, 1951-2 C.B. 4; and *Pan American Bank & Trust Co.*, 5 B.T.A. 839, 844 (1926).

Accordingly, in the instant case, the taxpayer is using an improper method of accounting with respect to its securities activity. The taxpayer must use the accrual method of accounting with regard to its bond department, but the items of income and expense of its business other than the bond department, may continue to be accounted for under the cash receipts and disbursements method, provided it clearly reflects income, a complete and separate set of books and records are maintained for each trade or business, and there is no shifting of profits or losses between trades or businesses so that income of the taxpayer is not clearly reflected. See section 1.446-1(d) of the regulations.

Any change in the taxpayer's present method of accounting is a change in method of accounting to which sections 446 and 481 of the Code and regulations thereunder apply.

26 CFR 1.471-11: Inventories of manufacturers.

Special election which may be made by a taxpayer to change to the "full" absorption method of inventory costing. See Rev. Proc. 74-9, page 420.

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes for department stores. The January 1974 Bureau of Labor Statistics price indexes are acceptable for use by department stores employing the retail and last-in, first-out methods of valuing inventories.

Rev. Rul. 74-212

The following price indexes for January 1974, published by the Bureau of Labor Statistics on March 4, 1974, for use by department stores employing the retail inventory and last-in first-out inventory methods, are accepted by the Internal Revenue Service pursuant to section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories for taxable years of 12 months ended December 31, 1973, and January 31, 1974.

Indexes are given on a national basis for store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper as well as contract departments.

Bureau of Labor Statistics, Department Store Inventory Price Indexes, by Department Groups

[January 1941 = 100]

	Department Group	January 1973	January 1974	Percentage Change from January 1973 to January 1974 [1]
I	Piece Goods	226.3	261.4	15.5
II	Domestics and Draperies	252.7	271.6	7.5
III	Women's and Childrens' Shoes	378.4	390.0	3.1
IV	Men's and Boys' Shoes	378.0	408.9	8.2
V	Infants' Wear	219.6	236.0	7.5
VI	Women's Underwear	222.3	230.8	3.8
VII	Women's and Girls' Hosiery	155.8	159.8	2.6
VIII	Women's and Girls' Accessories	267.3	290.4	8.6
IX	Women's Outerwear and Girls' Wear	256.3	276.7	8.0
X	Men's Clothing	345.6	351.6	1.7
XI	Men's Furnishings	255.9	271.5	6.1
XII	Boys' Clothing and Furnishings	275.9	285.3	3.4
XIII	Jewelry	271.6	312.4	15.0
XIV	Notions	252.5	269.2	6.6
XV	Toilet Articles and Drugs	269.9	281.4	4.3
XVI	Furniture and Bedding	307.4	325.6	5.9
XVII	Floor Covering	211.7	237.4	12.1
XVIII	Housewares	334.0	351.3	5.2
XIX	Major Appliances	148.9	149.9	0.7
XX	Radio and Television Sets	107.2	106.8	—0.4
	Groups I—XV: Soft Goods	270.9	288.3	6.4
	Groups XVI—XX: Durable Goods	249.1	261.2	4.9
	Store Total	263.7	279.6	6.0

[1] Absence of a minus sign before percentage change signifies price increase.

26 CFR 1.472-1: Last-in, first-out inventories.

Whether the disclosure statement required by the Securities and Exchange Commission regarding the effect of inflation on the earnings of a taxpayer using the LIFO inventory method will terminate the LIFO method. See Rev. Proc. 74-18, page 434.

26 CFR 1.472-2: Requirements incident to adoption and use of LIFO inventory method.

Whether the disclosure statement required by the Securities and Exchange Commission regarding the effect of inflation on the earnings of a taxpayer using the LIFO inventory method will terminate the LIFO method. See Rev. Proc. 74-18, page 434.

26 CFR 1.472-3: Time and manner of making election.

T.D. 7295

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

Election of LIFO Inventory Method

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224

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

This document contains amendments to the Income Tax Regulations to give the Commissioner the authority to accept a taxpayer's election to adopt the LIFO inventory method where no Form 970 is filed by the taxpayer. The present regulations require that such inventory method may be adopted only if a properly completed Form 970 is attached to the taxpayer's income tax return.

Adoption of amendments to the Income Tax Regulations.

The following amendments to the Income Tax Regulations (26 CFR Part 1) are hereby adopted:

Paragraph 1. Paragraph (a) of §1.472-3 is amended to read as follows:

§ 1.472-3 Time and manner of making election.

(a) The LIFO inventory method may be adopted and used only if the taxpayer files with his income tax return for the taxable year as of the close of which the method is first to be used a statement of his election to use such inventory method. The statement shall be made on Form 970 pursuant to the instructions printed with respect thereto and to the requirements of this section, or in such other manner as may be acceptable to the Commissioner. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the LIFO inventory method is proposed first to be used, and also as of the beginning of the prior taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.

* * * * *

Because this Treasury decision provides rules relating to administrative practice and procedure, it is found that it is unnecessary to issue the Treasury decision with notice and public procedure thereon under section 553(b) of title 5 of the United States Code, or subject to the effective date limitation of subsection (d) of such section.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 7, 1973.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 11, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 12, 1973, 38 F.R. 34203)

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26 CFR 1.472-3: Time and manner of making election.

Validity of an election to use the LIFO method of inventory valuation when the requisite Form 970 is not filed with the return for the taxable year as of the close of which the method is first to be used. See Rev. Proc. 74-2, page 412.

Part III.—Adjustments

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

Whether a contractor engaged in the construction of ships may report income on the completed contract method of accounting with respect to cost-plus-fixed-fee contracts. See Rev. Rul. 74-129, page 109.

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Allocation of income; blocked royalty payments of foreign subsidiary. Payments due and unpaid by a wholly-owned foreign subsidiary to its domestic parent under a royalty agreement which provides for deferral of payments until the agreement is approved by the foreign government, but approval is not requested because competent foreign legal counsel advises that approval would be denied and economic sanctions might be imposed on the subsidiary if payment were enforced, will be considered deferrable income of the parent within the meaning of section 1.482-1(d)(6) of the regulations if an accounting method is elected which defers reporting such income until it ceases to be deferrable income.

Rev. Rul. 74-245

Advice has been requested whether, under the circumstances described below, the taxpayer's income from a transaction is deferrable income under section 1.482-1(d)(6) of the Income Tax Regulations.

P, a domestic corporation, owns all of the capital stock of *S*, a foreign subsidiary organized under the laws of country *Y*. During 1971, *P* entered into a written agreement with *S* permitting *S* to use certain registered designs and granting *S* an exclusive license to operate in country *Y*. The consideration payable to *P* is based upon a percentage of the net sales of *S* for the duration of the assets and license. The contract contained a clause which provided that: "Payments under the contract from *S* will commence when *S* receives approval of this contract from the government of country *Y*." The reason for this clause is that royalties may be paid to foreigners by country *Y* companies only with the approval of the government of country *Y*. *P* has been advised by competent foreign legal counsel that the government of country *Y* would not be receptive to allowing *S* to make such royalty payments and might consider placing some economic sanctions on *S* if *P* attempted to enforce the agreement to make such payments. For this reason *P* has never insisted that *S* seek government approval of the contract. Therefore, for the year 1972, the first year in which royalties were payable, no royalties were paid to *P* by *S* and no income was recorded on *P*'s books.

The District Director proposed a section 482 allocation of royalty income to *P*, whereupon *P*, pursuant to the provisions of section 1.482-1(d)(6) of the regulations, elected to use a method of accounting in which the reporting of the deferrable income is deferred until the income ceases to be deferrable income.

The question is whether the described situation resulted in deferrable income subject to the election by *P* under section 1.482-1(d)(6) of the regulations.

Section 1.482-1(d)(6) of the regulations provides, in part, that if payment or reimbursement for the sale, exchange, or use of property, the rendition of services, or the advance of other consideration among members of a group of controlled entities was prevented or would have been prevented, at the time of the transaction because of currency or other restrictions imposed under the laws of any foreign country, any distribution, apportionments, or allocations which may be made under section 482 of the Internal Revenue Code of 1954 with respect to such transactions may be treated as deferrable income or deductions, providing the taxpayer has, for the year to which the distributions, apportionments, or allocations relate, elected to use a method of accounting in which the reporting of deferrable income is deferred until the income ceases to be deferrable income.

Since the government of country *Y* would not be receptive to the agreement between *P* and *S* and might have considered placing economic sanctions on *S* as a result of such agree-

ment, *P* and *S* did not seek *Y*'s approval. Thus, *S* was unable to make distributions to *P* since under the laws of country *Y*, the royalties could be paid only with the government's approval.

Under the circumstances of the instant case, it is held that the royalty income will be considered deferrable income within the meaning of section 1.482-1(d)(6) of the regulations.

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26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Provisions governing the adjustment of accounts and the transfer of amounts as the result of allocations of income or deductions to liquidated corporations. See Rev. Proc. 65-17, Amendment II, page 411.

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26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Effect of an allocation of income from a foreign subsidiary to a domestic parent upon the credit for foreign taxes deemed paid under section 902(a) of the Code. See Rev. Rul. 74-158, page 182.

Section 483.—Interest on Certain Deferred Payments

26 CFR 1.483-1: Computation of interest on certain deferred payments. (Also Section 346; 1.346-1.)

Unstated interest on distribution in partial liquidation. The provisions of section 483 of the Code, relating to unstated interest, do not apply to a distribution in partial liquidation of a corporation as defined in section 346(a)(1).

Rev. Rul. 74-89

Section 346(a)(1) of the Internal Revenue Code of 1954 defines a distribution in partial liquidation as one in a series of distributions in redemption of all of the stock of a corporation pursuant to a plan.

Section 483 of the Code provides, in general, that in the case of a contract for the sale or exchange of property in which no interest, or an inadequate rate of interest is provided, a portion of each payment represents "unstated interest" and is to be treated as interest income rather than part of the sales price.

Section 1.483-1(b)(1) of the Income Tax Regulations provides, in part. that section 483 does not apply to a distribution in complete liquidation of a corporation, regardless of whether the corporation is liquidated in one distribution or in a series of distributions.

Held, since section 1.483-1(b)(1) of the regulations excludes distributions in complete liquidation from the ambit of section 483 of the Code, whether such liquidation is accomplished in a single distribution or a series of distributions, a distribution in partial liquidation defined in section 346(a)(1) is not subject to the provisions of section 483.

Subchapter F. Exempt Organizations
Part I.—General Rule

Section 501.—Exemption from Tax on Corporations, Certain Trusts, etc.

26 CFR 1.501(a)-1: Exemption from taxation.

Effect of purchase of mortgage participation certificate in mortgage "pool" guaranteed by Federal Home Loan Mortgage Corporation on tax-exempt status of employees' pension or profit-sharing trust. See Rev. Rul. 74-221, page 365.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Public housing authority. A public housing authority incorporated under a State statute conferring upon it the power to conduct examinations and investigations, to administer oaths, issue subpoenas, and make its findings and recommendations available to appropriate agencies does not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-14

Advice has been requested whether the municipal instrumentality described below qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

A public housing authority was organized to undertake the clearance, replanning, and reconstruction of areas in which unsanitary or unsafe housing conditions exist and to provide safe and sanitary dwelling accommodations for low income families in a particular municipality. It was incorporated under a state statute conferring upon it the power to conduct examinations and investigations, to hear testimony and take proof under oath at public or private hearings on any matter material for its information, to administer oaths, to issue subpoenas requiring the attendance of witnesses or the production of books and papers, and to issue commissions for the examination of witnesses who are outside the state or unable to attend before the authority, or who are excused from attendance. The authority was also empowered to make available to appropriate agencies (including those charged with a duty of abating or requiring correction of nuisances, or of demolishing unsafe or unsanitary structures) its findings and recommendations with regard to any buildings or property where conditions exist that are dangerous to public health, morals, safety, or welfare.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Rev. Rul. 60-384, 1960-2 C.B. 172, holds that a wholly-owned state or municipal instrumentality that is a separate entity and a counterpart of an organization described in section 501(c)(3) of the Code may qualify for exemption under that section. However, the Revenue Ruling holds

that it would not be a clear counterpart of a section 501(c)(3) organization if it is clothed with powers beyond those of an organization described in section 501(c)(3). Examples of such powers set forth in the Revenue Ruling are enforcement or regulatory powers exercised in the public interest, such as health, welfare, or safety.

Although the housing authority is a separate entity, its investigatory powers are to be exercised for the purpose, among others, of collecting information and making it available to appropriate agencies for use in furthering and enforcing local ordinances regarding planning, building, and zoning matters. Hence, such powers are regulatory or enforcement powers of the kind referred to in Rev. Rul. 60-384. Therefore, this organization would not be a clear counterpart of an organization described in section 501(c)(3) of the Code. Compare with Rev. Rul. 74-15, below, and Rev. Rul. 67-290, 1967-2 C.B. 183, which hold that the powers referred to therein are not regulatory or enforcement powers.

Accordingly, the organization does not qualify for exemption under section 501(c)(3) of the Code.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Public library. A public library organized as a separate entity under a State statute, without power to impose taxes for its operation but whose funds are obtained by certification of a tax rate needed for its operation to the rate-making authority, qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-15

Advice has been requested whether the nonprofit county library described below is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

A corporation was separately organized under a State statute to maintain a public library for the people of a particular county. The statute confers upon the library board, its governing body, a limited power to determine the tax rate necessary to support its operations within specified maximum and minimum rates. The effect of the statute is not to grant the library board the power to impose or levy taxes. Instead, the board submits the tax rate so determined to the county auditor who certifies the tax rate to the county adjustment board in the same manner as other tax rates are certified. All of these taxes are collected by the county treasurer who transmits to the library its share of revenue.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Rev. Rul. 55-319, 1955-1 C.B. 119, holds that a wholly-owned State instrumentality may, under certain circumstances, qualify for exemption from Federal income tax under section 501(c)(3) of the Code. This position is amplified in Rev. Rul. 60-384, 1960-2 C.B. 172, which holds that a wholly-owned instrumentality must be organized and operated exclusively for section 501(c)(3) purposes in order to qualify for exemption under section 501(c)(3). Thus, an organization clothed with regulatory or enforcement powers, or other powers beyond those of an organization described in section 501(c)(3), would not be a clear counterpart of an organization described in section 501(c)(3).

Although the library is wholly-owned by a political subdivision of a State, it is a separate entity and is otherwise a counterpart of an organization exempt from Federal income tax under section 501(c)(3) of the Code. The power regarding the tax rate described above is not a regulatory or enforcement power within the meaning of Rev. Rul. 60-384, since it merely involves the determination, subject to specified limits, of a tax rate necessary to support the library's operation. Therefore, this organization is not considered to be clothed with a power beyond those of an organization described in section 501(c)(3). See Rev. Rul. 67-290, 1967-2 C.B. 183. Compare with Rev. Rul. 74-14, page 125, this Bulletin which holds that the power to issue subpoenas and take proof under oath are regulatory or enforcement powers of the type considered in Rev. Rul. 60-384.

Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the Income Tax Regulations.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Educational; establishment of credit unions in developing nations. An organization formed to assist individuals in developing nations to improve their living conditions through educational programs on credit problems and to instruct and train individuals from those nations in the techniques of organizing and managing credit unions qualifies for exemption as an edu-

cational organization under section 501(c)(3) of the Code.

Rev. Rul. 74-16

Advice has been requested whether the activities of the organization described below qualify as educational for purposes of exemption from Federal income tax as a charitable organization under section 501(c)(3) of the Internal Revenue Code of 1954 where the organization otherwise qualifies for such exemption.

The organization was formed for the purpose of assisting farmers, workers, and small businessmen in developing nations to improve their living conditions through educational programs on credit problems. The organization conducts seminars for individuals in these nations dealing with techniques of organizing and managing credit unions and conducts a training program for them in the United States. Pamphlets and other materials providing information on the provident use of money and the need for cooperative action to solve the problems of scarcity of credit are distributed to members of the community.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(d)(3) of the Income Tax Regulations provides that the term "educational" includes the instruction or training of the individual for the purpose of improving or developing his capabilities or the instruction of the public on subjects useful to the individual and beneficial to the community.

An organization that instructs or trains individuals to improve their business or professional capabilities is exempt under section 501(c)(3) of the Code. See Rev. Rul. 65-298, 1965-2 C.B. 163. The seminars and training programs relate to the instruction and training of the individuals for the purpose of improving and developing their capabilities in organizing and managing credit unions. In addition, the distribution of the materials providing information on the provident use of money and the need for cooperative action to solve credit problems instructs the public on subjects useful to the individual and beneficial to the community. Therefore, the activities qualify as educational within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Educational; computer users. An organization whose membership is limited to organizations that own, rent, or use a specific type of computer and whose activities are designed to keep members informed of current scientific and technical data of special interest to them as users of the computer is not exempt under section 501(c)(3) of the Code.

Rev. Rul. 74-116

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization is a membership association devoted to developing and exchanging research data among users of a specific type of computer. The organization also serves as liaison between users and the manufacturer of the computer.

In furtherance of its objectives, the organization conducts meetings and seminars at which operational and technical problems relating to the use of this computer are discussed. Representatives of the manufacturer are invited to attend these functions to answer questions concerning the computer's operation.

The organization publishes reports of its meetings and seminars for distribution to members. It also publishes a monthly newsletter to keep members informed of current scientific and technical data of special interest to them as users of the computer. A section of the newsletter is devoted to advice and other comments from the manufacturer relating to the use of the computer.

Membership is limited to organizations that own, rent, or use this specific computer. Income is from membership dues and seminar fees. Expenditures are made primarily for instructional materials, publishing, and other operational expenses.

Section 501(c)(3) of the Code provides for exemption from Federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for any exempt purpose set forth in section 501(c)(3) of the Code unless it serves a public rather than a private interest.

By making specialized information available to its members under the circumstances described above, the organization is serving the private interest of its members rather than a

public interest. Accordingly, the organization is not exempt from Federal income tax under section 501(c)(3) of the Code.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Political activities; assisting in transition of office of Governor. A nonprofit organization formed to implement an orderly change of administration of the office of Governor of a State by assisting the Governor-elect, during the period between his election and inauguration in screening and selecting applicants for State appointive offices and preparing a legislative message and program reflecting the party's platform and budget, is an "action" organization under section 1.501(c)(3)-1 of the regulations, and does not qualify for exemption.

Rev. Rul. 74-117

Advice has been requested whether the nonprofit organization described below is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

The organization was formed for the purpose of implementing an orderly change of administration of the office of the Governor of a particular State in the most efficient and economical fashion possible by assisting the Governor-elect during the period between his election and inauguration. The principal functions of the subject organization are: (1) to screen and select applicants for important State appointive offices and (2) to prepare a legislative message and program reflecting the party's platform and a proposed budget and budget message for the Governor-elect which he will present for enactment by the Legislature immediately after his inauguration.

The State will officially provide similar services to the executive after the inauguration, but has never provided these services prior to any inauguration.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for religious, charitable or educational purposes, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in or intervene in any political campaign on behalf of any candidate for public office.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes lessening of the burdens of Government, and the promotion of social welfare by organizations designed to accomplish the above.

Section 1.501(c)(3)-1(b)(3)(iii) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to have objectives and to engage in activities which characterize it as an "action" organization as defined in paragraph (c)(3) of this section.

Section 1.501(c)(3)-1(c)(3) of the regulations provides that an organization is an "action" organization if it advocates, to a substantial extent, the adoption or rejection of legislation or has the following two characteristics: (a) its main or primary objective or objectives may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of such main or primary objective or objectives distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public. In determining whether an organization has such characteristics, all the surrounding facts and circumstances, including the articles and all activities of the organization are to be considered.

The government is the party best qualified to decide whether a particular activity is sufficiently in the public interest to warrant its recognition as a legitimate function of government. Unlike some other jurisdictions, this particular jurisdiction has not seen fit to provide services of the type described above for the Governor-elect and thus has not recognized such activities as functions of government prior to his inauguration.

Thus, the activities of the subject organization are not relieving any burden of the government.

Furthermore, while the people of the jurisdiction may well derive a substantial benefit from the activities of this organization, its predominant purpose is to effectuate changes in the government's policies and personnel which will make them correspond with the partisan political interests of both the Governor-elect and the political party he represents.

Since the activities are partisan in nature and are directed to a substantial extent to the adoption of legislation, the organization is an "action" organization as described in section 1.501(c)(3)-1(c)(3) of the regulations.

Accordingly, the organization described above is not exempt from

Federal income tax under section 501 (c)(3) of the Code.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Educational institution accreditation organization. A nonprofit organization of accredited educational institutions, whose membership includes a small number of proprietary schools, and whose activities include the preparation of accreditation standards, identification of schools and colleges meeting these standards, and the dissemination of accredited institution lists qualifies as an exempt organization under section 501(c)(3) of the Code.

Rev. Rul. 74-146

Advice has been requested whether an organization with the activities described below is advancing education for purposes of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 where the organization otherwise qualifies for such exemption.

The organization's principal activity is to identify those schools and colleges located in a specific geographic region of the United States as being of sufficient acceptable quality to be designated as accredited institutions. Its activities are controlled by institutional members. Only institutions which are accredited may be admitted as institutional members. The actual accrediting activity is carried on by committees which are drawn from the members of the organization and which are designated as a Commission on Higher Education and a Commission on Secondary Schools. Each committee is invested with the power to set standards and to enforce compliance with such standards for the accreditation of educational facilities coming under its specific jurisdiction. Neither its charter nor its bylaws prohibit the accreditation and membership of proprietary schools (educational facilities operated for profit). However, there are a very few proprietary schools in the region and these have been, on application, accredited and approved for membership in the organization. Such schools represent a small minority of the members of the organization.

Specific standards and requirements for accreditation of schools and colleges are prepared and published by the organization. A list of the names of accredited institutions is prepared and disseminated regularly. The accreditation by the organization is recognized on a local, regional, national and international basis. The accreditation program is designed to foster excellence in education, and develop criteria and guidelines for assessing educational effectiveness. It encourages institutional improvement of educational endeavors through continuous self-study and evaluation. It assures the educational community, the general public, and other agencies or organizations that an accredited educational institution has clearly defined and appropriate educational objectives, has established conditions under which their achievement can reasonably be expected, appears in fact to be accomplishing them substantially, and is so organized, staffed, and supported that it can be expected to continue to do so. The organization also provides counsel and assistance to establish and develop new institutions. Accreditation is retained by member institutions through a process of evaluation and periodic review by the applicable committees of the organization.

The organization's income is obtained primarily from membership dues.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" includes the advancement of education.

The development and publication of standards for accreditation of schools and colleges, along with their regular inspection and evaluation, and the development of recommendations for improvement of such institutions are all activities which support and advance education by providing significant incentive for maintaining a high quality educational program. Any private benefit that may accrue to the few proprietary members because of accreditation is incidental to the purpose of improving the quality of education.

Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Prevention of cruelty to animals; birth control. A nonprofit organization formed to prevent the overbreeding of cats and dogs by providing funds to pet owners who wish to have their pets spayed or neutered but cannot afford the cost of such operations qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-194

Advice has been requested whether the activities of the nonprofit organization described below which otherwise qualifies for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 are within the scope of the applicable exemption provisions.

The organization was formed to prevent cruelty to unwanted animals by preventing the overbreeding of cats and dogs. The organization is concerned about the unnumbered thousands of abandoned, unwanted animals in the community. Many of these deserted animals die of starvation, disease, or injury.

The organization advocates the spaying or neutering of the mixed-breed dog and cat, and raises funds to aid pet-owners who desire to spay or neuter their pets but who cannot afford the rates charged by veterinarians to perform the operations. There is no relationship between any member of the organization and the veterinarians who perform the operations.

The income of the organization is derived from membership fees, contributions, and fund-raising activities. All funds are expended for the organization's program.

Section 501(c)(3) of the Code specifically provides for exemption from Federal income tax organizations formed and operated exclusively for the prevention of cruelty to children or animals.

By preventing the birth of unwanted animals and their eventual suffering by providing funds for those owners of pets who cannot afford the spaying or neutering operation, the organization is engaged in the prevention of cruelty to animals. Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the Income Tax Regulations.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Community welfare; apprehension of criminals. An organization assisting the police department in the apprehension and conviction of criminals by making funds available for use in offering rewards qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-246

Advice has been requested whether the activities of the organization described below qualify as charitable for purposes of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 where the organization otherwise qualifies for such exemption.

The organization makes funds available to the police department to assist the department, as a regular part of its operations in offering rewards for information leading to the apprehension and conviction of persons engaging in criminal activity within a particular community. The fact that rewards are being offered in specific cases is publicized by the police department to save investigative time and to assist in obtaining prompt results. In this manner the organization assists the police department in the prevention of crime and apprehension of criminals in the community. In addition, it is expected that the rewards will deter criminal activity within the community.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states that the term "charitable" is used in its generally accepted legal sense, and includes lessening of the burdens of government.

The gratuitous performance of services to Federal, state or local governments is charitable in the generally accepted legal sense. For example, an organization assisting firemen, police, and other personnel to perform their duties more efficiently during emergency conditions is performing charitable services. See Rev. Rul. 71-99, 1971-1 C.B. 151. By providing funds to enable the police department to perform its regular duties, the organization is assisting the government in carrying out its function.

Accordingly, the activities of the organization qualify as charitable for purposes of exemption from Federal income tax under section 501(c)(3) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Condominium housing association. An organization formed by the unit owners of a condominium housing project to provide for the management, maintenance, and care of the common areas of the

project, as defined by State statute, with membership assessments paid by the unit owners does not qualify for exemption under section 501 (c)(4) of the Code.

Rev. Rul. 74-17

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501 (c) (4) of the Internal Revenue Code of 1954.

The organization is an association that was formed by the unit owners of a condominium housing project and is operated to provide for the management, maintenance, and care of the common areas of the project. Its income is from membership assessments and its disbursements are for normal operating expenses.

A condominium is defined by statute in the state in which the organization is located as an estate in real property consisting of an undivided interest in common in a portion of a parcel of real property together with separate interest in space in a residential, industrial, or commercial building on such real property, such as an apartment, office, or store. The statute provides that the owner of a condominium unit individually owns the interior surfaces of the perimeter walls, floors, ceilings, wndows, and doors of his unit.

The statute further provides that the common areas of the condominium property are owned by the unit owners as tenants in common, in equal shares, one for each unit. It lists the following elements as common areas of condominium property: bearing walls, columns, floors, central heating, central refrigeration, and central air conditioning equipment, reservoirs, tanks, pumps, and other central services, pipes, ducts, flues, chutes, conducts, wires, and other utility installation, wherever located, except the outlets thereof when located within the unit. This statutory definition implicitly includes common areas normally forming a part of a residential development such as streets, sidewalks, parks, and open areas.

The statute also imposes a requirement on the owner of the project to make and record a declaration of project restrictions and servitudes prior to the conveyance of any condominium therein, such restrictions to bind all owners of condominiums in the project. The statute states that such servitudes may provide for the management of the project by either the condominium owners, a board of directors elected by the owners, or a management agent elected by the owners or the board or named in the declaration.

Section 501(c)(4) of the Code provides for the exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(3)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged n promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing agout civic betterments and social improvements.

In *Commissioner v. Lake Forest, Inc.,* 305 F. 2d 814 (4th Cir. 1962), the court held that a cooperative housing corporation was not exempt as a social welfare organization under section 501(c)(4) of the Code since its activities were of the nature of an economic and private cooperative undertaking.

Rev. Rul. 65-201, 1962-5 C.B. 170, holds that a cooperative organization operating and maintaining a housing development and providing housing facilities does not qualify for exemption from Federal income tax under section 501(c)(12), or any other provision of the Code.

Rev. Rul. 69-280, 1969-1 C.B. 152, holds that a nonprofit organization formed to provide maintenance of exterior walls and roofs of members' homes in a development is not exempt from Federal income tax under section 501(c)(4) of the Code.

By virtue of the essential nature and structure of a condominium system of ownership, the rights, duties, privileges, and immunities of the members of an association of unit owners in a condominium property derive from, and are established by, statutory and contractual provisions and are inextricably and compulsorily tied to the owner's acquisition and enjoyment of his property in the condominium. In addition, condominium ownership necessarily involves ownershp in common by all condominium unit owners of a great many so-called common areas, the maintenance and care of which necessarily constitutes the provision of private benefits for the unit owners.

Since the organization's activtiies are for the private benefit of its members, it cannot be said to be operated exclusively for the promotion of social welfare. Accordingly, it does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Homeowners association, preserving appearance and maintaining common areas. A homeowners association, to qualify for exemption under section 501(c)(4) of the Code, (1) must serve a "community" which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must

be for the use and enjoyment of the general public; Rev. Rul. 72-102 modified.

Rev. Rul. 74-99

The Internal Revenue Service has been requested to clarify the circumstances in which an organization similar to the homeowners' association described in Rev. Rul. 72-102, 1972-1 C.B. 149, may qualify for exemption under section 501(c)(4) of the Internal Revenue Code of 1954.

The characteristics of the organization of homeowners described in Rev. Rul. 72-102 are generally typical of many such organizations formed in recent years that seek exemption under section 501(c)(4) of the Code and may be summarized as follows: The organization is formed by a commercial real estate developer as an integral part of a plan for the development of a subdivision. Membership in the association is required of all purchasers of lots in the development. Membership is open only to the developer (at least for such time as he owns property in the development) and those who purchase lots. The organization is supported by periodic assessments against the members and an unpaid assessment constitutes a lien on the property of the homeowner-member. The stated purposes of the organization are, generally speaking, to administer and enforce covenants for preserving the architecture and appearance of the given real estate development, and to own and maintain common green areas, streets, and sidewalks.

The foregoing format is spelled out in written documents which form a part of, and are inextricably tied to, enforceable contracts for the sale and purchase of private property. In the light of this combination of factors, the *prima facie* presumption is that these organizations are essentially and primarily formed and operated for the individual business or personal benefit of their members, and, as such, do not qualify for exemption under section 501(c)(4) of the Code. However, an organization of this kind may in certain circumstances overcome the presumption and qualify for recognition of exemption under section 501(c)(4).

Thus, notwithstanding the combination of characteristics which the organization in Rev. Rul. 72-102 has in common with many other homeowners' associations, it was considered to have established its qualification for recognition of exemption as an organization described in section 501(c)(4) of the Code. In reaching this conclusion Rev. Rul. 72-102 reads, in part, as follows: "For the purposes of section 501(c)(4) of the Code, a neighborhood, precinct, subdivision, or housing development may constitute a community. For example, exempt civic leagues in urban areas have traditionally represented neighborhoods or other subparts of much larger political units. By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development."

Increasing experience with homeowners' associations of this general kind has demonstrated, however, that the Revenue Ruling does not delineate the bases for the favorable holding in the case clearly enough to prevent misconceptions as to its scope. Specific questions have been raised as to (1) the scope of the term "community" as used in the ruling; (2) whether an organization whose program includes activities devoted to exterior maintenance of private residences comes within the ambit of the ruling; and (3) the interpretation of the phrase "non-residential, non-commercial properties of the type normally owned and maintained by municipal governments."

One misconception generated by Rev. Rul. 72-102 is that the ruling appears unqualifiedly to equate a housing development with the term "community" within the meaning of section 501(c)(4) of the Code, thereby giving rise to the implication that any housing development may qualify as a community for exemption purposes regardless of any other attendant facts and circumstances in the case. Rev. Rul. 72-102 is hereby modified to reject its apparent acceptance of such a narrow definition of "community" for purposes of section 501(c)(4).

A community within the meaning of section 501(c)(4) of the Code and the regulations is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. Although an exact delineation of the boundaries of a "community" contemplated by section 501(c)(4) is not possible, the term as used in that section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof.

A second feature of Rev. Rul. 72-102 that has been subject to misinterpretation is whether, consistent with the position taken in the Revenue Ruling, an organization whose program includes, but is not limited to, activities directed to exterior maintenance of private residences may qualify for recognition of exemption under section 501(c)(4) of the Code. In the given facts in the Revenue Ruling there was no mention of any exterior maintenance activity. One of the stated purposes of the organization in Rev. Rul. 72-102, however, is to enforce covenants for preserving the architecture and appearance of a housing development. It has been contended that exterior maintenance

activities may properly be justified and subsumed under that purpose.

Given the combination of factors discussed above surrounding the formation and operation of this type of homeowners organization, the exterior maintenance activities reinforce the *prima facie* presumption that the organization is operated essentially for private benefit. See Rev. Rul. 69-280, 1969-1 C.B. 152, in which exemption of an organization formed to provide maintenance of exterior walls and roofs of members' home is denied under section 501(c)(4) of the Code. See also Rev. Rul. 74-17, page 130, relating denial of exemption under section 501(c)(4) of an organization formed by unit owners in a condominium housing project to provide for the management, maintenance and care of all the areas and elements in the project that are owned in common by the unit owners.

Another aspect of Rev. Rul. 72-102 that has given rise to some misconception of the ruling's scope involves interpretation of the phrase "non-residential, non-commercial properties of the type normally owned and maintained by municipal government" in determining what kinds of common areas or facilities an exempt homeowners' association may own and maintain. The Revenue Ruling in reciting the areas and facilities owned and maintained by the organization speaks only of "common green areas, streets, and sidewalks." The Revenue Ruling was, by the quoted phrases, designed to indicate that the only areas and facilities encompassed were those traditionally recognized and accepted as being of direct governmental concern in the exercise of the powers and duties entrusted to governments to regulate community health, safety, and welfare. Thus, the Revenue Ruling was intended only to approve ownership and maintenance by a homeowners' association of such areas as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners' association, as appropriate and consistent with exemption for the association. Rev. Rul. 72-102 is modified accordingly.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Rev. Rul. 74-281

A local association of employees that otherwise meets the requirements of section 501(c)(4) of the Internal Revenue Code of 1954 provides that retired employees who were members of the association at the time of retirement will have life-time membership and will be eligible to hold office. A retiree's participation in the association's activities or eligibility to hold office does not differ from that of an active employee. However, a retiree is not required to pay annual dues.

Held, the term "employees" also includes retired employees who were members of the association at the time of retirement for purposes of section 501(c)(4) of the Code.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Professional golf tournament; social welfare. A nonprofit organization, whose membership is limited to local residents, and whose sole activity is sponsoring an annual professional golf tournament for which it leases a golf course and charges admission, is not operated primarily for the promotion of social welfare and does not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 74-298

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

The organization was formed by local businessmen to provide recreation and entertainment for the citizens and visitors of the community. All residents of the community are eligible to become members of the organization upon payment of a nominal initiation fee and approval of a majority of the Board of Directors. The organization's sole activity is the sponsorship of an annual professional golf tournament that would otherwise not be available to the community. The tournament features nationally known competitors and receives nation-wide news coverage. The organization charges a standard admission fee to the public to attend the tournament.

The organization's income is from gate receipts, membership fees, and assessments. Its disbursements are for prize money for the golfers, rental of a golf course, and miscellaneous administrative expenses.

Section 501(c)(4) of the Code provides for the exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization coming within the scope of this section is one which is operated primarily to bring about civic betterments and social improvements.

Section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

A professional golf tournament is

an activity that can be operated for profit, and the sponsorship of such a golf tournament can itself be a business for profit. The golf tournament sponsored by the organization is carried on with the general public and is operated in a manner similar to tournaments operated for profit.

Accordingly, the organization is not operated primarily for the promotion of social welfare and, therefore, does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

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26 CFR 1.501(c)(5)-1: Labor, agricultural, and horticultural organizations.

Agricultural; farmers' wives promoting farming. A nonprofit organization of farmers' wives formed to improve the agricultural way of life in a particular State qualifies for exemption under section 501(c)(5) of the Code.

Rev. Rul. 74-118

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(5) of the Internal Revenue Code of 1954.

The organization, the membership of which is composed of wives of farmers, was formed to advance the farming interests of the members' husbands and to insure the survival of agriculture as a way of life in a particular state. Its activities consist of recommending legislation favorable to persons engaged in agriculture, conducting programs to inform the public about problems facing farmers, and participating in and supporting activities designed to obtain higher prices for farm products such as urging local farmers not to sell their products to processors at prevailing prices.

The organization is in no sense a social club, all of its endeavors being directed to the furthering of the business objectives of the members and their husbands. No part of its net earnings inures to the benefit of any private individual.

Section 501(c)(5) of the Code provides for the exemption from Federal income tax of agricultural organizations.

Section 1.501(c)(5)-1 of the Income Tax Regulations provides that agricultural organizations contemplated by section 501(c)(5) of the Code are those which have no net earnings inuring to the benefit of any member, and have as their objectives the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

In this case the organization's members have a mutual interest in promoting the occupation of their husbands who are engaged in agriculture and thus for purposes of section 501(c)(5) of the Code the organization's members are considered as being engaged in agriculture. The organization's activities are directed toward enhancing and improving this occupation as a way of life. Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(5).

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1024, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(5) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(5)-1. Labor, agricultural, and horticultural organizations.

Labor organization including self-employed members. The inclusion of some self-employed persons in the membership of a qualified labor organization does not affect the organization's exempt status under section 501(c)(5) of the Code.

Rev. Rul. 74-167

Advice has been requested whether a nonprofit organization which otherwise qualifies for exemption from Federal income tax under section 501(c)(5) of the Internal Revenue Code of 1954, continues to qualify under the circumstances described below.

The organization was formed to better the conditions of its members who are all engaged in a particular trade. It carries out its purposes by working for better wages and working conditions. Most of the members are employees. However, some members work for themselves rather than for the employers with whom the organization negotiates. The organization states that the self-employed are members since they believe that the organization's activities better their conditions.

Section 501(c)(5) of the Code provides for exemption from Federal income tax of labor organizations.

Section 1.501(c)(5)-1(a) of the Income Tax Regulations states that a labor organization described in section 501(c)(5) of the Code is one that has as an objective the betterment of the conditions of those engaged in labor.

Since the organization otherwise meets the requirements of exemption under section 501(c)(5) of the Code, and most of its members are employees, the inclusion of self-employed persons in the membership of this organization does not affect its exempt status.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1024, Exemption Application, in order to be recognized by the Service as exempt under sec-

tion 501 (c)(5) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(5)-1: Labor, agricultural, and horticultural organizations.

Cooperative management, grazing, and sale of members' cattle. A nonprofit organization formed to manage, graze, and sell its members' cattle is providing a direct business service to its members and does not qualify for exemption as an agricultural organization.

Rev. Rul. 74-195

Advice has been requested whether the organization described below qualifies for exemption from Federal income tax under section 501(c)(5) of the Internal Revenue Code of 1954.

The organization was formed under State law as a nonprofit, non-stock cooperative corporation to handle, graze, care for, and manage the cattle of its members. The organization carries out these operations on a range which it operates under a permit from a governmental agency. In actual operation the organization provides such supplies, materials, feed, and equipment as may be useful or necessary for the handling and breeding of said livestock. It may also sell said livestock for the members.

Any person who owns ten head of range cattle may be admitted to membership. Members are assessed fees on the basis of the number of cattle owned. A percentage of the proceeds from the sale of cattle is retained by the organization to help meet expenses of operation, with the balance being remitted to members. Expenses are mainly for wages, feed and grazing, and farm operations.

Section 501(c)(5) of the Code provides for the exemption from Federal income tax of agricultural organizations.

Section 1.501(c)(5)-1 of the Income Tax Regulations provides that the organizations contemplated by section 501(c)(5) of the Code as entitled to exemption from income taxation are those which (1) have no net earnings inuring to the benefit of any member, and (2) have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

The cooperative management, grazing, and sale of members' cattle does not of itself better the conditions of those engaged in agricultural pursuits, improve the grade of their products, or develop a higher degree of efficiency in their operations within the meaning of the cited sections of the Code and regulations. The principal purpose of the organization is to provide a direct business service for its members' economic benefit. See Rev. Rul. 66-105, 1966-1 C.B. 145, which holds that an organization composed of agricultural producers whose principal activity is marketing livestock for its members does not qualify for exemption under section 501(c)(5) of the Code.

Accordingly, the organization does not qualify for exemption from Federal income tax as an organization described in section 501(c)(5) of the Code.

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26 CFR 1.501(c)(6)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

Business leagues providing workmen's compensation insurance. A nonprofit organization formed to promote the business welfare and interests of persons engaged in the contracting trade and related industries and whose principal activity is to provide its members with group workmen's compensation insurance is not entitled to exemption under section 501(c)(6) of the Code.

Rev. Rul. 74-81

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(6) of the Internal Revenue Code of 1954.

The organization was formed to promote, protect, and foster the business welfare and interests of persons engaged in the business of building, contracting and related activities. Membership is limited to any individual, corporation, company, or firm engaged in the contracting trade and related industries, of good credit and moral standing, doing business in a particular State, and with an estimated annual premium for workmen's compensation insurance of not less than a stipulated amount per year.

The organization maintains a safety committee which seeks to reduce the incidence and severity of accidents by means of educational campaigns, inspections, and loss analysis. Also, the organization provides its members with group workmen's compensation insurance, which is underwritten by a private insurance company. The operation of the insurance service is the organization's principal activity.

The organization's receipts consist of membership dues and amounts refunded by the insurance company which represent excess premium charges paid by the organization's members and which the organization refunds to its members in proportion to the amounts each member has overpaid. Expenditures are made for distribution of refunds, the promotion of safety investigations, and miscellaneous administrative costs.

Section 501(c)(6) of the Code provides for the exemption from Federal income tax of business leagues not organized for profit, no part of the net earnings of which inures to the

benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations defines a business league as an association of persons having some common business interest, the purpose of which is to promote such common interest. Its activities should be directed towards the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons.

Rev. Rul. 68-264, 1968-1 C.B. 264, involving the operation of a traffic bureau, and Rev. Rul. 68-265, 1968-1 C.B. 265, involving the operation of a credit information service, hold that an activity that serves as a convenience or economy to members in the operation of their businesses is a particular service of the type proscribed.

By providing group workmen's compensation insurance for its members, the organization relieves the members of obtaining this insurance on an individual basis, resulting in a convenience in the conduct of their businesses. Therefore, the organization is rendering particular services for individual persons as distinguished from the improvement of business conditions in the contracting and related industries generally.

Accordingly, the organization does not qualify for exemption from Federal income tax under section 501(c)(6) of the Code.

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26 CFR 1.501(c)(6)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

Business leagues; digital computer users. A nonprofit organization, whose members represent diversified businesses that own, rent, or lease digital computers produced by various manufacturers, organized to improve the efficiency of its members' use of computers, qualifies for exemption under section 501(c)(6) of the Code.

Rev. Rul. 74-147

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(6) of the Internal Revenue Code of 1954.

The organization was formed to stimulate the development of, with free interchange of information pertaining to, systems and programming of electronic data processing equipment. Its membership is made up of representatives of diversified businesses who own, rent, or lease one or more digital computers, produced by various manufacturers, without regard to identity of the manufacturer of any such computer.

The organization holds semi-annual conferences, lasting from two to four days, at which operational and technical problems relating to computer use are discussed. Nonmembers are invited to attend the conferences and are encouraged to join as members. The organization does not provide counseling or other services to its members with respect to specific individual problems.

The speakers at the conferences typically include both members as well as recognized professionals in the computer industry. Also, manufacturers of computer equipment are invited to attend and disseminate current information relative to their equipment.

Income is from conference registration fees. Expenditures are made for meeting expenses, and miscellaneous administrative costs.

Section 501(c)(6) of the Code provides for the exemption from Federal income tax of business leagues not organized for profit, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations defines a business league as an association of persons having some common business interest, the purpose of which is to promote such common interest. Its activities should be directed towards the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons.

Rev. Rul. 65-164, 1965-1 C.B. 238, and the decision in the case of *Associated Industries of Cleveland v. Commissioner*, 7 T.C. 1449 (1946), acq. 1947 C.B. 1, cited therein, hold that organizations dealing with common business interests which are the business problems the members have in common qualify for exemption under section 501(c)(6) of the Code.

Here, the common business interest of the members of the organization is their common business problem concerning the use of digital computers. The primary objective of the organization is to provide a forum for the exchange of information which will lead to the more efficient utilization of computers by its members and other interested users, and thus improve the overall efficiency of the business operations of each. Accordingly, the organization qualifies for exemption from Federal income tax under section 501(c)(6) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1024, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(6) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(6)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

Business league; appointing travel agents. A nonprofit organization, formed by carriers engaged in regular transoceanic passenger service, whose primary activity consists of appointing travel agents

to book passenger travel on its members' ships is performing particular services for its members and does not qualify for exemption under section 501(c)(6) of the Code.

Rev. Rul. 74-228

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501 (c) (6) of the Internal Revenue Code of 1954.

The organization was formed by several carriers engaged in maintaining a regular transoceanic passenger service. Its purpose is to promote, improve, and regulate the sale and handling of passenger traffic within a particular area and to harmonize policies and stabilize fares for the benefit of its members and the traveling public.

The organization's primary activity consists of appointing travel agents to book passenger travel on the ships of its members. Each appointed travel agent is required to pay an annual fee to the organization and is required to be bonded by a company selected by the organization. The principal purpose of this bonding is to indemnify the organization's members against losses which they might sustain as a result of some act by the travel agents. A list of approved travel agents is periodically distributed to the organization's members who furnish promotional materials to such agents to assist them in selling passages. Travel agents are paid commissions for selling passages by the individual members of the organization.

Income of the organization is derived primarily from travel agents fees and disbursements are for operating expenses.

Section 501(c)(6) of the Code provides for the exemption from Federal income tax of nonprofit business leagues whose net earnings do not inure to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations defines a business league as an association of persons having a common business interest. The activities of the association must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

By appointing travel agents to sell passages on the ships of its members under the circumstances described above, the organization is providing its members with a service that assists them in the conduct of their businesses. This activity constitutes the performance of particular services for members and is not directed to the improvement of general business conditions within the meaning of the regulations. Accordingly, the organization does not qualify for exemption from Federal income tax under section 501(c)(6) of the Code.

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26 CFR 1.501(c)(7)-1: Social clubs.

Flying club organized for pleasure and recreation. A flying club of limited membership that provides flying privileges solely for its members, assesses dues based on the club's fixed operating costs and charges fees based on variable operating expenses, and whose members are interested in flying as a hobby, constantly comingle in informal meetings, maintain and repair the aircraft owned by the club, and fly together in small groups qualifies for exemption under section 501(c)(7) of the Code; Rev. Rul. 70-32 distinguished.

Rev. Rul. 74-30

Advice has been requested whether, under the circumstances described below, a club qualifies for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

The club owns and operates several small aircraft, which only members of the club may fly. Applicants for membership, which is limited, must be interested in flying as a hobby and must be approved by a two-third vote of the members in good standing at a regular meeting. Club planes are used only for recreational purposes. There is no paid staff or management. Members do the work required to maintain and operate the aircraft, under the supervision of elected officers. Occasionally outside experts may be hired for certain repair work. Officers earn two hours of flying time per month. Members earn one hour of flying time for each three hours of manual work on the aircraft, such as washing, polishing, changing tires, etc. The club's income is derived from membership fees, dues, and the sale of flying time to its members. Flying charges are established to meet variable operating expenses, whereas dues are based on fixed operating costs. Its only expenditures are for obligations arising from the ownership, operation, and maintenance of its aircraft.

Members are constantly in personal contact with each other by formal meetings of the board and the general membership, and by informal meetings to schedule the use of aircraft. Further, many are in contact to assist in training, to wash the planes, to inspect the aircraft and to make maintenance decisions regarding work to be done and who will be hired to do it, to ferry aircraft to service shops, to admit new members, to review and pay bills, to review financial reports, to handle delinquent accounts, to purchase or sell aircraft, to comply with FAA directives, etc. In addition, small groups of members also fly together in the club's aircraft.

Section 501(c)(7) of the Code provides for exemption from Federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes provided no part of the net earnings

inures to the benefit of any private shareholder.

In order for a club to meet the requirements for exemption under section 501(c)(7) of the Code, there must be an established membership of individuals, personal contacts, and fellowship. Furthermore, a commingling of members must play a material part in the activities of the organization. See Rev. Rul. 58-589, 1958-2 C.B. 266, and Rev. Rul. 69-635, 1969-2 C.B. 126.

The facts indicate that the club is of limited membership, that the work of the club is shared among the members, and that there is constant person-to-person association among the members. The fact that much of the work is done in small groups or committees does not alter the fact that the members are commingling in fellowship in pursuance of club purposes.

By flying and maintaining aircraft in the manner described above, the club members are jointly participating in the hobby of flying for pleasure and recreation within the meaning of section 501(c)(7) of the Code. Accordingly, the club qualifies for exemption from Federal income tax under section 501(c)(7).

This organization is distinguishable from the club which was held not to be exempt under section 501(c)(7) of the Code in Rev. Rul. 70-32, 1970-1 C.B. 132. In that case the club was open to all persons who were interested in flying. The members did not join to participate as a group in the hobby of flying for recreation, but to obtain economic flying facilities suitable for their individual business or personal use. The members had no expectation of personal relationship with the other members. The facts in the Revenue Ruling show that the club was operated primarily as a service to members, rather than for the pleasure and recreation of the members.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1025, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(7) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the Income Tax Regulations.

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26 CFR 1.501(c)(7)-1: Social clubs.

Social clubs; conducting bowling tournaments. A nonprofit organization that conducts regular bowling tournaments for its members qualifies for exemption under section 501(c)(7) of the Code where its overall program is designed to effect a commingling of members for their pleasure and recreation. The awarding of cash prizes to tournament winners from tournament entry fees is not an inurement of net income to members.

Rev. Rul. 74-148

Advice has been requested whether a nonprofit organization that holds bowling tournaments and pays cash prizes, under the circumstances described below, qualifies for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

The organization is a membership organization formed for the purpose of providing bowling tournaments and recreational bowling competition among its members. Membership is by invitation only and all applicants must be approved by the organization's Board of Directors. Members pay annual dues. The organization conducts monthly bowling tournaments and an annual "tournament of champions" for members at which it awards cash prizes to the winners. The members are required to pay entry fees in order to participate in the tournaments. Prize money is paid from the entry fees.

The organization derives its income solely from membership dues and tournament entry fees.

In addition to the tournaments, the organization has a minimum of one general membership meeting per month, as well as an annual membership meeting and banquet. Members are encouraged to bring guests to the annual meeting. The annual meeting is held in a lounge where music and a catered buffet-type dinner are provided for a reasonable charge to the members and their guests.

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(a) of the Income Tax Regulations provides that section 501(c)(7) of the Code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreational clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities. See Rev. Rul. 69-68, 1969-1 C.B. 153.

Rev. Rul. 58-589, 1958-2 C.B. 266, provides that in order for an organization to establish that it is a club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, it must have an established membership of individuals, personal contacts, and fellowship. A commingling of the members must

play a material part in the life of the organization.

The activities of this organization satisfy the commingling requirement set out above as the bowling tournaments and annual meetings constitute affairs designed to provide recreation and pleasure to its members. The awarding of prizes paid from entry fees does not constitute inurement of the organization's net income but is in furtherance of the members' pleasure and recreation.

Accordingly, the organization described above qualifies for exemption from Federal income tax under section 501(c)(7) of the Code.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1025, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(7) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

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26 CFR 1.501(c)(7)-1: Social clubs.

Social club; corporation sponsored members. A social club does not jeopardize its exemption under section 501(c)(7) of the Code by admitting corporation sponsored individuals who have the same rights and privileges as regular individual members and who must be approved by the membership committee.

Rev. Rul. 74-168

Advice has been requested whether a social club exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 jeopardizes its exemption by admitting corporation sponsored individuals as members under the circumstances described below.

The club is a nonprofit membership corporation that was formed for the pleasure and recreation of its members. Its bylaws provide for both individual membership and corporation sponsored membership. Corporations, partnerships, sole proprietorships, or other business entities in the community may sponsor for membership in the club one representative designated by the business entity. Such individual is subject to the same approval by the membership committee as is required of all members. Each person so designated and accepted by the membership committee has all of the rights and privileges of regular individual members, including the right to vote at club meetings, the use of all club facilities, and the distributive rights to the club's assets upon dissolution. The corporation sponsoring a member does not thereby become entitled itself to vote at club meetings. It exercises no control over the management of the club and enjoys no ownership rights.

A corporation sponsored membership may be transferred to another individual. However, the newly designated individual must also be approved by the membership committee before he is admitted to the club. The business entity pays for the corporation sponsored membership.

Section 501(c)(7) of the Code provides for exemption from Federal income tax for clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

Rev. Rul. 58-589, 1958-2 C.B. 266, discusses the criteria for exemption under section 501(c)(7) of the Code and holds that a club must have an established membership of individuals, personal contacts, and fellowship to be a social club within the meaning of the statute.

The corporation sponsored membership described above rests with the individual designated by the business entity and accepted by the membership committee. Because it involves the bona fide membership of individuals, rather than business entities, such corporation sponsored membership is consistent with the conclusions of Rev. Rul. 58-589. Compare Rev. Rul. 67-428, 1967-2 C.B. 204, which holds that an organization composed of artificial entities rather than individual members does not qualify as an exempt social club.

Accordingly, a social club does not jeopardize its exemption under section 501(c)(7) of the Code by admitting corporation sponsored individuals as members under the circumstances described above.

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26 CFR 1.501(c)(9): Statutory provisions; exemption from tax on corporations, certain trusts, etc.; voluntary employees' beneficiary associations.

Association providing required workmen's compensation benefits. An association formed by a corporation to provide workmen's compensation benefits that the corporation was already obligated to pay under State law does not qualify for exemption under section 501(c)(9) of the Code.

Rev. Rul. 74-18

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(9) of the Internal Revenue Code of 1954.

The organization is an association formed by a commercial corporation to provide workmen's compensation benefits to its employees. All employees of the corporation are members of the association.

The association processes and pays claims for workmen's compensation benefits. The state in which the corporation operates has a statute that imposes an obligation on all employers to pay such benefits. The statute was in existence prior to the formation of

the association. The amount of the awards paid by the association is based on the state statute which provides for the payment of set amounts for specific injuries. The corporation remains ultimately liable for all employee claims and will pay any claim the association is unable to pay.

The association is funded entirely through contributions from the corporation. Employees make no payments to it. The association's disbursements are for the claims and other normal operating expenses.

Section 501(c)(9) of the Code provides for the exemption from Federal income tax of voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Since the employees of the corporation were already entitled under state statute to the payment of workmen's compensaion benefits, the formation of the association did not result in the receipt of any additional employee benefits. The association merely ensures the discharge of an obligation already imposed by statute upon the corporation.

Accordingly, the association does not qualify for exemption from Federal income tax under section 501(c)(9) of the Code.

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26 CFR 1.501(c)(15)-1: Mutual insurance companies or associations.
(Also Sections 801, 821; 1.801-3, 1.821-4.)

Mutual insurance company; definition. To qualify as a mutual insurance company under section 501(c)(15) of the Code the following characteristics, while not conclusive, must be present: (1) the right of policyholders to be members to the exclusion of others and the right of such members to choose the management; (2) the sole business purpose is to supply insurance substantially at cost; (3) the right of members to the return of premiums in excess of those amounts needed to cover losses and expenses; and (4) common equitable ownership of the assets by the members; G.C.M. 25497 superseded.

Rev. Rul. 74-196[1]

Advice has been requested whether the company described below qualifies as a "mutual insurance company other than life" under section 501(c)(15) of the Internal Revenue Code of 1954.

The company, a membership organization without capital stock, issues casualty insurance policies on property and life insurance policies. Membership in the organization is limited to holders of its insurance policies. All policyholders are members and entitled to vote for management. In the event of dissolution, each policyholder is entitled to a pro-rata share of the net assets.

The insurance policies are issued at premiums set by the board of directors based on loss experience, recognized mortality tables, and assumed rates of interest. The policies are nonassessable. While the company's charter authorizes the board of directors to return portions of premiums to the policyholders in the form of dividends if experience under the rates used warrants such action, all of the unearned premiums to date have been retained as reserves for the payment of insurance claims and related expenses. The reserves accumulated for these purposes are reasonable in amount. The company's life insurance reserves, plus unearned premiums and unpaid losses on its life insurance policies not included in its life insurance reserves, comprise less than 50 percent of its total reserves.

During the taxable year, the gross amount received by the company, consisting of premiums and investment income, did not exceed $150,000.

Section 501(c)(15) of the Code provides for the exemption from Federal income tax of mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not exceed $150,000.

The Income Tax Regulations under section 501(c)(15) do not define a mutual insurance company, a mutual life insurance company, or a mutual marine insurance company. Subchapter L of the Code contains the general rules for taxation of insurance companies. The legislative history of the Revenue Act of 1962, amending Part II of Subchapter L of the Code (sections 821-826 dealing with mutual insurance companies other than life or marine), suggests that "mutual insurance company" was intended to have the same meaning for the purposes of both section 501(c)(15) and Subchapter L. See *H. R. Rept. No. 1447*, 87th Cong., 2d Sess., 1962-3 C.B. 405, 555; *S. Rept. No.* 1881, 87th Cong., 2d Sess., 1962-3 C.B. 707, 763, 902; and *Conference Rept. No. 2508*, 87th Cong., 2d Sess., 1962-3 C.B. 1129, 1153.

Section 821(a) of the Code provides for the taxation of certain mutual insurance companies other than life. Section 1.821-4(a)(1)(i) of the regulations contains a reference to section 501(c)(15) for the exemption from income tax of the companies described therein. Therefore, the same criteria should be used to determine whether an organization is a mutual insurance company, other than life, for purposes of both section 501(c)(15) and section 821.

While neither the Code nor the

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

regulations thereunder defines a mutual insurance company, the courts have found the following characteristics to be among those indicating a mutual insurance company:

1. the right of policyholders to be members to the exclusion of others and the right of such members to choose the management;

2. the sole business purpose is to supply insurance substantially at cost;

3. the right of members to the return of premiums in excess of those amounts needed to cover losses and expenses; and

4. common equitable ownership of the assets by the members.

Cf. *Modern Life and Accident Insurance Co. v. Commissioner*, 49 T.C. 670(1968), aff'd. 420 F.2d 36 (7th Cir. 1969). The presence of these characteristics alone, however, will not be considered as conclusive that a company is a mutual insurance company.

In determining whether policyholders have the right to be members to the exclusion of others and to choose the management, the actual exercise of control by the policyholders is essential, not merely the power of the policyholders to exercise control conferred by statute or otherwise. Rev. Rul. 58-616, 1958-2 C.B. 928, clarifying Rev. Rul. 55-240, 1955-1 C.B. 406.

The fact that policies are nonassessable (issued at fixed premiums with no contingent liability of the policyholders for additional assessments) is not contrary to the principle that insurance is furnished substantially at cost. *Modern Life and Accident Insurance Co.*, 49 T.C. at 673-4. Moreover, the fact that the premium charged is greater than the expected cost of the insurance does not necessarily violate the principle since the excess may furnish the guaranty fund from which extraordinary losses may be met. However, the excess of the premium over actual cost and reserves, as later ascertained, must be returned to the policyholder. *Penn Mutual Life Insurance Co. v. Lederer*, 252 U.S. 523 (1920). This may take the form of a reduction in renewal premiums or the payment of dividends on the policies. The maintenance of reasonable reserves to pay losses and expenses is consistent with furnishing insurance substantially at cost, but an unreasonable accumulation suggests the company is not providing insurance to its members substantially at cost. See *Mutual Fire Insurance Co. of Germantown v. United States*, 142 F.2d 344 (3rd Cir. 1944); *Keystone Mutual Casualty Co. v. Driscoll*, 137 F.2d 907 (3rd Cir. 1943).

Common equitable ownership of the company's net assets by the members is represented by the right to receive the company's net assets in the event the members vote to wind up and dissolve the company. *Mutual Fire Insurance Co. of Germantown, v. United States, supra.*

The company described in this ruling has the characteristics of a mutual insurance company discussed above. Membership is limited to policyholders; all policyholders are members and have the right to vote for management; the company furnishes insurance substantially at cost while providing reasonable reserves against its policy obligations and operational expenses; the members have the right to return of the portion of premiums in excess of the amounts needed for losses and expenses; and the ownership of the company's net assets is equitably shared by the members who are entitled to receive the net assets pro-rata in the event of dissolution.

Section 501(c)(15) of the Code requires the company to be a mutual insurance company "other than life." Insofar as pertinent, section 501(a) and section 1.801-3(b)(1) of the regulations define a life insurance company as an insurance company engaged in the business of issuing life insurance contracts if its life insurance reserves, plus the amount of unearned premiums, and unpaid losses on its life insurance policies not included in its life insurance reserves, comprise more than 50 percent of its total reserves. Accordingly, the mutual insurance company in question is not a life insurance company since its life insurance reserves, plus unearned premiums, and unpaid losses on its life insurance policies not included in such reserves, comprise less than 50 percent of the company's total reserves.

In view of the foregoing, the company described is a mutual insurance company other than life or marine. Since the gross income received during the taxable year from the items described in section 822(b) of the Code (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) did not exceed $150,000, it qualifies for exemption under section 501(c)(15).

Even though an organization considers itself within the scope of this Revenue Ruling, it must file Form 1026, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(15) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which the principal place of business or principal office of the organization is located. See section 1.501(a)-1 of the regulations.

G.C.M. 25497, 1948-1 C.B. 60, is hereby superseded since the position stated therein is restated under the current law in this Revenue Ruling.

Part II.—Private Foundations

Section 508.—Special Rules with Respect to Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.

T.D. 7300

TITLE 26.—INTERNAL REVENUE SERVICE.—CHAPTER I, SUBCHAPTER A, PART 1.—IN-

COME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Extension of reliance period for certain charitable, etc., organizations

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

The prior regulations under section 508 of the Internal Revenue Code of 1954 generally allow certain contributors to organizations which have notified the Commissioner of Internal Revenue that they are not private foundations to rely upon such notice with respect to grants, contributions, and distributions made before January 1, 1974. The amendment to the regulations which appears below extends the period of reliance to grants, contributions, and distributions made before January 1, 1975. This will permit grantors, contributors, and distributors who make grants, contributions, and distributions during 1974 generally to rely upon the claimed public charity status of such organizations.

Amendments to the regulations

The Income Tax Regulations (26 CFR Part 1) are amended as follows:

Paragraph 1. Paragraph (b)(4) of § 1.508-1 is amended to read as follows:

§ 1.508-1 Notices.

* * * * *

(b) *Presumption that old and new organizations are private foundations.* * * *

(4) *Effect of notice upon grantors or contributors to the filing organization.* In the case of grants, contributions, or distributions made prior to January 1, 1975, any organization which has properly filed the notice described in section 508(b) prior to March 22, 1973 will not be treated as a private foundation for purposes of making any determination under the internal revenue laws with respect to a grantor, contributor or distributor (as for example, a private foundation distributing all of its net assets pursuant to a section 507(b)(1)(A) termination) thereto, unless the organization is controlled directly or indirectly by such grantor, contributor or distributor, if by the 30th day after the day on which such notice is filed, the organization has not been notified by the Commissioner that the notice filed by such organization has failed to establish that such organization is not a private foundation. See subparagraph (b)(6) of this section for the effect of an adverse notice by the Internal Revenue Service. For purposes of this subparagraph, an organization which has properly filed the notice described in section 503(b) prior to March 22, 1973, and which has claimed recognition of its status under only one paragraph of section 509(a) in such notice, will be treated only for purposes of grantors, contributors or distributors as having the classification claimed in the notice if the provisions of this subparagraph are otherwise satisfied.

Because this Treasury decision extends certain transitional rules and because of the need for immediate guidance with respect to the provisions contained in the Treasury decision, it is found impracticable to issue it with notice and public procedure thereon under section 553(b) of title 5 of the United States Code, or subject to the effective date of limitations of subsection (d) of such section.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 19, 1973.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed in the Office of the Federal Register on December 26, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 27, 1973, 38 F.R. 35303)

Section 509.—Private Foundation Defined

26 CFR 1.509(a)-3: Broadly publicly supported organizations.

Whether an organization comprised of churches of various denominations as opposed to churches of the same denomination constitutes an association of churches within the meaning of section 170(b)(1)(A)(i) of the Code for purposes of section 509(a)(1). See Rev. Rul. 74-224, page 61.

26 CFR 1.509(a)-4: Supporting organizations.

Private foundations; support of foreign organization. An organization that is organized and operated in support of a foreign, rather than a domestic, organization meeting the requirements of section 509(a)(1) and (a)(2) of the Code and that otherwise meets the requirements of section 509(a)(3) qualifies as an organization described in that section.

Rev. Rul. 74-229

Advice has been requested whether an organization that otherwise meets the requirements of section 509(a)(3) of the Internal Revenue Code of 1954 and the Income Tax Regulations thereunder qualifies as an organization described in section 509(a)(3) where the organization is organized and operated in support of a foreign rather than a domestic organization.

Section 509(a)(1) of the Code provides that the term "private foundation" does not include a domestic or foreign organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)).

Section 1.509(a)-2(a) of the regulations provides that an organization

may qualify as a section 509(a)(1) organization regardless of the fact that it does not satisfy section 170(c)(2) of the Code because it was created or organized other than in, or under the law of, the United States, any State or territory, the District of Columbia, or any possession of the United States.

Section 509(a)(3) of the Code requires that the organization support a section 509(a)(1) or (2) organization. The provision is silent as to whether the supported organization must be a domestic or foreign organization.

Accordingly, an organization which otherwise meets the requirements of section 509(a)(3) of the Code and the regulations thereunder qualifies as an organization described in section 509(a)(3) where it supports a foreign organization described in section 501(c)(3) that otherwise meets the requirements of section 509(a)(1) and (a)(2), and the regulations thereunder.

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26 CFR 1.509(a)-4: Supporting organizations.

Whether a public charity exercises sufficient control over a supporting exempt foundation that is trustee of a fund, so that the fund, that otherwise qualifies as a pooled income fund under section 642(c)(5) of the Code, will continue to so qualify. See Rev. Rul. 74-132, page 152.

Part III.—Taxation of Business Income of Certain Exempt Organizations

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Section 511.—Imposition of Tax on Unrelated Business Income of Charitable, etc., Organizations

26 CFR 1.511-2: Organizations subject to tax.

Income from interest of an exempt employees' trust in a limited partnership that borrows money to invest in securities. See Rev. Rul. 74-197, below.

Section 512.—Unrelated Business Taxable Income

26 CFR 1.512(b)-1: Exceptions, additions, and limitations.
(Also Sections 511, 514; 1.511-2, 1.514(c)-1.)

Unrelated income; debt-financed investment by employees' trust. The investment by an exempt employees' trust in a partnership that was organized to invest in securities and borrows funds for that purpose may result in unrelated business taxable income to the extent its share of partnership income is derived from or on account of the debt-financed securities.

Rev. Rul. 74-197

Advice has been requested whether, under the circumstances described below, investment activity by an exempt employees' trust may result in unrelated business taxable income within the meaning of section 512 of the Internal Revenue Code of 1954.

An exempt employees' trust became a partner in a partnership that was organized to make investments in securities. All partners paid a fixed dollar amount directly to the partnership to become members. The partnership borrows funds to invest in securities and is primarily liable for repayment of the borrowed principal and interest thereon. However, if it is unable to repay any portion when due, the partners become liable for repayment of the obligation in proportion to their respective interests.

Section 511 of the Code imposes a tax on the unrelated business taxable income of certain organizations, one of which is an exempt employees' pension, profit-sharing, or stock bonus trust.

Sections 512(b)(4) and 514(a)(1) of the Code require that a portion of the income derived from or on account of each debt-financed property shall be included as an item of gross income derived from an unrelated trade or business.

Section 514(b) of the Code defines "debt-financed property" to mean, with certain exceptions, any property which is held to produce income and with respect to which there is an "acquisition indebtedness" at any time during the taxable year. Under section 514(b)(1)(A)(i), "debt-financed property" does not include any property substantially all of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of its purpose or function constituting the basis for its exemption. Acquisition indebtedness, in turn, is defined in section 514(c) to include the unpaid amount of indebtedness incurred in acquiring or improving the property. However, section 514(c)(4) states that acquisition indebtedness does not include indebtedness the incurrence of which is inherent in the performance or exercise of the purpose or function constituting the basis of the organization's exemption.

Section 1.401-1(a)(2)(i) of the Income Tax Regulations provides that a qualified pension plan is one established and maintained by an employer to provide for the payment of definitely determinable benefits to the employees or their beneficiaries after the retirement of such employees.

Rev. Rul. 71-311, 1971-2 C.B. 184, states that although there is no prohibition in the Code or regulations against a qualified employees' trust borrowing funds to purchase investments, it is subject to tax on unrelated business taxable income under section 511 of the Code. In this connection, the Revenue Ruling cites section 512(b)(4) and 514 requiring the inclusion of certain debt-financed income in unrelated business taxable income.

In this case the employees' trust is a partner. Section 1.702-(a) of the regulations provides that each partner is required to take into account separately in his return his distributive share of each class of item of partnership income, gain, loss, deduction, or credit described in subparagraphs (1) through (9).

The exempt trust is part of a plan which is maintained to pay definitely

determinable benefits to its participants or their beneficiaries without regard to profits. The indebtedness was used to acquire investment property, and would not have occurred but for the investment property acquisition. Therefore, whether the trust's investment activity can result in unrelated business taxable income is determined by whether its share of any partnership income is derived from or on account of debt-financed property. In making this determination it is necessary to ascertain whether the exception contained in either section 514(b)(1)(A)(i) of the Code or 514(c)(4) is applicable.

In this case an indebtedness was incurred to acquire property for investment purposes. This indebtedness was an acquisition indebtedness as defined in section 514(c) of the Code and its incurrence was not inherent in the performance or exercise of the purpose or function constituting the basis of the trust's exemption, since that purpose is to receive the contributions of the employer, the employees, or both, and to use the contributions and increments thereon to provide pension benefits to the employee participants at retirement. Furthermore, the investment property acquired with the borrowed funds was not substantially related (aside from the need of the trust for funds) to the exercise or performance by the trust of the purpose or function constituting the basis for its exemption. See also Senate Report No. 91-552 (1st Session), 1969-3 C.B. 423, at page 465, which states that the provisions of section 514 cannot be circumvented where investment property is also acquired and the borrowing would not have occurred but for the investment property acquisition.

Accordingly, the exempt trust's investment activity may result in unrelated business taxable income within the meaning of section 512 of the Code.

Section 513.—Unrelated Trade or Business

26 CFR 1.513-1: Definition.

Sale of space in journal. Income derived by an association of law enforcement officials, exempt under section 501(c)(6) of the Code, from the sale of space in its journal either for conventional advertising or merely to identify the purchasing organization without a further advertising message constitutes unrelated trade or business income under section 513 of the Code.

Rev. Rul. 74-38

Advice has been requested whether the amounts realized in connection with the publishing activities described below constitute income from the conduct of unrelated trade or business within the meaning of section 513 of the Code.

The organization is exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code of 1954. It is an association whose membership is principally made up of highway patrolmen and other professional law enforcement officials who are actively employed within a single state. It publishes a monthly journal containing articles and other editorial material of professional interest to its members. The organization derives income from the sale of space in its journal for conventional advertising or such other messages as the purchasers direct. Most of the space so sold for such purposes is devoted to ordinary advertising which features the products or services of a commercial enterprise. Some of the space, however, is merely used to identify the purchasing organization or individual without any further advertising message. Typical of this letter usage are insertions such as the following:

Compliments
ABC Manufacturing Corporation
Central City
X State, U.S.A.

* * *

Y Restaurant
10 Main Street
Northwest Town
X State, U.S.A.

In some instances, the messages are those of noncommercial organizations such as churches, labor unions, and farmers' cooperatives.

The question is whether and to what extent amounts realized from the foregoing activities constitute income from the conduct of unrelated trade or business within the meaning of section 513 of the Code.

Section 511(a) of the Code imposes a tax upon the unrelated business taxable income (as defined in section 512) of organizations exempt from Federal income tax under section 501(c)(6). Section 512(a) defines "unrelated business taxable income" as the gross income from any "unrelated trade or business" regularly carried on by the organization as computed in the manner provided in section 512.

The term "unrelated trade or business" is defined in section 513(a) of the Code as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt functions.

Section 513(c) of the Code provides that for the purposes of this section the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Section 1.513-1(d)(4)(iv) of the Income Tax Regulations provides that in certain cases activities carried on by an organization in the performance of

exempt functions may generate good will or intangibles which may be exploited in commercial endeavors. Where an organization exploits such intangibles in commercial activities, the mere fact that the resultant income depends in part upon an exempt function of the organization does not make it gross income from related trade or business. Example 6 of this section provides that income from commercial advertising in a journal of an association exempt under section 501(c)(6) of the Code is gross income from unrelated trade or business.

The publication and distribution of advertising and other messages in periodicals is a recognized form of commercial service. The regular sale of space for such purposes is carried on for the production of income and constitutes the conduct of trade or business. The fact that the message published may not be of a commercial nature is not determinative. There are many forms of institutional messages designed for the promotion of good will which do not directly refer to any commercial product or service, but merely identify the particular enterprise or institution involved. The controlling factor in this case is that the activities giving rise to the income in question constitute the sale and performance of a valuable service on the part of the publisher, and the purchase of that service on the part of the other party to the transaction.

Since the publication of the advertising and other messages in question is regularly carried on, and is not substantially related to the exercise or performance of the organization's exempt functions, the income derived therefrom constitutes gross income from unrelated trade or business within the meaning of section 513 of the Code.

Section 514.—Unrelated Debt-Financed Income

26 CFR 1.514(c)-1: Acquisition indebtedness.

Income from the interest of an exempt employees' trust in a limited partnership that borrows money to invest in securities. See Rev. Rul. 74-197, page 143.

Subchapter G. Corporations Used To Avoid Income Tax on Shareholders
Part I.—Corporations Improperly Accumulating Surplus

Section 531.—Imposition of Accumulated Earnings Tax

26 CFR 1.531-1: Imposition of tax.

Application of the accumulated earnings tax with respect to corporate taxpayers complying with the spirit of the stabilization guidelines. See Rev. Proc. 74-7, page 419.

26 CFR 1.531-1: Imposition of tax.

Whether the accumulated earnings tax is subject to the tax surcharge imposed by section 51 of the Internal Revenue Code of 1954. See Rev. Rul. 74-93, page 13.

Part II.—Personal Holding Companies

Section 542.—Definition of Personal Holding Company

Personal holding company; affiliated group includes bank subsidiary. The corporation parent of an affiliated group that includes a bank subsidiary and files a consolidated return, whose income consists of dividends from the bank subsidiary and dividends and interest from other investments, determines whether and to what extent it is liable for the personal holding company tax based on its separate personal holding company income excluding the subsidiary's dividends.

Rev. Rul. 74-131

Advice has been requested whether, under the circumstances described below, a corporation met the definition of a personal holding company under section 542(a) of the Internal Revenue Code of 1954.

Y, a wholly-owned subsidiary of *X*, is a corporation engaged in banking within the meaning of section 581 of the Code. *X* and *Y*, both domestic corporations, constitute an affiliated group and, pursuant to an election made under section 1502, *X*, as parent, filed a consolidated Federal income tax return for the taxable year ended December 31, 1972. During 1972, *X* received 10,000*x* dollars of dividends from *Y*, and 500*x* dollars of interest and dividends from other investments. Also, the stock ownership requirements of section 542(a)(2) were met by *X* in that more than 50 percent in value of its outstanding stock was owned, directly or indirectly, by or for not more than five individuals.

Section 542(a)(1) of the Code provides that a corporation will be considered a personal holding company if at least sixty percent of its adjusted ordinary gross income (as defined in section 543(b)(2)) for the taxable year is personal holding company income (as defined in section 543(a)).

Section 542(b)(1) of the Code provides that, subject to certain exceptions, an affiliated group of corporations filing a consolidated return will compute its liability for the personal holding company tax with respect to the consolidated adjusted ordinary gross income and the consolidated personal holding company income of the group.

Section 542(b)(3) of the Code provides an exception to section 542(b)(1) in that members of an affiliated group of corporations filing a consolidated return will compute their liability for the personal holding company tax on a separate basis if any member of the group is a corporation excluded from the definition of personal holding company under section 542(c). A bank is one of the types of corporations excluded from the definition of personal holding company under section 542(c)(2). Thus, *X* under section 543(b)(3) is required to compute its personal holding company tax on a separate basis. See also, section 1.1502-2(c) of the Income Tax Regulations.

Rev. Rul. 71-531, 1971-2 C.B. 242, provides that dividends received by a common parent company of an affiliated group from a bank member of the group during a consolidated return year are eliminated in computing the parent's separate personal holding company income.

The situation in Rev. Rul. 71-531 is similar to the instant case except that the parent in Rev. Rul. 71-531 was shown not to have received additional personal holding company income pursuant to section 543(a) of the Code.

The specific question is whether only the remaining 500*x* dollars of interest and dividends received by *X*, in 1972, should be used for purposes of determining *X*'s personal holding company income tax liability and meeting the sixty percent test under section 542(a)(1) of the Code.

Pursuant to Rev. Rul. 71-531, *X*'s income is determined without regard to the intercompany dividends from *Y*. Rev. Rul. 71-531 holds that intercompany dividends paid by a member that is a bank and not itself a personal holding company are eliminated for all purposes in determining the personal holding company income of the recipient member.

Accordingly, it is held that, since *X*'s income, excluding *Y*'s dividends, consisted entirely of interest and dividends from other investments, *X* is a personal holding company for 1972 with only the income from interest and dividends from other investments being subject to the personal holding company tax computation.

Section 545.—Undistributed Personal Holding Company Income

26 CFR 1.545-2: Adjustments to taxable income.

Whether a public charity exercises sufficient control over a supporting exempt foundation that is trustee of a fund, so that the fund, that otherwise qualifies as a pooled income fund under section 642 (c)(5) of the Code, will continue to so qualify. See Rev. Rul. 74-132, page 152.

Part III.—Foreign Personal Holding Companies

Section 551.—Foreign Personal Holding Company Income Taxed to United States Shareholders

26 CFR 1.551-2: Amounts included in gross income.

Whether a dividend received by a foreign personal holding company and included in the gross income of its United States parent corporation as undistributed foreign personal holding income will be treated as a dividend received by the parent for purposes of the foreign tax credit provisions of section 902 of the Code. See Rev. Rul. 74-59, page 183.

Section 556.—Undistributed Foreign Personal Holding Company Income

26 CFR 1.556-2: Adjustments to taxable income.

Whether a public charity exercises sufficient control over a supporting exempt foundation that is trustee of a fund, so that the fund, that otherwise qualifies as a pooled income fund under section 642 (c)(5) of the Code, will continue to so qualify. See Rev. Rul. 74-132, page 152.

Part IV.—Deduction for Dividends Paid

Section 561.—Definition of Deduction for Dividends Paid

26 CFR 1.561-1: Deduction for dividends paid.

Whether a dividend received by a foreign personal holding company and included in the gross income of its United States parent corporation as undistributed foreign personal holding income will be treated as a dividend received by the parent for purposes of the foreign tax credit provisions of section 902 of the Code. See Rev. Rul. 74-59, page 183.

Section 565.—Consent Dividends

26 CFR 1.565-1: General rule.

Whether a dividend received by a foreign personal holding company and included in the gross income of its United States parent corporation as undistributed foreign personal holding income will be treated as a dividend received by the parent for purposes of the foreign tax credit provisions of section 902 of the Code. See Rev. Rul. 74-59, page 183.

Subchapter H. Banking Institutions
Part I.—Rules of General Application to Banking Institutions

Section 584.—Common Trust Funds

26 CFR 1.584-1: Common trust funds.

Common trust fund; member banks of bank holding company. A trust fund established and maintained by member banks of a bank holding company for the common investment of moneys each holds in its capacity as a fiduciary will not qualify as a common trust fund under section 584 of the Code.

Rev. Rul. 74-213

Advice has been requested whether, under the circumstances described below, a fund maintained by member banks of a bank holding company may qualify as a "common trust fund" within the meaning of section 584 of the Internal Revenue Code of 1954.

Several member banks of a bank holding company propose to jointly establish and maintain a trust fund pursuant to recently enacted state legislation permitting the creation of multi-institutional common trust funds. The member banks, as co-trustees of the proposed trust fund, intend to maintain it for the investment by them of moneys each holds in its capacity as a fiduciary.

Section 584(b) of the Code provides that a common trust fund shall not be subject to taxation under chapter 1 and for purposes of this chapter shall not be considered a corporation.

Section 584(a) of the Code provides, in part, that "* * * the term 'common trust fund' means a fund maintained by a bank—(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and (2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve

System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks."

Section 1.584-1(b) of the Income Tax Regulations provides, in part, that certain conditions must be satisfied by a fund maintained by a bank before such fund may be designated as a "common trust fund." One of these conditions is that such fund must be maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank, whether acting alone or in conjunction with one or more co-fiduciaries, solely in its capacity (i) as a trustee of a trust created by will, deed, agreement, declaration of trust, or order of court, (ii) as an executor of the will of, or as an administrator of the estate of, a deceased person, or (iii) as a guardian (by whatever name known under local law) of the estate of an infant, of an incompetent individual, or of an absent individual.

The language "maintained by a bank" and "moneys contributed thereto by the bank" in the context in which it is used in section 584(a) of the Code, specifically limits the maintenance of a common trust fund to a single bank for Federal income tax purposes.

Accordingly, it is held that the trust fund which the banks in the instant case propose to jointly establish and maintain for the common investment of moneys each holds in its capacity as a fiduciary would not qualify as a "common trust fund" within the meaning of section 584 of the Code.

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26 CFR 1.584-1: Common trust funds.

Whether a pooled income fund will maintain its qualified status under the provisions of section 642(c)(5) of the Code, where its moneys are invested in a common trust fund. See Rev. Rul. 74-247, page 152.

Part II.—Mutual Savings Banks, etc.

Section 593.—Reserves for Losses on Loans

26 CFR 1.593-6: Addition to reserve for losses on qualifying real property loans. (Also Section 1212.)

Capital loss carryback; mutual savings bank. A net capital loss carryback from 1972 to 1969 will not affect a mutual savings bank's computation of the deduction for the addition to its bad debt reserve for 1969.

Rev. Rul. 74-188

Advice has been requested whether a capital loss carryback from the taxable year 1972 to the taxable year 1969 will affect the computation by the taxpayer of the deduction for the addition to the bad debt reserve under section 593 of the Internal Revenue Code of 1954 for the taxable year 1969.

The taxpayer is a mutual savings bank not having capital stock represented by shares. The taxpayer's taxable year is the calendar year. It has employed the reserve method of computing bad debts for all taxable years subsequent to 1952. In its Federal income tax return for 1969, a deduction of 2,200*x* dollars was taken by the taxpayer for an addition to the bad debt reserve computed under section 593(b)(2) of the Code, relating to the percentage of taxable income method.

During 1972, the taxpayer sold capital assets as defined in section 1221 of the Code. The sale of these capital assets has resulted in an excess of capital losses over capital gains of 1,000*x* dollars for 1972. The taxpayer will carry back this capital loss under section 1212 of the Code to the year 1969, and this will reduce the taxpayer's taxable income for such year. As a result, the question has arisen as to whether the net capital loss carryback from 1972 to 1969 will affect the computation of the deduction for the addition to the bad debt reserve in the year 1969.

Section 1212(a) of the Code, as amended by the Tax Reform Act of 1969, Public Law 91-172, provides, in part, that if a corporation has a net capital loss for any taxable year, the net capital loss shall be treated as a capital loss carryback to each of the three taxable years preceding the loss year and shall be treated as a short-term capital loss in each such taxable year. Prior to such amendment, section 1212(a) of the Code did not permit net capital loss carrybacks.

Section 1.593-6(b)(2)(iv) of the Income Tax Regulations, applicable for taxable years beginning before July 12, 1969, states that taxable income for purposes of the deduction for addition to the bad debt reserve shall be computed without regard to any net operating loss carryback under section 172 of the Code.

Since a capital loss carryback is, for purposes of section 1.593-6(b)(2)(iv), similar to a net operating loss carryback, similar treatment should be accorded to such carrybacks for taxable years beginning before July 12, 1969.

Accordingly, the net capital loss carryback from 1972 to 1969 of 1,000*x* dollars will not affect the computation of the deduction for the addition to the bad debt reserve for the taxable year 1969.

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26 CFR 1.593-11: Qualifying real property loan and nonqualifying loan defined.

Mortgage pool; mortgage-backed certificates; savings and loan associations. Government National Mortgage Association "straight pass-through" and "fully modified pass-through" mortgage-backed certificates issued in accordance with Rev. Ruls. 70-544 and 70-545 and held by a domestic savings and loan association or other eligible mortgage institution constitute "qualifying real property loans" within the meaning of section 593

(e) of the Code provided the underlying real property is or will become the type of real property prescribed in that section; Rev. Ruls. 70-544 and 70-545 modified.

Rev. Rul. 74-169

Rev. Rul. 70-544, 1970-2 C.B. 6, and Rev. Rul. 70-545, 1970-2 C.B. 7, concerned the tax consequences of transactions involving certain certificates guaranteed by the Government National Mortgage Association ("GNMA") that represent a proportionate interest in mortgages on real property maintained in a "pool" by a savings and loan association.

The above Revenue Rulings held, in part, that a certificate owned by a savings and loan association is considered as representing "loans secured by an interest in real property" within the meaning of section 7701(a)(19)(C)(v) of the Internal Revenue Code of 1954, provided the real property is (or, from the proceeds of the loan, will become) the type of real property described in that section of the Code.

Held, a certificate issued in accordance with the terms of Rev. Rul. 70-544 and Rev. Rul. 70-545 which is held by a domestic building and loan association (or other eligible mortgage institutions) within the meaning of section 7701(a)(19) of the Code is considered as representing "qualifying real property loans" within the meaning of section 593(e) provided the real property underlying the mortgages is (or, from the proceeds of the loan, will become) the type of real property described in that section.

Rev. Rul. 70-544 and Rev. Rul. 70-545 are hereby modified.

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26 CFR 1.593-11: Qualifying real property loan and nonqualifying loan defined.

Whether mortgage participation certificate in mortgage pool guaranteed by Federal Home Loan Mortgage Corporation and held by a savings and loan association within the meaning of section 7701(a)(19) of the Code represents qualifying real property loans. See Rev. Rul. 74-221, page 365.

Subchapter I. Natural Resources
Part I.—Deductions

Section 611.—Allowance of Deduction for Depletion

26 CFR 1.611-1: Allowance of deduction for depletion.

Whether under the circumstances described, for the taxable years beginning after December 31, 1965, section 631(c) of the Internal Revenue Code of 1954 can apply to transactions between members of an affiliated group filing consolidated returns. See Rev. Rul. 74-10, page 251.

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26 CFR 1.611-1: Allowance of deduction for depletion.

Treatment of depreciation or depletion of partnership property where an estate or a trust is a partner. See Rev. Rul. 74-71, page 158.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-3: Depletion; treatment of bonus and advanced royalty.

Depletion; advance payments subject to recoupment. Under a coal lease agreement granting to the lessee the right to mine coal, a lump sum payment made to the lessor in advance of mining and subject to recoupment at a specified rate per ton against coal mined in subsequent years is an advanced royalty within the meaning of section 1.612-3(b) of the regulations.

Rev. Rul. 74-214

Advice has been requested whether, under the circumstances described below, the amount paid by a mining company pursuant to a coal mining lease is an advanced royalty within the meaning of section 1.612-3(b) of the Income Tax Regulations.

M, a bituminous coal mining company, and *P*, a gas pipeline company, cooperate to produce pipeline gas from coal under a gasification agreement that provides, in part, for the formation of two corporations, *O* and *R*, in each of which *M* and *P* have a 50 percent equity interest. *O* is a coal mining company and *R* is a coal gasification company.

M leases coal mining properties to coal mining company *O* under a bona fide lease agreement that is not terminable except for cause. Under the lease, *O* acquires the exclusive right to mine coal, by any method other than stripping, for a period of 25 years and as long thereafter as mining from the property by the lessee continues.

The coal lease provides for two types of payments from *O* to *M*:

1. the sum of $15x$ dollars prior to mining during the period between the execution of the mining lease and the time when coal is required for the production of gas, and

2. a production royalty of a specified amount per ton when coal is being produced.

The advanced payment will be recouped by *O* out of the production royalty. Coal reserves committed to the lease are substantially in excess of those sufficient for complete recoupment of the advanced payment.

Under the gasification agreement *P* will contribute to *O* sufficient funds for *O* to pay the advances due *M* prior to mining. Funds so contributed by *P* are in addition to amounts which *P* is otherwise required to contribute to *O*.

O will mine coal from the leased properties and sell such coal to *R* pursuant to a coal supply agreement that provides for a base coal price equal to the sum of the net royalties payable by *O* to *M*, all mining delivery costs, and an arms-length fixed profit margin. The base coal price is subject to periodic revisions to reflect *O*'s basic costs.

R will convert the coal supplied under the coal supply agreement into pipeline gas and sell it to *P* pursuant to a gas supply agreement that provides for a base price per unit (1,000 cubic feet) for all gas delivered to *P* by *R* of the sum of the cost of coal consumed, all coal gasification costs,

and an arms-length fixed profit margin. The base pipeline gas price is subject to periodic revision to reflect *R*'s basic costs.

Section 1.612-3(b)(1) of the regulations defines advanced royalties to include amounts that are required to be paid by the owner of an operating interest in a mineral deposit on a specified number of units of mineral, whether or not extracted within the year, which may be applied, to the extent paid on account of units not extracted in the year of payment, against the royalty due on the minerals thereafter extracted.

Section 1.612-3(b)(3) of the regulations permits an election which either allows a deduction for advanced royalties from gross income for the year in which such advanced royalties are paid or accrued, or allows the deduction from gross income for the year in which the mineral is produced and sold.

Rev. Rul. 70-20, 1970-1 C.B. 144, holds that advanced royalties include lump sum payments made by the lessee at the beginning of each of the first nine years of a mineral lease which are recoupable out of royalties based on production during the entire lease term. The lump sum payments in that case were due whether or not there was any mineral production; the payments were recouped only out of a limited portion of the royalties due on production in later years unless sooner recouped against royalties paid on mineral production during the year of payment. There was no production during the first year of the lease in that case and advanced royalties paid in that year were recouped out of royalties due on production in subsequent years.

In the instant case *O* acquires the right to mine immediately upon execution of the coal lease, but is required by the lease to make payment in advance of mining for the right to mine. The advance payment made by *O* is recoupable at a specified rate per ton against coal mined in years subsequent to payment of the advance.

Section 1.612-3(b)(1) of the regulations by its terms contemplates that advanced royalties include amounts that are recouped against production in years subsequent to payment. It refers to amounts paid on account of units not extracted within the year which may be applied against royalty on the mineral thereafter extracted.

Accordingly, in the instant case the amount of $15x$ dollars paid by *O* to *M* in advance of mining is an advanced royalty within the meaning of section 1.612-3(b) of the regulations and thus is either an allowable deduction from gross income for the year in which such advanced royalty is paid or accrued, or as an allowable deduction from gross income for the year in which the mineral is produced and sold.

Section 614.—Definition of Property

26 CFR 1.614-1: Definition of property.

Depletion; aggregation; two properties. A mining company acquired 18 separate mineral interests comprising a single ore body in 18 separate tracts of land within a single operating unit and extracted minerals from two mines, one an open-pit operation and the other an underground mine. Ore quality is different in the two mines and operation of each requires different techniques, personnel, and equipment. In computing its percentage depletion, the company properly treated its operating mineral interests in its operating unit as consisting of two properties under section 614 of the Code, one comprising an open-pit mine and the other an underground mine.

Rev. Rul. 74-215

Advice has been requested whether, in computing its percentage depletion, a taxpayer properly treated its operating mineral interests in its operating unit as consisting of two properties, one comprising an open pit mine and the other comprising an underground mine under section 614(c) of the Internal Revenue Code of 1954.

In 1969, a taxpayer acquired 18 separate mineral interests in 18 separate tracts of land in a single operating unit and extracted mineral from two mines, one an open pit operation and the other an underground mine. The various mineral interests comprised a single ore body. The minerals reached by the open pit mine are located close to the surface while those reached by the underground mine are substantially below the surface. The minerals reached by the underground mine are not accessible by open pit mining, and it is not economically feasible to extract minerals from the deposits near the surface by any method other than open pit mining. Operation of the two mines requires the use of different techniques, personnel, and equipment. Ore quality in the two mines is different.

Pursuant to section 614(c)(2) of the Code, the taxpayer elected to allocate a portion of each of the mineral interests to the open pit mine and a portion of each interest to the underground mine on the basis of the existing facts and circumstances. The taxpayer elected, pursuant to section 614(c)(1), to aggregate the mineral interests allocated to the underground mine and to aggregate the mineral interests allocated to the open pit mine, thus forming two properties for percentage depletion purposes.

Section 614(c)(1) of the Code provides, in pertinent part, that a taxpayer can elect to aggregate and treat as one property all operating mineral interests which comprise any one mine or any two or more mines. This section further provides that a taxpayer may elect to form more than one aggregation of operating mineral interests within any one operating

unit; but no aggregation may include any operating mineral interest which is a part of a mine without including all of the operating mineral interests which are a part of such mine in the first taxable year for which the election to aggregate is effective, and any operating mineral interest which thereafter becomes a part of such mine shall be included in such aggregation.

Section 614(c)(2) of the Code provides, in pertinent part, that if a single tract or parcel of land contains a mineral deposit which is being extracted, or will be extracted, by means of two or more mines for which expenditures for development or operation have been made by the taxpayer, the taxpayer can elect to allocate to such mines all of the tract or parcel of land and of the mineral deposit contained therein, and to treat as a separate property that portion of the tract or parcel of land and of the mineral deposit so allocated to each mine.

Section 1.614-3(a)(1) of the Income Tax Regulations provides, in part, that a taxpayer who owns two or more separate operating mineral interests that constitute all or part of the same operating unit may elect under section 614(c)(1) of the Code to form an aggregation of all such operating mineral interests which comprise any one mine or any two or more mines. This regulation further provides that a taxpayer may elect to form more than one aggregation of separate operating mineral interests within one operating unit so long as each aggregation consists of all the separate operating mineral interests which comprise any one mine or any two or more mines.

Section 1.614-3(b)(1) of the regulations provides, in part, that a taxpayer who owns a separate operating mineral interest in a mineral deposit in a single tract or parcel of land may elect under section 614(c)(2) of the Code to treat such interest as two or more separate operating mineral interests if such mineral deposit is being developed or extracted by means of two or more mines.

Section 1.614-3(b)(2) of the regulations provides, in part, that if a taxpayer elects to treat a separate operating mineral interest in a single tract or parcel of land as more than one separate operating mineral interest, all of such mineral deposit therein and all of the land allocated thereto must be allocated to the newly formed separate operating mineral interest. This regulation further provides that a portion of such mineral deposit and tract or parcel of land must be allocated to each such newly formed separate operating mineral interest upon the basis of the facts and circumstances of the particular case and that each such interest must contain at least one mine.

In the instant case there was an allocation under section 614(c)(2) of the Code of each of the 18 original separate operating mineral interests into two parts resulting in 18 interests allocated to the open pit mine and 18 interests allocated to the underground mine. There was then an aggregation under section 614(c)(1) of the 18 surface interests into one property and another aggregation of the 18 underground interests into one property.

Accordingly, the taxpayer, in the instant case, in computing its percentage depletion, properly treated its operating mineral interests in its operating unit as consisting of two properties, one comprising an open pit mine and the other comprising an underground mine under section 614(c) of the Code.

Section 615.—Pre-1970 Exploration Expenditures

26 CFR 1.615-1: Exploration expenditures.

Whether certain expenditures incurred, before January 1, 1970, for drilling to ascertain the existence, location, extent, or quality of a mineral deposit may be deducted. See Rev. Rul. 74-67, page 63.

Section 616.—Development Expenditures

26 CFR 1.616-1: Development expenditures.
(Also Section 167; 1.167(a)-1.)

Strip mining; land purchased as dumping area for overburden. The cost of a tract of land containing an exhausted open-pit mine, purchased for use as a dumping area for overburden removed from an adjacent strip mine at a price greater than the going price of similar tracts containing no open-pit mine, is not deductible as a development expenditure. The entire cost must be capitalized, but the portion attributable to the exhausted open-pit mine is an expenditure for an asset that is depreciable over its useful life based on the capacity of the open pit and the rate of dumping overburden into it.

Rev. Rul. 74-282

Advice has been requested whether, under the circumstances described below, a deduction is allowable as a "development expenditure" under section 616 of the Internal Revenue Code of 1954 for the amount paid by a taxpayer for land containing an exhausted open-pit mine purchased for use as a dumping area for overburden removed in stripping an adjacent mineral deposit.

The taxpayer, a mining company, lacked sufficient disposal area for overburden in the vicinity of a mineral deposit that it was developing and, therefore, purchased an adjacent tract of land containing an exhausted open-pit mine for use as a dumping area. The open pit could reasonably be expected to provide sufficient capacity to permit the dumping of a determinable number of units of overburden. The purchase price in this instance was greater than the going price for tracts of land useful for dumping overburden, but containing no open pit, in the same vicinity. The value of

the tract of land after the open pit is filled to capacity will be no greater than undisturbed surface land in the same area.

Section 616 of the Code applies to expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil and gas well) if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed. The expenditures may be deducted currently or, if the taxpayer so elects, may be treated as deferred expenses in accordance with section 616(b).

The expenditures described in section 616 of the Code are those resulting directly from the mining process or activity of making the ore or mineral in place accessible for production operations through the removal of material, by the driving of shafts, tunnels, galleries, and similar processes or activities. Expenditures for the acquisition of land are not expenditures of the type to which section 616 applies. See Rev. Rul. 67-35, 1967-1 C.B. 159.

In the instant case, the exhausted open-pit mine is a land improvement that is a separate valuable asset and is not a detriment to the value of the land. Therefore, the purchase price is attributable to the acquisition of two assets, the tract of land on which the open pit was excavated, and the exhausted open-pit mine itself.

Accordingly, the expenditure involved in the instant case is not a "development expenditure" within the meaning of section 616(a) of the Code. Therefore, the portion of the purchase price attributable to the tract of land is to be capitalized until there is a closed transaction, such as a sale or exchange, that fixes the amount of gain or loss realized or sustained. *Denise Coal Co. v. Commissioner,* 271 F. 2d 930 (3rd Cir. 1959), *rev'g in part,* 29 T.C. 528 (1957).

However, the portion of the purchase price attributable to the exhausted open-pit mine is the cost of acquiring a tangible asset the life of which extends substantially beyond the close of the taxable year. Therefore, the portion of the purchase price attributable to the exhausted open-pit mine is a capital expenditure that is depreciable over its useful life based on the number of units of capacity of the open pit and the rate of dumping of overburden into it.

This open pit is not included in any of the asset guideline classes in Rev. Proc. 72-10, 1972-1 C.B. 721.

Section 617.—Deduction and Recapture of Certain Mining Exploration Expenditures

26 CFR 1.617-1: Exploration expenditures.

Whether certain expenditures incurred after December 31, 1969, for drilling to ascertain the existence, location, extent, or quality of a mineral deposit may be deducted. See Rev. Rul. 74-67, page 63.

Part III.—Sales and Exchanges

Section 631.—Gain or Loss in the Case of Timber, Coal, or Domestic Iron Ore

26 CFR 1.631-1: Election to consider cutting as sale or exchange.

Timber; cutting contract. The terms of a contract under which the taxpayer acquired the unrestricted right to cut and use timber in its lumber manufacturing business are not relevant in determining the fair market value of timber cut for the purposes of section 631(a) of the Code.

Rev. Rul. 74-271

The taxpayer elected to treat the cutting of timber as a sale or exchange of such timber under the provisions of section 631(a) of the Internel Revenue Code of 1954. The timber cut was acquired under a contract that granted to the taxpayer the right to cut and use such timber in its lumber manufacturing business. However, while the contract did not restrict the taxpayer's rights in the logs or the lumber produced from the timber, it contained a formula for computing stumpage payments based on percentages of profits that varied according to the end products produced and sold. In addition, the contract contained other provisions that required the taxpayer to pay all taxes and other charges levied against the lands and timber included under the contract, required the purchaser to pay for all merchantable logs left in the woods 30 days after logging, granted the seller the right to demand that the taxpayer's management be maintained at a level of competence at least equal to similar competitive operations, required that all roads necessary for logging the timber be constructed at the taxpayer's expense, and provided that all such roads constructed on the seller's land become the property of the seller upon construction.

Held, the provisions of this contract under which the taxpayer acquired the right to cut timber for sale or for use in its trade or business are not relevant in determining the fair market value of the timber cut thereunder for the purposes of section 631(a) of the Code. The fair market value of the timber is to be determined under the objective standards set forth in sections 1.631-1(d)(2) and 1.611-3(f) of the Income Tax Regulations.

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26 CFR 1.631-1: Election to consider cutting as sale or exchange.

Whether a nonexempt cooperative within the meaning of section 1381(a) of the Code, who elected the provisions of section 631(a) has income from a patronage source. See Rev. Rul. 74-24, page 244.

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26 CFR 1.631-3: Gain or loss upon the disposal of coal or domestic iron ore with a retained economic interest.

Whether under the circumstances described, for the taxable years beginning after December 31, 1965, section 631(c) of the Internal Revenue Code of 1954 can apply to transactions between members of an affiliated group filing consolidated returns. See Rev. Rul. 74-10, page 251.

Subchapter J. Estates, Trusts, Beneficiaries and Decedents
Part I.—Estates, Trusts, and Beneficiaries
Subpart A.—General Rules for Taxation of Estates and Trusts

Section 641.—Imposition of Tax

26 CFR 1.641(a)-0: Scope of subchapter J.

Taxation of a trust, its grantor, and its beneficiaries, where the trust was established by a former husband, under an agreement in contemplation of divorce. See Rev. Rul. 74-94, page 26.

Section 642.—Special Rules for Credits and Deductions

26 CFR 1.642(c)-5: Definition of pooled income fund.
(Also Sections 170, 509, 545, 556; 1.170A-1, 1.509(a)-4, 1.545-2, 1.556-2.)

Pooled income fund; maintenance by public charity. The power of a public charity's board of directors to remove the members of a supporting foundation's board of directors and appoint new directors is substantially equivalent to the power to remove the foundation as trustee of a pooled income fund that qualifies under section 642(c)(5) of the Code. Thus, the requirement that the pooled income fund must be maintained by the public charity has been met.

Rev. Rul. 74-132

Advice has been requested whether the otherwise qualified fund described below is maintained by a public charity so that it qualifies as a pooled income fund under the provisions of section 642(c)(5) of the Internal Revenue Code of 1954.

The functions of an exempt foundation are to foster and support the activities and purposes of an exempt hospital corporation and to advance the hospital's objectives, including, subject to approval by the hospital's board of directors, the sponsorship of specific projects and programs to improve the hospital's services to its patients and to support and promote the hospital's education, training and research programs. Except for reasonable expenses incurred in carrying out the purposes of the foundation, all payments must be made exclusively to the hospital. Members of the foundation's board of directors are appointed by the hospital's board of directors, that may, in its discretion, remove any director or officer of the foundation from office. Both the hospital and the foundation qualify as organizations described in section 501(c)(3) of the Code that are exempt from Federal income tax. The hospital is excluded from the definition of a "private foundation" under the provisions of section 509(a)(1) of the Code, and the foundation is excluded from such definition under the provisions of section 509(a)(3) of the Code.

In 1971, the foundation became the trustee of a fund intended to qualify as a "pooled income fund" under section 642(c)(5) of the Code. The provisions of the fund's declaration of trust and instrument of transfer are in accordance with the requirements of sections 508(e) and 642(c)(5) of the Code and the Income Tax Regulations thereunder, including the requirement that each donor transferring property to the fund must contribute an irrevocable remainder interest in such property to or for the use of the hospital. In the event that the foundation shall become an organization other than one described in section 509(a)(3) or the corresponding provisions of any subsequent Federal tax law, or shall no longer be controlled by the hospital, or shall resign as trustee, the hospital shall become the trustee of the fund.

Section 642(c)(5) of the Code, in defining a pooled income fund, provides, in pertinent part, that a pooled income fund is a trust to which each donor transfers property, contributing an irrevocable remainder interest in such property to or for the use of an organization described in section 170(b)(1)(A), other than certain private foundations referred to in clauses (vii) or (viii) of that section.

Section 1.642(c)-5(b)(5) of the regulations provides, in part, that a pooled income fund must be maintained by the same public charity to or for the use of which the irrevocable remainder interest is contributed. The requirement of maintenance will be satisfied where the public charity exercises control directly or indirectly over the fund. For example, this requirement of control shall ordinarily be met when the public charity has the power to remove the trustee or trustees of the fund and designate a new trustee or trustees.

The power of the hospital's board of directors to remove the members of the foundation's board of directors and appoint new directors is substantially equivalent to the power to remove the foundation as trustee of the fund and designate a new trustee.

Thus, in the instant case, the hospital exercises control, directly or indirectly, over the fund and therefore, the requirement of section 642(c)(5) of the Code that the fund be maintained by a public charity is met.

Accordingly, it is held that the fund qualifies as a pooled income fund defined in section 642(c)(5) of the Code, and the regulations thereunder, since it meets all of the requirements of a pooled income fund, including the requirement that it be maintained by a public charity.

It is further held that contributions or transfers to the fund will be deductible under the provisions of sections 170, 545, 556, 2055, 2106, and 2522 of the Code, subject to the restrictions and limitations applicable to those sections.

26 CFR 1.642(c)-5: Definition of pooled income fund.
(Also Section 584; 1.584-1.)

Pooled income funds; investment in common trust fund. The investment of moneys of pooled income funds by a bank, as trustee of such

funds, in the bank's common trust fund, will not disqualify the funds under section 642(c)(5) of the Code provided the common trust fund does not contain or acquire any tax-exempt securities.

Rev. Rul. 74-247

Advice has been requested whether a pooled income fund will maintain its qualified status under the provisions of section 642(c)(5) of the Internal Revenue Code of 1954 where, under the circumstances described below, its moneys are invested in a common trust fund to which section 584 applies.

A bank is the trustee of a number of trusts that qualify as pooled income funds under the provisions of section 642(c)(5) of the Code.

The bank maintains several "common trust funds" as that term is defined in section 584 of the Code, but does not have a common trust fund established solely for the purpose of investing the moneys of pooled income funds. In its capacity as trustee of the pooled income funds, the bank transferred moneys of the pooled income funds to one of the common trust funds maintained by it. None of the securities held by the common trust fund were of a type, the income of which is exempt from tax under subtitle A of the Code, and because of its control over the common trust fund the bank is able to avoid future investment in tax-exempt securities.

Section 1.642(c)-5(b)(3) of the regulations provides, in part, that a bank which serves as trustee of more than one pooled income fund may maintain a common trust fund, to which section 584 of the Code applies, for the collective investment and reinvestment of moneys of such funds.

Section 1.642(c)-5(b)(4) of the regulations provides that the property transferred to the pooled income fund by any donor must not include any securities, the income from which is exempt from tax under subtitle A of the Code, and the fund must not invest in such securities.

Accordingly, the investment of the moneys of the pooled income funds by the bank, in its capacity as trustee of such funds, in the bank's common trust fund, will not cause the pooled income funds to lose their status as qualified pooled income funds under section 642(c)(5) of the Code, provided that the common trust fund does not invest or reinvest in any securities, the income from which is exempt from tax under subtitle A of the Code. This is true even though such common trust fund was not established and operated exclusively for pooled income funds.

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26 CFR 1.642(e)-1: Depreciation and depletion.

Treatment of depreciation or depletion of partnership property where an estate or a trust is a partner. See Rev. Rul. 74-71, page 158.

Section 643.—Definitions Applicable to Subparts A, B, C, and D

26 CFR 1.643(a)-0: Distributable net income; deduction for distributions; in general.

Determination as to the proper amount of distributable net income of a trust. See Rev. Rul. 74-257, below.

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26 CFR 1.643(a)-0: Distributable net income; deduction for distributions; in general.

Application of section 661(a) of the Code to distributions by a nonexempt employees' trust to a beneficiary. See Rev. Rul. 74-299, page 154.

Subpart B.—Trusts which Distribute Current Income Only

Section 651.—Deduction for Trusts Distributing Current Income Only

26 CFR 1.651(a)-1: Simple trusts; deduction for distributions; in general.
(Also Sections 643, 652; 1.643(a)-0, 1.652(b)-3.)

Estates and trusts; State income tax on capital gains. The State income tax paid by an irrevocable inter vivos trust, which distributes all of its net income currently, on capital gains retained by the trust in accordance with the terms of its governing instrument for the benefit of noncharitable remaindermen, is allowable as a deduction in arriving at the trust's taxable income and is deducted in arriving at its distributable net income. Further, the deduction for the distribution to the beneficiaries is limited to the trust's distributable net income for the taxable year.

Rev. Rul. 74-257

Advice has been requested whether a trust may be allowed a deduction for State income taxes it paid as a result of capital gains retained by the trust in accordance with the terms of its governing instrument for the benefit of noncharitable remaindermen under the circumstances described below.

The governing instrument of an irrevocable inter vivos trust provides that all of its net income is to be distributed currently in equal amounts to four beneficiaries. During the taxable year 1972 the trust collected 60x dollars of qualifying dividends and 1x dollars of interest on United States Government obligations. It also realized capital gains of 200x dollars on the sale of securities and paid 25x dollars of fiduciary income tax attributable solely to such capital gains to the department of revenue of the State in which the trust was created.

As of December 31, 1972, the trustee remitted an amount equal to the dividend income and the interest income, less a trustee's fee of 1x dollars, to the beneficiaries of the trust. The proceeds of the sale of the securities were retained by the trustee as principal and were reinvested, after deducting therefrom the amount of the fiduciary income taxes paid. The retention of the proceeds of the sale was in accordance with applicable local law.

Section 641 of the Internal Revenue Code of 1954 provides, in part, that the taxable income of a trust is com-

puted in the same manner as in the case of an individual, except as otherwise provided in this part. Also, a trust is allowed to deduct, in computing its taxable income, the deductions provided by section 651 and the regulations thereunder, relating to distributions to beneficiaries.

Section 651 of the Code provides for a deduction in the case of a trust that distributes current income only. The deduction is limited to the amount of the distributable net income regardless of whether the amount of income required to be distributed currently exceeds the distributable net income of the trust for the taxable year.

Under section 1.642(a)-0 of the Income Tax Regulations "distributable net income" means for any taxable year, the taxable income of the trust computed with the modifications set forth in section 1.643(a)-1 through 1.643(a)-7. The deduction allowable to a trust under section 651 of the Code for amounts paid to beneficiaries, and the deduction for personal exemption under section 642(b) are not allowed in the computation of distributable net income. The gains or losses from the sale or exchange of capital assets, with certain exceptions not here pertinent, are ordinarily excluded from distributable net income.

Section 652 of the Code provides, in part, that the amount of income for the taxable year required to be distributed currently by a trust shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. Such includible amount shall be an amount equal to each beneficiary's share of the distributable net income of the trust.

Items of deduction of a trust that enter into the computation of distributable net income are to be allocated among the items of income. Section 1.652(b)-3(a) of the regulations provides that deductions that are directly attributable to a specific class of income must be allocated to that class of income. Section 1.652(b)-3(c) provides that State income tax is an item of expense that is not directly attributable to a specific class of income. Section 1.652(b)-3(b) provides that deductions that are not directly attributable to a specific class of income may be allocated to the items of income included in computing distributable net income. Under this section of the regulations no part of any deduction may be allocable to capital gains retained by a trust if under the terms of the trust instrument the capital gains are allocable to corpus and thus excluded from the computation of distributable net income. See *Marcia Brady Tucker,* 38 T.C. 955 (1962), *aff'd.* 322 F. 2d 86 (2d Cir. 1963) and *Manufacturers Hanover Trust Co. v. United States,* 312 F. 2d 785 (Ct. Cl. 1963). In the instant case, under the terms of the trust instrument the capital gains are allocable to corpus.

Accordingly, in this case, the State income tax paid as a result of capital gains retained by the trust is allowable as a deduction in arriving at the taxable income of the trust under section 641 of the Code. Further, the State income tax paid is deducted in arriving at distributable net income as provided in section 1.652(b)-3 of the regulations. The deduction for the distribution to the beneficiaries, as provided in section 651, is limited to the distributable net income regardless of the fact that the actual distribution exceeded the distributable net income of the trust for the taxable year.

Section 652.—Inclusion of Amounts in Gross Income of Beneficiaries of Trusts Distributing Current Income Only

26 CFR 1.652(b)-3: Allocation of deductions.

Treatment of an item of deduction that enters into the computation of distributable net income. See Rev. Rul. 74-257, page 153.

Subpart C.—Estates and Trusts Which May Accumulate Income or Which Distribute Corpus

Section 661.—Deduction for Estates and Trusts Accumulating Income or Distributing Corpus

26 CFR 1.661(a)-2: Deduction for distributions to beneficiaries.
(Also Sections 402, 643, 662, 663; 1.402 (b)-1, 1.643(a)-0, 1.662(a)-1, 1.663(c)-1.)

Nonexempt trust; distributions in retirement year. A nonexempt employees' trust is allowed a deduction under section 661(a) of the Code for distributions to a retired employee under a deferred compensation plan. The separate share rule of section 663 applies and thus the deduction under section 661(a) is limited to the distributee's separate share of the distributable net income. In determining the taxability of beneficiaries of nonexempt employees' trusts, the provisions of section 402(b) take precedence over those of section 662(a), and the fact that section 662(a) is not applicable to the beneficiary does not in and of itself make section 661(a) inapplicable to the trust.

Rev. Rul. 74-299

Advice has been requested concerning the treatment, for Federal income tax purposes, of an amount distributed by a nonexempt employees' trust under the circumstances described below.

In 1963 a corporation created a trust as part of a deferred compensation plan for the benefit of its employees. The trust is not qualified under the provisions of section 401(a) of the Internal Revenue Code of 1954 and therefore it is not exempt from taxation under section 501(a) of the Code. Separate accounts are maintained for each participating employee that reflect his share of the net trust assets and income. Annual employer contributions and forfeitures by disqualified employees are allocated to

each participating employee's account based on his proportionate share of the total compensation of all participating employees for the year.

Employees covered under the plan, or their estates, are entitled to receive their prior years' vested interest in the net assets of the trust when they retire, terminate their employment, become disabled, or in event of death. No amount may vest in any participating employee before he has completed at least three years of continuous service for the employer. Only one of the employees covered under the plan retired in 1972. During the calendar year 1972, under the terms of the plan, the trust made distributions to the retired employee totaling $12x$ dollars. For the calendar year 1972 the trust had "distributable net income", as that term is described in section 643(a) of the Code, in the amount of $75x$ dollars. However, the distributable net income allocable to the retired employee's separately computed share was $1x$ dollars.

Section 1.661(a)-2(a) of the Income Tax Regulations provides, in part, that in computing the taxable income of an estate or trust a deduction is allowed for distributions to beneficiaries equal to the sum of the amount of income for the taxable year that is required to be distributed currently and any other amounts properly paid or credited or required to be distributed for such taxable year. However, the total amount deductible under section 661(a) of the Code cannot exceed the distributable net income as computed under the provisions of section 643(a).

Section 662(a) of the Code provides, in general, the rules for determining the amount and character of amounts to be included in the gross income of a beneficiary receiving an amount specified in section 661.

Section 402(b) of the Code provides, in part, that the amount actually distributed or made available by a nonexempt trust to any distributee shall be taxable to such distributee under rules contained in section 72 in the year in which the amount is so distributed or made available.

For the purpose of determining the taxability of beneficiaries of employees' trusts that are not exempt from tax under section 501(a) of the Code, the specific provisions of section 402(b) apply, rather than the general provisions of section 662(a). In the instant case, the fact that the provisions of section 662(a) do not apply to the employee, as beneficiary of the trust, does not preclude the application of the provisions of section 661(a) to the trust itself.

Section 663(c) of the Code provides, in part, that for the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts.

Section 1.663(c)-1(a) of the regulations provides, in part, that if a single trust has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of distributable net income allocable to the respective beneficiaries under sections 661 and 662 of the Code.

Thus, even though for the calendar year 1972 the trust had "distributable net income," as that term is described in section 643(a) of the Code, in the amount of $75x$ dollars, the distributable net income allocable to the retired employee's separate share, under section 663, was only $1x$ dollars.

Accordingly, in the instant case, the deduction allowable to the trust for 1972, under section 661(a) of the Code, is limited to the retired employee's separate share of distributable net income ($1x$ dollars) as determined under section 663(c) and the regulations thereunder.

However, as provided by section 402(b) of the Code, the taxability of the distribution of $12x$ dollars to the retired employee is determined in accordance with the rules contained in section 72. It is not governed by the provisions of section 662(a).

Section 662.—Inclusion of Amounts in Gross Income of Beneficiaries of Estates and Trusts Accumulating Income or Distributing Corpus

26 CFR 1.662(a)-1: Inclusion of amounts in gross income of beneficiaries of estates and complex trust; general.

Nonapplicability of section 662(a) of the Code to distributions received by a beneficiary of a nonexempt employees' trust. See Rev. Rul. 74-299, page 154.

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26 CFR 1.662(a)-4: Amounts used in discharge of a legal obligation.

Taxation of a former husband as beneficiary of a trust established by him for the benefit of his former wife and support of their children under an agreement in contemplation of divorce. See Rev. Rul. 74-94, page 26.

Section 663.—Special Rules Applicable to Sections 661 and 662

26 CFR 1.663(c)-1: Separate shares treated as separate trusts; in general.

Applicability of the separate share rule to a nonexempt employees' trust for purposes of determining the trust's deduction for distributions to a beneficiary under section 661(a) of the Code. See Rev. Rul. 74-299, page 154.

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-1: Charitable remainder trusts.

Charitable remainder unitrust; trustee's fee charged against unitrust amount. A trust, otherwise qualifying as a charitable remainder unitrust, whose governing instrument provides that a portion of a specified trustee's fee shall be charged against the "unitrust

amount" does not meet the "fixed percentage" requirement of section 1.664-3 of the regulations even though the "unitrust amount" may never be less than five percent of the trust assets valued annually.

Rev. Rul. 74-19

Advice has been requested whether the charging of a specified trustee's fee in arriving at the "unitrust amount" under the circumstances described below will disqualify the trust as a charitable remainder unitrust under section 664 of the Internal Revenue Code of 1954.

The governing instrument of a trust provides for an amount of 6 percent of the net fair market value of the trust assets, valued annually, to be paid each year to certain individuals for their lives. Upon termination of the trust, the remainder interest is required to be transferred to a charitable organization described in section 170 (c) of the Code. The instrument also provides that a portion of the trustee's fee shall be charged against the stated 6 percent, but in no event shall the annual unitrust amount payable be less than 5 percent of the net fair market value of the trust assets, valued annually. In every other respect the trust qualifies as a charitable remainder unitrust under section 664 and the applicable regulations.

Section 664(d)(2)(A) of the Code defines a charitable remainder unitrust as a trust from which a fixed percentage (which is not less than 5 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (as least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals. In addition, under section 664(d)(2)(B), it must be a trust from which no amount other than the payments described in section 664(d)(2)(A) may be paid to or for the use of any person other than an organization described in section 170(c). Section 664(d)(2)(C) provides that following the termination of the payments described in section 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such use.

Section 1.664-1(a)(2) of the Income Tax Regulations provides, in part, that a trust is a charitable remainder trust only if it is either a charitable remainder annuity trust in every respect or a charitable remainder unitrust in every respect.

Section 1.664-1(a)(1)(iii)(c) of the regulations provides, in part, that the term "unitrust amount" means the amount described in section 1.664-3(a)(1) which is payable, at least annually, to the beneficiary of a charitable remainder unitrust. Section 1.664-3 sets forth the requirements that must be met in order to qualify as a charitable remainder unitrust.

Among the requirements of section 1.664-3 of the regulations is the requirement that the unitrust amount be computed as a fixed percentage of the net fair market value of the trust assets valued annually. Thus, if any portion of the trustee's fee is charged against the amount so computed, the requirement of section 1.664-3 that the unitrust amount be computed as a fixed percentage is not met. Therefore, the trust is not a charitable remainder unitrust in every respect.

Accordingly, since the amount arrived at after charging the trustee's fee is not determined by application of a fixed percentage, it is not a unitrust amount and, therefore, the trust will not qualify as a charitable remainder unitrust under section 664 of the Code, even though the resulting amount, after reduction by the trustee's fee, may never be less than 5 percent of the net fair market value of the trust assets valued annually.

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26 CFR 1.664-1: Charitable remainder trusts.

Charitable remainder unitrust; successor beneficiary. A trust otherwise qualifying as a charitable remainder unitrust whose governing instrument provides an income interest to an individual, or in the event of his death to a successor beneficiary or his heirs for a term of 20 years, qualifies as a charitable remainder unitrust.

Rev. Rul. 74-39

A made a gift in 1971 to a university, an organization described in section 170(c) of the Internal Revenue Code of 1954, through a trust. Pursuant to the governing instrument of the trust the university will be the trustee of the funds transferred to the trust. The trust instrument provides that each year quarterly distributions at an annual rate of 6 percent of the net fair market value of the trust assets, determined annually, are to be made to *B* for a term of 20 years. If *B* dies before the expiration of the 20-year term, the payments will be made to *C* for the balance of the 20-year period remaining. If *C* also dies before the expiration of the 20-year period, then distributions for the balance of the period remaining are to be made to *C*'s heirs at law excluding the donor and his spouse. At the end of the 20-year term the balance remaining in the trust is to be distributed to the university. The trust is irrevocable and otherwise complies with the requirements of section 664 of the Code and the applicable Income Tax Regulations.

Held, in the instant case, the trust is a charitable remainder unitrust and the contribution for 1971 to the trust is deductible as a charitable contribution subject to the limitations of section 170(b) of the Code.

26 CFR 1.664-1: Charitable remainder trusts.

Rev. Rul. 74-283

A trust created within the meaning of applicable local law subsequent to July 31, 1969, and prior to December 31, 1972, which was not a charitable remainder trust at the date of its creation, may be treated as a charitable remainder trust if the instrument is amended so that the trust meets the definition of a charitable remainder trust and such amendment is made and implemented in the manner and within the time limits specified in section 1.664-1(f)(3) of the Income Tax Regulations. Thus, where action to obtain judicial authorization for a qualifying amendment has been initiated prior to December 31, 1972, and the requisite amendment has been duly adopted and implemented in accordance with a resulting court decree, the trust will qualify as a charitable remainder trust under the provisions of section 664 of the Internal Revenue Code of 1954 and the applicable regulations, and contributions to the trust will be charitable contributions that are deductible under section 170, 2055, 2106 or 2522.

The principles set forth by the United States Supreme Court in *Commissioner v. Bosch,* 387 U.S. 456 (1967), 1967-2 C.B. 337, are not applicable to post July 31, 1969, charitable remainder trusts that are judicially reformed or amended pursuant to the rules set forth in section 1.664-1(f)(3) of the regulations. The regulation rules are a relief measure that is an exception to the principle that, in the determination of a Federal tax question, Federal authorities are not bound by retroactive determinations made by a state trial court.

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26 CFR 1.664-3: Charitable remainder unitrust.

Charitable remainder unitrust; termination of life interest; additional contributions. A trust, the governing instrument of which otherwise satisfies the unitrust requirements of section 664 of the Code and which reserves in the donor the rights to terminate by will the spouse's life interest and to make inter vivos and testamentary additions, qualifies as a charitable remainder unitrust.

Rev. Rul. 74-149

Advice has been requested whether a trust qualifies as a charitable remainder unitrust under section 664 of the Internal Revenue Code of 1954 and the applicable Income Tax Regulations under the circumstances described below.

The governing instrument of an irrevocable inter vivos trust provides that the trustee will pay the unitrust amount to the donor for life. The instrument further provides that upon the donor's death the unitrust amount will be paid to the donor's spouse for life, but the donor reserves the right to terminate the spouse's interest by will.

Upon the death of the survivor of the donor and his spouse, the trust will terminate and the trustee will distribute all of the principal and income of the trust, other than any amount due the income beneficiary, to charity.

The trust instrument provides that additional contributions may be made to the trust. The instrument also provides that, in addition to inter vivos additions, if any, the donor reserves the right to make a testamentary addition to the trust. In all other respects, additional contributions are to be treated in accordance with the applicable section of the regulations.

A charitable remainder trust is a trust that provides for a specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity, for life or for a term of years, with an irrevocable remainder interest to be held for the benefit of or paid over to charity. In the case of a charitable remainder unitrust, the specified distribution to be paid at least annually must be a fixed percentage that is not less than 5 percent of the net fair market value of the trust assets, valued annually.

The trust instrument complies with the provisions of section 664 of the Code and the applicable regulations, for example, the creation and payment of the unitrust amount for life, the creation of a remainder interest in charity, the selection of an alternative charitable beneficiary if the remaindermen do not qualify under section 170(c) at the time of distribution, the adjustment for incorrect valuations, the computation of the unitrust amount in short and final taxable years, and the prohibitions governing private foundations.

Section 1.664-1(a)(4) of the regulations provides that in order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust.

Section 1.664-3(a)(4) of the regulations provides, in part, that the grantor may retain the power exercisable only by will to revoke or terminate the interest of any recipient other than an organization described in section 170(c) of the Code.

A trust will not cease to be a charitable remainder trust if its governing instrument provides that valuation and payment of the required payout relating to each additional contribution to the trust are made in accordance with the provisions of section 1.664-3(b) of the regulations.

The provisions in the governing instrument relating to the termination of the spouse's interest by will and to inter vivos and testamentary additions comply with the requirements of section 664 of the Code and the applicable regulations. Accordingly, in the instant case, the trust will qualify as a charitable remainder unitrust.

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26 CFR 1.664-4: Calculation of the fair market value of the remainder interest in a charitable remainder unitrust.

The actuarial computation of the present value of the remainder interest in a charitable remainder unitrust. See Rev. Rul. 74-53, page 60.

Subpart E. Grantors and Others Treated as Substantial Owners

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-1: Grantors and others treated as substantial owners; scope.

Ownership of a trust established by a former husband for the benefit of his former wife and the support of their children under an agreement in contemplation of divorce. See Rev. Rul. 74-94, page 26.

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26 CFR 1.671-1: Grantors and others treated as substantial owners; scope.

Whether holders of mortgage participation certificates in mortgage "pool" guaranteed by Federal Home Loan Mortgage Corporation are owners of trust. See Rev. Rul. 74-221, page 365.

Section 677.—Income for Benefit of Grantor

26 CFR 1.677(a)-1: Income for benefit of grantor; general rule.

Taxation of a former husband as owner of a portion of a trust established by him for the benefit of his former wife and support of their children under an agreement in contemplation of divorce. See Rev. Rul. 74-94, page 26.

Subpart F.—Miscellaneous

Section 682.—Income of an Estate or Trust in Case of Divorce, etc.

26 CFR 1.682(a)-1: Income of trust in case of divorce, etc.

Taxation of a trust, its grantor, and its beneficiaries, where the trust was established by a former husband under an agreement in contemplation of divorce for the benefit of his former wife and their children. See Rev. Rul. 74-94, page 26.

Subchapter K.—Partners and Partnerships
Part I.—Determination of Tax Liability

Section 702.—Income and Credits of Partner

26 CFR 1.702-1: Income and credits of partner.

(Also Sections 167, 611, 642; 1.167(h)-1, 1.611-1, 1.642(e)-1.)

Estate or trust; depreciation or depletion deduction of partnership. An estate or trust member of a partnership must separately take into account its distributive share of the partnership depreciation or depletion deductions in those cases where such treatment would result in a tax liability for the estate or trust different from that which would result if such deductions were not taken into account separately; Rev. Rul. 61-211 modified.

Rev. Rul. 74-71

Advice has been requested concerning the treatment for Federal income tax purposes of the allowable deductions for depreciation and depletion of partnership properties under the circumstances described below.

A partnership owns certain properties that are subject to allowable deductions for depreciation and depletion. Among its partners are an estate and a trust.

Section 642(e) of the Internal Revenue Code of 1954 provides that an estate or trust shall be allowed the deduction for depreciation and depletion only to the extent not allowable to beneficiaries under sections 167(h) and 611(b).

Section 167(h) of the Code, relating to depreciation allowable to life tenants and beneficiaries of trusts and estates, provides, in part, that in the case of an estate the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each. Section 611(b)(4), relating to depletion of property held by an estate, contains a corresponding provision.

Section 167(h) of the Code also provides that in the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. Section 611(b)(3), relating to depletion of property held in trust, contains a corresponding provision.

Section 702(a)(8) of the Code provides, in pertinent part, that in determining his income tax, each partner shall take into account separately his distributive share of partnership items of income, gain, loss, deduction, or credit to the extent provided by regulations prescribed by the Secretary or his delegate. Section 702(b) provides, in part, that the character of the above items shall be determined as if they were realized directly from the sources from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Section 1.702-1(a)(8) of the regulations provides, in pertinent part, that each partner shall take into account separately, any items of income, gain, loss, deduction, or credit subject to a special allocation under the partnership agreement which differs from the allocation of partnership taxable income or loss generally and any partnership item which if separately taken into account by any partner would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

Accordingly, where under the provisions of section 167(h) and section 611(b) of the Code, the depreciation or depletion deduction of the estate is allocable to its heirs, legatees, or devisees or, in the case of the trust are allocable to its beneficiaries, and where such deductions if separately taken into account by the estate or trust would result in an income tax liability for the estate or trust different from that which would result if the estate or trust did not take such deductions into account separately,

then the depreciation or depletion of property held by any partnership in which the estate or trust is a partner must be taken into account separately by the estate or trust under the rules contained in section 702(a)(8) and the regulations pertaining thereto.

Rev. Rul. 61-211, 1961-2 C.B. 124, holds, in part, that if a partnership agreement provides for a special allocation of depreciation or depletion to a partner which is a trust or an estate, such trust or estate may determine its share of the partnership deduction for depreciation and depletion as if it were realized directly from the depreciable or depletable partnership property. Therefore, such a partner is considered the holder of a share of the partnership depreciable or depletable property for the purpose of any allocation of the deductions between the trust and its beneficiaries, or the estate and its heirs, legatees and devisees, as the case may be.

Rev. Rul. 61-211 is hereby modified to remove any implication that its holding precludes an estate or a trust which is a member of a partnership from taking its distributive share of depreciation or depletion into account separately in cases other than those involving a special allocation to the estate or trust of such depreciation or depletion.

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26 CFR 1.702-1: Income and credits of partner.

Treatment of a partner's distributive share of partnership earned income for purposes of computing his maximum tax on earned income under section 1348 of the Code. See Rev. Rul. 74-231, page 240.

Part II.—Contributions, Distributions, and Transfers
Subpart B.—Distributions by a Partnership

Section 731.—Extent of Recognition of Gain or Loss on Distribution

26 CFR 1.731-1: Extent of recognition of gain or loss on distribution.

Treatment of a limited partner's proportionate share of partnership liabilities, on which no personal liability is assumed by the partners or the partnership, as a distribution. See Rev. Rul. 74-40, below.

Subpart C.—Transfers of Interests in a Partnership

Section 741.—Recognition and Character of Gain or Loss on Sale or Exchange

26 CFR 1.741-1: Recognition and character of gain or loss on sale or exchange.

Treatment of a limited partner's proportionate share of partnership liabilities, on which no personal liability is assumed by the partners or the partnership, as an amount realized. See Rev. Rul. 74-40, below.

Subpart D.—Provisions Common to Other Subparts

Section 752.—Treatment of Certain Liabilities

26 CFR 1.752-1: Treatment of certain liabilities.
(Also Sections 731, 741; 1.731-1, 1.741-1.)

Limited partner's interest sold or withdrawn. Federal income tax consequences to a limited partner from the sale or exchange of his partnership interest and to a limited partner who withdraws from the partnership in cases where no personal liability has been assumed either by the partnership or by any of the partners with respect to the limited partner's share of partnership liabilities.

Rev. Rul. 74-40

Advice has been requested concerning the Federal income tax consequences to a limited partner in the situations described below.

Situation 1: *L* is a limited partner in partnership *GL* to which he contributed $10,000 in cash on its formation. His distributive share of partnership items of income and loss is 10 percent and he is not entitled to receive any guaranteed payments. The adjusted basis of his partnership interest at the end of the current year is $20,000. His proportionate share of partnership liabilities, on which neither he, the other partners nor the partnership have assumed any personal liability, is $15,000. The partnership has no other liabilities. *L* sells his interest in the partnership to *M*, an unrelated taxpayer, for $10,000 in cash. At the time of the transaction the partnership had no unrealized receivables or inventory items described in section 751 of the Internal Revenue Code of 1954 nor any goodwill and *L* had been paid his distributive share of partnership income.

Section 752(c) of the Internal Revenue Code of 1954 provides that for purposes of section 752, a liability to which property is subject shall, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

Section 1.752-1(e) of the Income Tax Regulations provides, in part, that where none of the partners have any personal liability with respect to a partnership liability (as in the case of a mortgage on real estate acquired by the partnership without the assumption by the partnership or any of the partners of any liability on the mortgage), then all partners, including limited partners, shall be considered as sharing such liability under section 752(c) of the Code in the same proportion as they share the profits.

Section 1.752-1(d) of the regulations provides that where there is a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships. For example, if a partner sells his interest in a partnership for $750 cash and at the same time transfers to the purchaser his share of partnership liabilities amounting to $250, the amount realized by the seller on the transaction is $1,000.

Section 741 of the Code provides, in pertinent part, that in the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner and

shall be considered gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 of the Code (relating to unrealized receivables and inventory items which have appreciated substantially in value).

Accordingly, in the instant situation, the amount realized by *L* from the sale of his partnership interest is $25,000, consisting of cash in the amount of $10,000 and release from his share of partnership liabilities in the amount of $15,000. Since the adjusted basis of *L*'s interest in the partnership is $20,000, he realized a gain of $5,000 determined under the provisions of section 741 of the Code.

Situation 2: The facts are the same as in situation 1, except that *L* withdraws from the partnership and the partnership distributes $10,000 to him in cash in complete liquidation of his interest in the partnership.

Section 752(b) of the Code provides that any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

Section 731(a) of the Code provides, in pertinent part, that in the case of a distribution by a partnership to a partner (1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution. Any gain recognized under section 731(a) shall be considered as a gain from the sale or exchange of the partnership interest of the distributee partner.

Section 731(c) of the Code provides, in part, that section 731 shall not apply to the extent otherwise provided by section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest) and section 751 of the Code (relating to unrealized receivables and inventory items).

Section 736(b) of the Code provides, in pertinent part, that payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments are determined to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share of partnership income or guaranteed payment.

Section 1.736-1(b)(1) of the Income Tax Regulations provides, in pertinent part, that gain or loss with respect to distributions under section 736(b) of the Code will be recognized to the distributee to the extent provided in section 731 of the Code.

Accordingly, in the instant situation, distributions to *L* with respect to his partnership interest total $25,000 and consist of cash in the amount of $10,000 and a decrease in his share of the partnership liabilities in the amount of $15,000 that is considered under section 752(b) of the Code as a distribution of money to *L* by the partnership.

Furthermore, since the money distributed ($25,000) exceeds the adjusted basis of *L*'s interest in the partnership immediately before the distribution ($20,000), he realizes a gain of $5,000 determined under the provisions of section 731(a) of the Code.

Situation 3: Instead of selling his interest *L* withdraws from the partnership at a time when the adjusted basis of his interest in the partnership is zero and his proportionate share of partnership liabilities, all of which consist of liabilities on which neither he, the other partners nor the partnership have assumed any personal liability, is $15,000.

Accordingly, *L* is considered to have received a distribution of money from the partnership of $15,000 and realizes a gain of $15,000 determined under the provisions of section 731(a) of the Code.

Subchapter L. Insurance Companies
Part I.—Life Insurance Companies
Subpart A.—Definition; Tax Imposed

Section 801.—Definition of Life Insurance Company

26 CFR 1.801-3: Definitions.

Definition of "mutual insurance company other than life" for purposes of section 501(c)(15). See Rev. Rul. 74-196, page 140.

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26 CFR 1.801-8: Contracts with reserves based on segregated asset accounts.

Life insurance companies; contract with reserves based on a segregated asset account. A contract between an employer and its wholly-owned life insurance company to fund pensions under a qualified employees' retirement plan is not a "contract with reserves based on a segregated asset account" within the meaning of section 801(g) of the Code where the employer has the option to direct the insurer to use the funds from such account to provide either guaranteed benefits or nonguaranteed benefits and on the effective date of the contract the insurer is directed to provide nonguaranteed benefits; Rev. Rul. 73-333 distinguished.

Rev. Rul. 74-189

Advice has been requested whether a contract, under which employer contributions are deposited into a separately maintained asset account of a life insurance company to fund benefits payable under an employees retirement plan, qualifies as a "contract with reserves based on a segregated asset account" under section 801(g) of the Internal Revenue Code of 1954.

X, a corporation engaged in the commercial credit business, owns all of the outstanding stock of *Y*, a life insurance company subject to tax

under section 802 of the Code. *X* adopted a retirement plan which meets the requirements of section 401 (a) to provide retirement benefits to its employees and to employees of its subsidiaries who adopt the plan. *X* entered into a contract which provides that all employer contributions shall be deposited into a segregated asset account maintained by *Y* pursuant to the laws and regulations of State *A*. Interest earned on all employer contributions was also required to be credited to *Y*'s segregated asset account.

Under the contract, *X* may direct *Y* to apply the funds held by *Y* in the segregated asset account to purchase guaranteed annuities for participants under the plan at guaranteed purchase rates specified in the contract. Modification of the annuity purchase rates is permitted after the fifth anniversary of the contract but any new annuity purchase rate schedule adopted is applicable only to funds contributed after the effective date of the new rates, and such new rates must remain in effect for a minimum of five years after first becoming effective. The normal retirement benefit provided under the plan is a pension payable for life at specified rates with optional alternative rates and benefits under joint pension arrangements for the survivor and the original annuitant. A lump sum payment may also be paid to the participant under the plan which is the actuarial equivalent of the pension payable under the plan.

The contract also provides that *X*, in lieu of the pension for life benefits, may direct *Y* to apply funds held under the plan to the payment of monthly benefits either directly to the participants or through *X*. However, under this alternative arrangement (hereinafter called non-guaranteed alternative), *Y* does not guarantee continuance of the payments nor the sufficiency of the funds in the segregated asset account to make such payments. After selecting the non-guaranteed alternative under the plan, *X* may, after 90 days written notice to *Y* direct *Y* to change over to the guaranteed annuity payments. Once a guaranteed annuity has been effected for a participant under the plan, payment under the alternative arrangement may not be substituted therefor.

Upon the effective date of the contract, *X* directed *Y* to apply the funds in its segregated asset account to provide benefits under the non-guaranteed alternative contained in the contract.

The guaranteed annuity purchase rates set forth in the contract are based on a recognized mortality table with a specified assumed interest earnings rate. The contract provides that the reserves for annuities purchased under the contract will be at least equal to a reserve computed on the mortality table and the interest rate upon which the annuity purchase rate for such annuity was based. Such reserves are required to be computed or estimated either on the basis of such mortality table and interest rate or on the basis of another recognized mortality table and/or interest rate.

The question is whether the contract with *Y* to fund *X*'s retirement benefit plan for employees is a contract with reserves based on a segregated asset account within the meaning of section 801(g) of the Code.

Section 801(g)(1)(B) of the Code defines the term "contract with reserves based on a segregated asset account" as follows:

> For purposes of this part, a "contract with reserves based on a segregated asset account" is a contract—
>
> (i) which provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company,
>
> (ii) which provides for the payment of annuities, and
>
> (iii) under which the amounts paid in, or the amount paid as annuities, reflect the investment return and the market value of the segregated asset account.
>
> If a contract ceases to reflect current investment return and current market value, such contract shall not be considered as meeting the requirements of clause (iii) after such cessation.

In the instant case, since *X* directed *Y* to apply funds held in the segregated asset account under the non-guaranteed alternative upon the effective date of the contract, *Y* is not obligated to provide an annuity to anyone or to pay out any particular amounts except as may be directed by *X*. Under these circumstances, *Y* is not obligated on an insurance risk to provide any specified benefits. In order for the provisions of section 801(g) of the Code to apply, the contract in question must impose an insurance risk on *Y*, the insurer.

Accordingly, it is held that the contract under which *Y* holds funds in a segregated asset account to fund benefits payable under *X*'s employee retirement plan does not qualify as a contract with reserves based on a segregated asset account within the meaning of section 801(g) of the Code.

Rev. Rul. 73-333, 1973-2 C.B. 218, is distinguishable from the instant case. In the instant case the contract involved contains an option to provide non-guaranteed benefits, which the employer exercised upon the effective date of the contract, thereby relieving the insurer of its insurance risk. On the other hand, in Rev. Rul. 73-333, the contract involved does not contain such a non-guaranteed benefits option and, under the options it does contain, the insurer is obligated to provide fixed annuities at guaranteed rates.

Rev. Rul. 73-333 distinguished.

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26 CFR 1.801-8: Contracts with reserves based on segregated asset accounts.

Whether purchase of substantially identical stock by segregated asset account following sale of stock from general asset account of life insurance company is a wash sale if it occurs within period proscribed by section 1091 of the Code. See Rev. Rul. 74-4, page 51.

Subpart B.—Investment Income

Section 805.—Policy and Other Contract Liability Requirements

26 CFR 1.805-5: Adjusted reserves rate and earnings rates.
(Also Section 818; 1.818-2.)

Life insurance companies; 1958 change in accounting method; average earnings rates. For purposes of computing the average earnings rates as defined in section 805(b)(3) of the Code for the years 1958 through 1961, a life insurance company that changed from the cash to the accrual method of accounting in 1958 pursuant to the Life Insurance Company Income Tax Act of 1959 may increase its investment yield for pre-1958 years by items of investment income not taken into account in computing taxable income solely by reason of the method of accounting previously used.

Rev. Rul. 74-190

Advice has been requested whether in determining investment yield for pre-1958 years to be used in computing the average earnings rate for 1958 under section 805(b)(3) of the Internal Revenue Code of 1954, a life insurance company may take into account items not taken into account in computing taxable income solely by reason of the method of accounting used by the life insurance company in reporting taxable income in pre-1958 years.

The taxpayer is a life insurance company subject to the tax imposed under section 802 of the Code. For taxable years 1954 through 1957, the taxpayer filed all of its income tax returns on the cash basis. For the taxable year 1958, and subsequent taxable years, the taxpayer filed all of its income tax returns on the accrual basis as required by section 818(a). When the Life Insurance Company Income Tax Act of 1959, Pub. L. 86-69, 1959-2 C.B. 654, was enacted, the taxpayer filed an amended income tax return for the taxable year 1957 reflecting a change in method of accounting from the cash to the accrual method pursuant to the provisions of section 818(e) of the Code. Since the change in method of accounting was made concurrently with the enactment of the 1959 Act, pursuant to the transitional requirements of section 818(e), permission of the Commissioner to make the change was not required.

The investment income for the pre-1958 years computed on the accrual basis (having been previously reported on the cash basis) included some items of income not previously reported or made subject to tax. This computation of investment income for pre-1958 years on an accrual basis resulted in an increase in the investment yield and current earnings rate for such years. The increased investment yield for pre-1958 years resulted in an increase in the average earnings rate, the policy and other contract liability requirements, and hence in the amount of the policyholder's share of investment yield excluded from taxation in taxable years 1958 through 1961. The question presented in the instant case is whether the taxpayer's investment yield for taxable years 1954 through 1957 to be used in computing its current earnings rate under section 805(b)(2) of the Code for such years may be increased by items of income taken into account solely by reason of the change in method of accounting to the accrual method in order to compute the taxpayer's average earnings rate as defined in section 805(b)(3) for taxable years 1958 through 1961.

Section 804(a)(1) of the Code provides generally that the policyholder's share of each item of investment yield of a life insurance company shall be excluded from taxable investment income. The policyholder's share of any item shall be that percentage obtained by dividing the policy and other contract liability requirements by the investment yield, limited to 100 percent.

Section 805(a) of the Code provides that for purposes of part I of subchapter L, Chapter 1 of the Code, the term "policy and other contract liability requirements" means, for any taxable year, the sum of (1) the adjusted life insurance reserves, multiplied by the adjusted reserves rate, (2) the mean of the pension plan reserves at the beginning and end of the taxable year, multiplied by the current earnings rate, and (3) the interest paid.

In pertinent part, for purposes of part I of subchapter L, Chapter 1 of the Code, section 805(b)(1) of the Code defines the term "adjusted reserves rate" for any taxable year as the average earnings rate or, if lower, the current earnings rate.

Section 805(b)(2) of the Code defines the term "current earnings rate" for any taxable year as the amount determined by dividing (A) the taxpayer's investment yield for such taxable year, by (B) the mean of the taxpayer's assets at the beginning and end of the taxable year. Section 805(b)(3)(A) defines the term "average earnings rate" for any taxable year as the average of the current earnings rate for such taxable year and for each of the four taxable years immediately preceding such taxable year.

Section 805(b)(3)(B) of the Code provides, in pertinent part, that for purposes of computing the 5 year average earnings rate, under section 805(b)(3)(A), the current earnings rate for any taxable year beginning before January 1, 1958, shall be determined as if part I of subchapter L, Chapter 1 of the Code (as in effect for 1958) and section 381(c)(22) applied to such taxable year. "Average earnings rate" and "current earnings rate" are items used in computing the adjusted reserves rate of a life insurance company, which, in turn, is used to determine the policy and other

contract liability requirements as provided in section 805(a).

Section 818(a)(1) of the Code provides, in general, that all computations entering into the determination of taxes imposed by part I of subchapter L, Chapter 1 of the Code, shall be made under an accrual method of accounting. This requirement for use of the accrual method as the overall method of accounting is applied to life insurance companies for taxable years beginning on or after January 1, 1958, the effective date of the Life Insurance Company Income Tax Act of 1959.

Section 1.818-2(a)(4)(i) of The Income Tax Regulations provides, in pertinent part, that for purposes of section 805(b)(3)(B)(i) of the Code (relating to the determination of the current earnings rate for any taxable year beginning before January 1, 1958), the determination for any year of the investment yield and the assets shall be made as though the taxpayer had been on the accrual method prescribed in section 1.818-2(a)(1) for such year, or the accrual method in combination with other methods of accounting (other than the cash receipts and disbursements method) prescribed in section 1.818-2(a)(2).

In the instant case, the increase in the investment yield for the taxable years 1954 through 1957 attributable to untaxed and previously unreported items of income results solely from the change to the accrual method of accounting required under section 818(a) of the Code, and the adjustments provided for in section 805(b)(3)(B) for determining the current earnings rate for taxable years beginning before January 1, 1958. These adjustments, resulting in an increase in the current earnings rate computed under section 805(b)(3)(B) of the Code for the taxable years 1954 through 1957 and corresponding increase in the average earnings rate computed under section 805(b)(3)(A) for taxable years 1958 through 1961, are required under the tax formula of part I of subchapter L, Chapter 1 of the Code in determining the policyholder's share of investment yield not taxed to the insurance company for taxable years 1958 through 1961.

Accordingly it is held that, for purposes of computing the average earnings rate as defined in section 805(b)(3) of the Code for taxable years 1958 through 1961, the taxapayer may, pursuant to section 805(b)(3)(B) and section 1.818-2(a)(4)(i) of the regulations, increase the investment yield for taxable years 1954 through 1957 by items of investment income not taken into account in computing taxable income solely by reason of the method of accounting used by the taxpayer in filing income tax returns for years 1954 through 1957.

Subpart C.—Gain and Loss from Operations

Section 809.—In General

26 CFR 1.809-5: Deductions.

Whether the deduction allowed for net increase in reserves from reserve strengthening is deductible in full where company ceases to be life insurance company. See Rev. Rul. 74-57, below.

Section 810.—Rules for Certain Reserves

26 CFR 1.810-3: Adjustment for change in computing reserves.
(Also Section 809; 1.809-5.)

Life insurance reserves; change in basis during last year as a life insurance company. A net increase or decrease in reserves resulting from a change in the reserve computation method to strengthen or weaken life insurance reserves, during the last taxable year in which a company qualifies as a life insurance company, under sections 809(d)(2) or (c)(2) and 810(d)(2) of the Code, is taken into account in such year for purposes of determining gain or loss from operations.

Rev. Rul. 74-57

Advice is requested with respect to the time when a life insurance company takes into account the net increase or net decrease in reserves that results from strengthening or weakening, respectively, certain of its life insurance reserves during the taxable year that is also the last taxable year in which the company qualifies as a life insurance company under section 801 of the Internal Revenue Code of 1954.

Prior to 1971, *X* and *Y* were both insurance companies that qualified as life insurance companies under section 801 of the Code. During 1970 *X* determined that certain of its life insurance reserves needed to be strengthened. Accordingly, it changed the basis upon which those reserves had been computed and took all other steps necessary to strengthen such reserves. As a result of this strengthening *X*'s life insurance reserves for the taxable year 1970 were increased by 10*x* dollars.

During 1970 *Y* insurance company determined that certain of its life insurance reserves should be weakened. It, too, changed the basis upon which such reserves were computed and took all other steps necessary to weaken its reserves. As a result of this weakening *Y*'s life insurance reserves for the taxable year 1970 were decreased by 10*x* dollars.

The taxable year 1970 is the last taxable year that both *X* and *Y* qualified as life insurance companies under section 801 of the Code both having failed to qualify as life insurance companies in 1971.

Section 809(d)(2) of the Code provides, in effect, that a life insurance company shall be allowed a deduction for a net increase in its life insurance reserves for the taxable year in which such increase occurs.

Correspondingly, section 809(c)(2) of the Code provides, in effect, that a life insurance company shall include in income the net decrease in its life

insurance reserves for the taxable year in which such decrease occurs.

Section 810(d)(1) of the Code provides as follows:

(1) IN GENERAL.—If the basis for determining any item referred to in subsection (c) as of the close of any taxable year differs from the basis for such determination as of the close of the preceding taxable year, then so much of the difference between—

(A) the amount of the item at the close of the taxable year, computed on the new basis, and

(B) the amount of the item at the close of the taxable year, computed on the old basis,

as is attributable to contracts issued before the taxable year shall be taken into account for purposes of this subpart as follows:

(i) if the amount determined under subparagraph (A) exceeds the amount determined under subparagraph (B), 1/10 of such excess shall be taken into account, for each of the succeeding 10 taxable years, as a net increase to which section 809(d)(2) applies; or

(ii) if the amount determined under subparagraph (B) exceeds the amount determined under subparagraph (A), 1/10 of such excess shall be taken into account, for each of the 10 succeeding taxable years, as a net decrease to which section 809(c)(2) applies.

Also, section 810(d)(2) of the Code and section 1.810-3(c) of the Income Tax Regulations provide, in effect, that if for any taxable year a company is not a life insurance company, then the entire balance of any adjustment remaining to be made under the 10-year spread rule described in section 810(d)(1) shall be taken into account for the preceding taxable year. Thus, the time when the adjustment attributable to the change in basis is taken into account as affected by the fact that the company may cease to be a life insurance company before the period covered by the 10-year spread rule has begun or elapsed.

In the instant situations, both *X* and *Y* insurance companies ceased to be life insurance companies after the change in basis was made to strengthen and weaken certain of their life insurance reserves, respectively, but before the beginning of the period when the adjustment for such change in basis could be taken into account in accord with section 810(d)(1) of the Code. Therefore, pursuant to section 810(d)(2) and section 1.810-3(c) of the regulations, the entire balance of such adjustment shall be taken into account for the taxable year preceding the year in which the company ceases to qualify as a life insurance company.

Accordingly, the full amount of the net increase in *X*'s life insurance reserves due to the change in basis in computing such reserves shall be taken into account as a net increase referred to in section 809(d)(2) of the Code in determining gain and loss from operations for the taxable year 1970. Similarly, the full amount of the net decrease in *Y*'s life insurance reserves due to the change in basis in computing such reserves shall be taken into account as a net decrease referred to in section 809(c)(2) in determining gain and loss from operations for the taxable year 1970.

Subpart E.—Miscellaneous Provisions

Section 818.—Accounting Provisions

26 CFR 1.818-2: Accounting provisions.

Whether life insurance company that changed to accrual method of accounting as of the effective date of the Life Insurance Company Tax Act of 1959 may increase investment yield for pre-1958 years with items of investment income not previously reported by reason of the method of accounting used in computing average earnings rate for 1958 and later years. See Rev. Rul. 74-190, page 162.

Section 819.—Foreign Life Insurance Companies

26 CFR 1.819-2: Foreign life insurance companies.

T.D. 7307

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

Percentage to be used by foreign life insurance companies in computing income tax for the taxable year 1973 and estimated tax for the taxable year 1974.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

To Officers and Employees of the Treasury Department and Others Concerned:

Preamble

This document contains the proclamation of the Secretary of the Treasury of a percentage to be used in determining a "minimum figure" for each foreign corporation carrying on a life insurance business, as provided for under section 819 of the Internal Revenue Code of 1954.

Where this minimum figure exceeds such a corporation's surplus held in the United States, the amount of the "policy and other contract liability requirements" (determined under section 805 without regard to section 819), and the amount of the "required interest" (determined under section 809 (a) without regard to section 819), must each be reduced by an amount determined by multiplying such excess by the "current earnings rate" (as defined in section 805 (b)(2)).

Proclamation

It is hereby determined that for purposes of computing the 1973 income tax for foreign corporations carrying on a life insurance business a percentage of 15.8 shall be used in determining the "minimum figure" under section 819.

It is presently anticipated that the date with respect to domestic life insurance companies for 1973 required for the computation of the percentage to be used by foreign corporations carrying on a life insurance business in computing their estimated tax for the taxable year 1974 will not be available in time for the filing of the

declaration of estimated tax for such taxable year. Accordingly, it is hereby determined that for purposes of computing the estimated tax for the taxable year 1974 and payment of installments thereof by such corporation a percentage of 15.8 (the percentage applicable for 1973) shall be used in determining the minimum figure under section 819. No additions to tax shall be made because of any underpayment of estimated tax for the taxable year 1974 which results solely from the use of this percentage.

Because the percentage announced in this Treasury decision is computed from information contained in the income tax returns of domestic life insurance companies for the year 1972, which are not open to public inspection, the public accordingly cannot effectively participate in the determination of such figure. Therefore, it is found that it is unnecessary to issue this Treasury decision with notice and public procedure thereon under subsection (b) of 5 U.S.C. 553 or subject to the effective date limitation of subsection (d) of that section.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 14, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 15, 1974, 39 F.R. 9945)

Part II.—Mutual Insurance Companies (Other Than Life and Certain Marine Insurance Companies and Other Than Fire or Flood Insurance Companies Which Operate on Basis of Perpetual Policies or Premium Deposits)

Section 821.—Tax on Mutual Insurance Companies to which Part II Applies

26 CFR 1.821-4: Tax on mutual insurance companies other than life insurance companies and other than fire, flood, or marine insurance companies subject to tax imposed by section 831.

Definition of "mutual insurance company other than life" for purposes of section 501(c)(15). See Rev. Rul. 74-196, page 140.

Subchapter M. Regulated Investment Companies and Real Estate Investment Trusts
Part I.—Regulated Investment Companies

Section 851.—Definition of Regulated Investment Company

26 CFR 1.851-1: Definition of regulated investment company.
(Also 1.851-5.)

Regulated investment companies; stock split as acquisition. A stock split that results in a change merely in the number of shares representing the original investment of a regulated investment company in stock of another corporation does not constitute an acquisition for purpose of section 851(d) of the Code; Rev. Rul. 63-170 distinguished.

Rev. Rul. 74-133

X, a domestic corporation, is registered with the Securities and Exchange Commission as a management, closed-end, non-diversified, investment company under the Investment Company Act of 1950, as amended (54 Stat. 789, 156 U.S.C. 80a-1 to 80b-2). Pursuant to section 851 of the Internal Revenue Code of 1954, *X* has elected and has qualified to be treated as a regulated investment company since 1970. It files its returns on a calendar year basis.

In April 1973, as a result of a 2 for 1 stock split, *X* received 2 shares of common stock of *Y*, a domestic company, for each share *X* held in *Y*. At the close of *X*'s quarter ended March 31, 1973, the value of *X*'s total assets invested in *Y*'s stock was not more than 25 percent. After the stock split, the value of *X*'s total assets invested in *Y*'s stock was 27 percent.

Section 851(b)(4)(B) of the Code sets out the requirement that at the end of each quarter of the taxable year a corporation may not have more than 25 percent of the value of its total assets invested in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer if the corporation intends to qualify as a regulated investment company.

Section 851(d) of the Code provides that a corporation which meets the requirements of section 851(b)(4) at the close of any quarter shall not lose its status as a regulated investment company because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition.

Held, since the stock split, in the instant case, results in a mere change in the number of shares representing *X*'s original investment in *Y*, it does not constitute an acquisition for purposes of section 851(d) of the Code. Furthermore, the discrepancy, as a result of the stock split, merely resulted from fluctuations in the market values of the investment. Therefore, *X* will not lose its status as a regulated investment company.

Rev. Rul. 63-170, 1963-2 C.B. 286, is distinguishable as a portion of the stock received in that case met the definition of an acquisition pursuant to section 851(d) of the Code in that such stock was received in exchange for stock of another company in an acquisitive reorganization under section 368(a)(1)(C).

Rev. Rul. 63-170 is distinguished.

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26 CFR 1.851-1: Definition of regulated investment company.

Regulated investment company investing in real estate investment trusts. The issuance of both common and preferred stock will not prevent a management company from qualifying as a regulated investment company under section 851(a) of the Code. Its investments in real estate investment trusts will be "other securities" and "stocks or securities" for purposes of section

851(b)(4)(A) and (b)(2). Capital gain dividends may be designated and paid to common shareholders and may be deducted for purposes of section 852(b)(3)(A); other dividends, including special distributions to preferred shareholders, may be deducted for purposes of section 852(b)(2)(D).

Rev. Rul. 74-177

Advice has been requested whether a taxpayer, under the circumstances described below, will qualify as a regulated investment company under subchapter M (sections 851 through 855) of the Internal Revenue Code of 1954.

The taxpayer is a domestic corporation registered with the Securities and Exchange Commission under the Investment Company Act of 1940, as a management closed-end diversified investment company. Registration is being completed for the public sale of $3x$ shares of the taxpayer's cumulative preference stock and $4x$ shares of its common stock. The preferred shares will account for three-sevenths and the common stock will provide four-sevenths of the capital to be raised.

The taxpayer's investment objective is to endeavor to secure current income sufficient to cover preferred dividends and to pay dividends on common shares and, to the extent consistent with this primary objective, to seek the long-term growth of income and capital desired by the common shareholders. A least 80 percent of its assets (exclusive of cash, cash equivalents, and Government securities) will be invested primarily in evidences of ownership or interests or participations issued by real estate investment trusts and, to a lesser extent, in convertible and non-convertible debt instruments and warrants to purchase any of the foregoing issued by real estate investment trusts. The remaining assets may be invested in securities of companies other than real estate investment trusts consistent with the primary investment objective. The taxpayer will not purchase securities (other than Government securities) of an issuer if immediately thereafter it will have more than 5 percent of its assets invested in that issuer or own more than 10 percent of the issuer's voting securities.

The preferred shares, in addition to a preference as to assets, will be entitled to fixed quarterly cumulative dividends, payable out of net investment income. Capital gains will be expressly excluded from the definition of net investment income. Common shares will have dividend rights to net investment income only if there is no arrearage on the preferred shares and if, after payment of any dividend on the common shares there is a 200 percent asset coverage, as defined in Section 18 of the Investment Company Act of 1940, of the preferred shares.

Special distributions will be paid on a pro rata basis to preference shareholders to the extent necessary to assure continued qualification under the Code by complying with the requirement that 90 percent of the net investment income must be distributed when, because of the 200 percent asset coverage restriction, distributions cannot be made to the common shareholders. Any net short-term capital gain will be distributed annually to the common shareholders, subject to the prior rights of the preference shares. Long-term capital gains will inure to the benefit of common shareholders.

Section 851(a) of the Code states the general rule that a corporation must be registered at all times during the taxable year under the Investment Company Act of 1940 as a management company or a unit investment trust if it attempts to qualify as a regulated investment company. Section 851(b)(2) requires a regulated investment company to derive at least 90 percent of its gross income from dividends, interest, and gains from the sale or other disposition of stock or securities. Section 851(b)(4)(A) states the general rule that at the close of each quarter of the taxable year at least 50 percent of the value of the company's total assets must be represented by cash and cash items, Government securities, securities of other regulated investment companies and other securities limited to an amount not greater in value than 5 percent of the value of the company's total assets and to not more than 10 percent of the issuer's outstanding voting securities. Section 851(c)(5) provides, in effect, that the term "securities" as used in section 851(b)(4) shall have the same meaning as when used in the Investment Company Act of 1940.

The Chief Counsel to the Division of Corporate Regulation (now Division of Investment Company Regulation), Securities and Exchange Commission, furnished an opinion to the Internal Revenue Service that evidences of ownership or interests or participations, convertible and nonconvertible debt instruments, and warrants to purchase any of the foregoing issued by real estate investment trusts are "securities" within the meaning of section 2(a)(36) of the Investment Company Act of 1940.

Section 852(b)(2)(D) of the Code provides that in computing investment company taxable income there shall be allowed a deduction for dividends paid (as defined in section 561) computed without regard to capital gains dividends.

Section 852(b)(3)(A) of the Code permits a reduction for dividends paid, determined with reference to capital gains, in determining the tax to be imposed on the excess, if any, of the net long-term capital gain over the net short-term capital loss for each taxable year. Section 852(b)(3)(C) defines a capital gain dividend as any dividend or part thereof which is designated by the paying company as a capital gain dividend in a written notice to its shareholders not later than 45 days after the close of its

taxable year, and provides that the amount designated as a capital gain dividend should not exceed the excess of the net long-term capital gain over the net short-term capital loss.

Section 562(c) of the Code provides that the amount of any distribution shall not be considered as a dividend for purposes of computing the dividends paid deduction, unless such distribution is pro rata with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

Section 854(b)(1) of the Code provides that in the event that the aggregate dividends received by a regulated investment company are less than 75 percent of its specially defined gross income, then a proportional reduction rule becomes operative which limits the amount of the investment company's ordinary income dividends which is eligible for the dividends received exclusion for individuals under section 116 and the deduction under section 243 for dividends received by corporations. Section 854(b)(3)(B) provides that the term "aggregate dividends received" includes only dividends received from domestic corporations other than from certain specified types. One of the specified types is the real estate investment trust.

The capital structure of a regulated investment company is subject to such requirements of the Securities and Exchange Commission as are necessary for registration under the Investment Company Act of 1940 and that of section 562(c) of the Code which prohibits "preferential dividends." The proposed investments by the taxpayer in real estate investment trusts will be, for purposes of the limitations of section 851(b) "other securities" or "stock or securities." Designating the common shareholders as the only class of shareholders entitled to capital gains dividends does not necessarily constitute a preferential dividend arrangement within the meaning of section 562(c). Finally, payment of special distributions to preferred shareholders under the outlined circumstances will be considered dividends to which such shareholders are entitled without a waiver of rights by the common shareholders.

Accordingly, it is held, based on the foregoing facts, that (1) the taxpayer's issuance of two classes of stock, preferred and common, will not in and of itself prevent it from qualifying as a regulated investment company under section 851(a) of the Code; (2) evidences of ownership or interests or participations, convertible and non-convertible debt instruments and warrants to purchase any of the foregoing issued by real estate investment trusts acquired by the taxpayer will be "other securities" for purposes of section 851(b)(4)(A) and "stock or securities" for purposes of section 851(b)(2); (3) the taxpayer may designate the excess of its net long-term capital gain over the net short-term capital loss as capital gains dividends to its common shareholders and deduct such amount so designated and paid in computing its dividend paid deduction determined with reference to capital gains for purposes of section 852(b)(3)(A); and (4) the taxpayer will be entitled to include dividends (other than capital gains dividends) paid on either the preferred shares or the common shares, including any special distributions paid on the preferred shares, in computing the deduction for dividends paid in arriving at investment company taxable income for purposes of section 852(b)(2)(D).

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26 CFR 1.851-2: Limitations.
(Also Sections 61, 854; 1.61-1, 1.854-1.)

Regulated investment company; litigation settlement. The amount received by a regulated investment company in settlement of litigation against a predecessor's investment advisor is includible in the company's gross income and, even though it exceeds ten percent of the company's gross income for the taxable year, will not cause the company to lose its status as a regulated investment company. For purposes of section 854(b) of the Code, the settlement amount should be allocated in the same proportion as interest and dividends derived during the year of settlement.

Rev. Rul. 74-248

Advice has been requested whether, under the circumstances described below, receipt of a sum of money in settlement of litigation will cause a corporation to lose its status as a regulated investment company as defined in section 851 of the Internal Revenue Code of 1954.

X corporation was formed in 1970 for the purpose of acquiring, by merger, the assets of *Y* corporation. *Y*, during its existence, was registered with the Securities and Exchange Commission (SEC) as an open-end investment company under the Investment Company Act of 1940, and elected to be taxed as a regulated investment company under subchapter M (sections 851-855) of the Code. *X* is registered with the SEC as an open-end investment company and has elected to be taxed as a regulated investment company. In approving the merger, the shareholders of *Y*, having received shares of *X* in exchange for their shares in *Y*, agreed to the appointment of a new investment advisor.

Subsequent to the merger, a shareholder's derivative lawsuit was filed against *Z* corporation, *Y*'s former investment advisor, in which it was alleged that *Z* received compensation in exchange for arranging the merger and approval of a successor investment

advisor. The shareholders contended that the transactions involved a sale by *Z* of its advisory office, in breach of its fiduciary duty to *Y*. They demanded that *Z* account to *Y* for the profits it realized from the transactions. In 1972, pursuant to an agreement by the parties to the action, *X* received a specified amount in total settlement of the litigation. The amount received in settlement of the litigation exceeded ten percent of *X*'s gross income for its taxable year 1972.

In Rev. Rul. 64-247, 1964-2 C.B. 179, the taxpayer brought a legal action against certain of its former officers and directors to recover excess management fees paid to a corporation owned by the former officers and directors. The amounts recovered as a result of this litigation exceeded ten percent of the taxpayer's gross income for its taxable year.

Rev. Rul. 64-247 held that the amounts recovered are includible in the taxpayer's gross income; however, the inclusion of such amounts in its gross income will not cause the taxpayer to fail to meet the definition of a regulated investment company contained in section 851 of the Code, provided that in all other respects the taxpayer qualifies for the regulated investment company status for its taxable year.

Rev. Rul. 64-247 also provides that for purposes of section 854 of the Code, relating to limitations applicable to dividends received from regulated investment companies, the amounts recovered by the taxpayer should be allocated between interest and dividends in proportion to the interest and dividends derived by the taxpayer during the taxable year of the recovery.

Accordingly, although the amount received in settlement of the litigation is ordinary income (see Rev. Rul. 74-251) includible in *X*'s gross income under section 61 of the Code, the inclusion of such amount in its gross income will not cause *X* to fail to meet the definition of a regulated investment company contained in section 851, provided that in all other respects *X* qualifies for regulated investment company status for its taxable year 1972.

For purposes of section 854(b) of the Code, relating to limitations applicable to dividends received from regulated investment companies, the settlement sum received by *X* should be allocated between interest and dividends in proportion to the interest and dividends derived by *X* during the taxable year the settlement sum is included in gross income.

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26 CFR 1.851-5: Examples.

Whether the example meets the provisions of section 851 of the Internal Revenue Code of 1954. See Rev. Rul. 74-133, page 165.

Section 854.—Limitations Applicable to Dividends Received from Regulated Investment Company

26 CFR 1.854-1: Limitations applicable to dividends received from regulated investment company.

Receipt of a sum of money in settlement of litigation by a regulated investment company. See Rev. Rul. 74-248, page 167.

Part II.—Real Estate Investment Trusts

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856-1: Definition of real estate investment trust.

Includibility in gross income of good-faith deposits. See Rev. Rul. 74-130, page 111.

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26 CFR 1.856-2: Limitations.

Real estate investment trust; "loan funding" fee. A "loan funding" fee received by a real estate investment trust in return for the trust's commitment to advance construction funds over a specified period of time at a specified rate of interest does not qualify as interest for purposes of section 856(c) of the Code.

Rev. Rul. 74-258

Advice has been requested whether, under the circumstances described below, a "loan funding" fee received by a real estate investment trust qualifies as interest within the meaning of section 856(c) of the Internal Revenue Code of 1954.

A real estate investment trust invests in construction loans. Under an agreement between the trust and a borrower, the trust agreed to advance funds to the borrower at a stated rate of interest as required by the borrower during the construction period. In return for the trust's commitment to advance funds over the construction period, the agreement required the borrower to pay the trust a "loan funding" fee equal to one percent per annum of the principal amount of the loan computed for the period from the date of the trust's first advancement of funds to the date the construction was required to be completed. The fee was paid in cash at the time the agreement was entered into. Interest at the stated annual interest rate of eight percent accrued from the time of and on the amount of each advance the trust made to the borrower.

Section 856(c) of the Code provides, in part, that for a trust to qualify as a real estate investment trust for Federal income tax purposes, certain percentages of its gross income must be derived from specified sources, including interest.

Section 1.856-2(c)(2)(ii) of the Income Tax Regulations provides, in part, that fees imposed upon borrowers that are in fact a charge for services in addition to the charge for the use of borrowed money, are not includible as interest.

For income tax purposes, interest has been defined by the Supreme Court of the United States as the amount one has contracted to pay for

the use of borrowed money and as the compensation paid for the use or forbearance of money. See *Old Colony Railroad Co. v. Commissioner,* 284 U.S. 552 (1932). XI-1 C.B. 274 (1932), and *Deputy v. Dupont,* 308 U.S. 488 (1940), 1940-1 C.B. 118.

Rev. Rul. 56-136, 1956-1 C.B. 92, provides, in part, that commitment fees or standby charges paid or incurred by a taxpayer for the purpose of insuring the availability of construction funds at a fixed rate of interest, at a future date or dates, are business expenses deductible under section 162 of the Code. That Revenue Ruling also holds that such fees are not interest charges, since they are not paid on an indebtedness, and that these fees are not expenses amortizable over the life of any debt instrument, since they are expenses applicable to the standby period prior to the issuance of a debt instrument. The rationale underlying this Revenue Ruling is that standby fees are paid or incurred in consideration of the lender's commitment to lend construction funds rather than in consideration of the borrower's use of the funds.

Rev. Rul. 70-540, 1970-2 C.B. 101, discusses "points," "commitment fees," and "service fees" charged by lending institutions in connection with real estate mortgage loans. Situation (3) of that Revenue Ruling holds that, where a borrower paid a commitment fee in consideration for a lender's agreement to make a mortgage loan at a specified date and at a specified rate of interest, the commitment fee is a charge for agreeing to make funds available to the borrower rather than for the use or forbearance of money and, therefore, is not interest. See also, Rev. Rul. 70-362, 1970-2 C.B. 147, which holds that fees earned by a real estate investment trust as consideration for the issuance of commitments to make permanent loans upon the maturity of construction loans do not qualify as interest under section 856(c) of the Code.

In the instant case the fee was not paid to the trust in consideration of the use of funds. Rather, it was paid in return for the trust's commitment to advance funds over a specified perior of time and at a specified rate of interest.

Accordingly, it is held that the fee received by the trust in the instant case does not qualify as interest within the meaning of section 856(c) of the Code and section 1.856-2(c)(2)(ii) of the regulations.

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26 CFR 1.856-2: Limitations.

FHLMC participation certificates owned by real estate investment trust. A real estate investment trust owning participation certificates issued by the Federal Home Loan Mortgage Corporation is considered as owning "real estate assets" within the meaning of section 856(c)(5)(A) of the Code and the interest income from such certificates is "interest on obligations secured by mortgages on real property" under section 856(c)(3)(B); Rev. Rul. 71-399 amplified.

Rev. Rul. 74-300

Advice has been requested whether the conclusions of Rev. Rul. 70-544, 1970-2 C.B. 6, and Rev. Rul. 70-545, 1970-2 C.B. 7, concerning mortgage-backed certificates guaranteed by the Government National Mortgage Association (GNMA) that are purchased by a real estate investment trust are also applicable to the participation certificates issued by the Federal Home Loan Mortgage Corporation (FHLMC) that are purchased by a real estate investment trust.

Rev. Rul. 70-544 and Rev. Rul. 70-545 hold, in part, that interest income from mortgage participation certificates guaranteed by the GNMA is interest on obligations secured by mortgages on real property under section 856(c)(3)(B) of the Internal Revenue Code of 1954, and that such certificates qualify as "real estate assets" within the meaning of section 856(c)(5)(A).

Rev. Rul. 71-399, 1971-2 C.B. 433, as amplified by Rev. Rul. 72-376, 1972-2 C.B. 647, and Rev. Rul. 74-221, page 365, sets forth the tax consequences of the purchase of mortgage participation certificates by the FHLMC and the sale of corresponding certificates to other savings and loan associations and exempt employees' trusts. Rev. Rul. 71-399 holds, in part, that FHLMC is a fiduciary and the sale of a certificate transfers equitable ownership in the underlying mortgages to the purchaser of the certificate. However, neither Rev. Rul. 71-399, Rev. Rul. 72-376, nor Rev. Rul. 74-221, set forth the tax consequences where a real estate investment trust owns such certificates.

In the case of both the FHLMC and the GNMA participating certificates, processing is commenced by an insured savings and loan association which assembles a "list" or "pool" of mortgages which are both "loans secured by an interest in real property" within the meaning of section 7701(a)(19)(C)(v) of the Code and "qualifying real property loans" within the meaning of section 593(e).

FHLMC purchases mortgage participation certificates representing fractional undivided interests aggregating 85 percent in each mortgage contained on the list of residential real estate mortgages prepared by the originating savings and loan association. For each such mortgage participation certificate purchased from the originating savings and loan association, FHLMC issues a corresponding certificate bearing its guarantee of principal and interest payment by the mortgagor and sells these corresponding certificates at par to other savings and loan associations, exempt employees' pension and profit sharing trusts, and real estate investment trusts.

GNMA does not purchase participations but instead issues to the origi-

nating savings and loan association, or other eligible mortgage institution a commitment to guarantee certificates representing an undivided interest in the pool of mortgages to be established by the originating savings and loan association. Based on this commitment the originating savings and loan association places the pool of mortgages with a commercial bank acting as custodian and then arranges for the sale of "pass-through" certificates backed by the mortgage pool in minimum denominations of $25,000 to other savings and loan associations, real estate investment trusts, exempt employees' pension and profit sharing trusts, and individuals. In the case of "straight pass-through" certificates, GNMA guarantees to the certificates holders only the proper performance of the mortgage servicing and the payment only of that interest and principal actually collected or collectable through due diligence by the originating association. In the case of "modified pass-through" certificates, GNMA guarantees the timely payment of principal and interest, whether or not collected by the originating association.

Based on the foregoing facts the conclusions of Rev. Rul. 70-544 and Rev. Rul. 70-545, as applied to the GNMA certificates owned by a real estate investment trust, also apply to FHLMC certificates owned by a real estate investment trust. Accordingly, the interest income on such certificates is considered "interest on obligations secured by mortgages on real property or on interests in real property" within the meaning of section 856(c)(3)(B) of the Code, and a real estate investment trust which owns participation certificates is considered as owning "real estate assets" within the meaning of section 856(c)(5)(A).

Rev. Rul. 71-399, as amplified by Rev. Rul. 72-376 and Rev. Rul. 74-221, is further amplified.

26 CFR 1.856-3: Definitions.

Real estate investment trust; property interests outside U.S. Foreign real estate acquired by a real estate investment trust with foreign funds is "real property" and security interests in foreign real property that are legally equivalent to mortgages or deeds of trust in the U.S. are "mortgages on real property" for purposes of section 856(c) of the Code.

Rev. Rul. 74-191

Advice has been requested whether, for purposes of section 856(c) of the Internal Revenue Code of 1954, the terms "real property" and "mortgages on real property" include real property and mortgages on real property located outside the United States.

An unincorporated domestic trust, otherwise qualifying as a real estate investment trust under section 856 of the Code, uses foreign funds to invest in foreign real estate. The trust makes short term construction loans secured by security interests in real property located outside the United States. Such security interests are legally equivalent to those created by mortgages or deeds of trust in the United States. The trust also has direct interests in real estate located abroad.

Section 856(c)(6)(B) of the Code provides, in part, that the term "real estate assets" means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other qualified real estate investment trusts.

Section 1.856-3(d) of the Income Tax Regulations provides, in part, that the term "real property" means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). In addition, the term "real property" includes interests in real property. Local definitions will not be controlling for purposes of determining the meaning of the term "real property" as used in section 856 of the Code and the regulations thereunder.

Section 1.856-3(b) of the regulations provides, in part, that the term "mortgages on real property" includes deeds of trust on real property.

Neither section 856 of the Code nor the regulations thereunder restrict the term "real estate assets" to those located within the United States. Accordingly, it is held that, for purposes of section 856(c), the term "real property" includes land or improvements thereon located outside the United States and the term "mortgages on real property" includes a security interest which, under the laws of the jurisdiction in which the property is located, is the legal equivalent of a mortgage or deed of trust in the United States.

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26 CFR 1.856-4: Rents from real property.

Real estate investment trust; rent as percentage of gross sales. Rents received by a real estate investment trust based on a percentage of a tenant's gross sales, but excluding from gross sales returns of merchandise, exchange of merchandise between stores of the tenant, sales of used fixtures, and sales and excise taxes, qualify as "rents from real property" within the meaning of section 856(d) of the Code.

Rev. Rul. 74-134

Advice has been requested whether, under the circumstances described below, amounts received by a real estate investment trust are based on a fixed percentage of a tenant's sales and therefore qualify as rents from real property within the meaning of section 856(d) of the Internal Revenue Code of 1954.

An unincorporated trust, otherwise qualifying as a real estate investment trust under section 856 of the Code,

leased space to a tenant in a building that it owns. The lease agreement provided for a rental based on a fixed percentage of the tenant's gross sales, but excluded from gross sales the following:

(1) returns and refunds in fact made by the tenant,

(2) exchange of merchandise between stores of the tenant where such exchanges are made solely for the convenient operation of the tenant's business and not for the purpose of consummating a sale which has theretofore been made.

(3) sales of fixtures after substantial use thereof in the conduct of the tenant's business on the premises, and

(4) the amount of any city, county, state, or Federal sales or excise taxes on such sales which is both added to the selling price (or absorbed therein) and paid to the taxing authority by the tenant.

Section 856(d)(1) of the Code provides that the term "rents from real property" does not include any amount received or accrued, directly or indirectly, with respect to any real property, if the deterrmination of such amount depends in whole or in part on the income or profits derived by any person from such property (except that any amount so received or accrued shall not be excluded from the term "rents from real property" solely by reason of being based on a fixed percentage or percentages of receipts or sales). Section 1.856-4(b)(1) of the Income Tax Regulations permits such receipts or sales to be adjusted for returned merchandise, or Federal, State or local sales taxes.

Accordingly, in the instant case, it is held that the amounts received by the trust from its tenant are based on a fixed percentage of the tenant's sales and therefore qualify as "rents from real property" within the meaning of section 856(d) of the Code and section 1.856-4(b)(1) of the regulations.

26 CFR 1.856-4: Rents from real property.

Rev. Rul. 74-198

An unincorporated trust that otherwise qualifies as a real estate investment trust as defined in section 856 of the Internal Revenue Code of 1954 entered into leases with tenants of a shopping center owned by the trust. The leases provide for an annual fixed rental payable in equal monthly installments. However, in addition to the fixed rent, each tenant is required to pay percentage rentals equal to an amount, if any, by which a certain fixed percentage of his gross sales for each lease-quarter-year exceeds his monthly installments of the fixed rental for such lease-quarter-year.

Held, the rental payments received by the trust under the above circumstances qualify for treatment as "rents from real property" as defined in section 856(d) of the Code.

Section 857.—Taxation of Real Estate Investment Trusts and Their Beneficiaries

26 CFR 1.857-1: Taxation of real estate investment trusts.

Real estate investment trust; taxable income increased by accounting method change. The portion of the net adjustment required to be included in a real estate investment trust's taxable income for the taxable year in which it changes its method of accounting is "real estate investment trust taxable income" within the meaning of section 857(b) of the Code; Rev. Rul. 64-330 modified.

Rev. Rul. 74-192

Advice has been requested whether all or part of the net adjustment is included in "real estate investment trust taxable income" within the meaning of section 857(b) of the Internal Revenue Code of 1954 for the taxable year in which a real estate investment trust changes from the cash to the accrual method of accounting.

A real estate investment trust filed the proper application and received permission to change its method of accounting, for Federal income tax purposes, from the cash receipts and disbursements method to the accrual method. As a condition to the change the trust is required to include in its taxable income one-tenth of the net adjustment required under section 481(a) of the Code for each taxable year over a ten-year period beginning with the year of the change.

Section 857(b) of the Code provides that, for purposes of sections 856 through 858, the term "real estate investment trust taxable income" means the taxable income of the real estate investment trust with certain adjustments not here applicable.

Rev. Rul. 64-330, 1964-2 C.B. 183, concludes that where the taxable income of a real estate investment trust has been increased as a result of the trust changing from the cash to the accrual method of accounting, the increase constitutes "real estate investment trust taxable income."

Accordingly, it is held that only that portion of the net adjustment that is required to be included in the trust's taxable income for the taxable year in which it changes its method of accounting is "real estate investment trust taxable income" within the meaning of section 857(b) of the Code for the taxable year of the change. The remainder of the net adjustment will be included in "real estate investment trust taxable income" ratably over the following nine years.

Rev. Rul. 64-330 is modified to the extent that it indicates that the amount of the adjustment required under section 481(a) of the Code that is not includible in taxable income for the taxable year in which a taxpayer changes its method of accounting is "real estate investment trust taxable income" for the year of the change.

Subchapter N. Tax Based on Income From Sources Within or Without the United States
Part I.—Determination of Sources of Income

Section 861.—Income from Sources within the United States

26 CFR 1.861-2: Interest.

T.D. 7314 [1]

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

Treatment of interest on a section 4912(c) debt obligation

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

By a notice of proposed rule making appearing in the Federal Register for October 12, 1973 (38 F.R. 28295), amendments to the Income Tax Regulations (26 CFR Part 1) were proposed in order to conform such regulations to subparagraph (G) of section 861(a)(1) of the Internal Revenue Code of 1954, relating to the treatment of interest on a section 4912(c) debt obligation, as added by section 3(a) of the Interest Equalization Tax Extension Act of 1971 (85 Stat. 15) [Pub. L. 92-9, 1971-1 C.B. 554].

Section 861(a)(1)(G) of the Internal Revenue Code was enacted in conjunction with section 4912(c) of the Code which provides, in effect, that a domestic corporation or partnership may elect to have certain debt obligations it issued subject to the interest equalization tax. Section 861(a)(1)(G) provides that interest paid by the issuing company or partnership on certain debt obligations with respect to which it has made a section 4912(c) election shall not be treated as U.S. source income. This has the effect of exempting such interest from the 30-percent U.S. withholding tax when it is paid to a nonresident alien individual or a foreign corporation.

The amendment to the regulations enumerates the conditions which must be met before the interest on certain debt obligations would not be treated as U.S. source income. The debt obligation must be part of an issue of debt obligations with respect to which an election has been made under section 4912(c). Such a debt obligation cannot have a maturity exceeding 15 years on the date it was originally issued or treated under section 4912(c)(2) as issued by reason of being assumed. When such debt obligation was originally issued it must have been purchased by one or more underwriters with a view to distribution through resale. If the preceding conditions are met, interest on a debt obligation attributable to periods after the effective date of the section 4912(c) election will not be treated as U.S. source income.

Based upon comments received from interested parties, certain changes were made to the regulations as originally proposed. The first such change occurs in § 1.861-2(d)(3) where additional language was added in order to illustrate that a "best-efforts" underwriter is not regarded as someone who purchased with an intent to resell. In addition, language was added to indicate that nothing in the regulations would prohibit the use by an issuer of a related underwriter. Since each instance where an issuer uses a related underwriter is to be decided on the individual facts and circumstances, the regulations provide that consideration shall be given as to whether the conditions governing the purchase of the debt obligation by the underwriter from the issuer are those which would have been imposed between independent persons.

Subdivision (ii) of § 1.861-2(d)(4) was amended by extending the time an underwriter has to register the debt obligations for trading on a foreign securities exchange or market from 15 calendar days to the latter of 4 months from the date on which the underwriter purchased the debt obligations or the date of the first interest payment. Additional language was also added for the purpose of defining what was meant by the term "foreign established securities market".

Language was added to the introductory language of § 1.861-2(d)(4)(iii) to clarify the point that in evaluating restrictions as to whom an underwriter may sell debt obligations, the material factor is whether such restriction was imposed by the issuer; if so, the restriction will prevent the debt obligations from qualifying under section 861(a)(1)(G) and these regulations. Subdivision (A) of § 1.861-2(d)(4)(iii) was changed to permit each obligation of an issue of debt obligations to qualify as purchased for resale if at least 95 percent of the face amount of the issue, of which it is a part, was sold by the underwriter within 30 days after he purchased it. Language was also added to subdivision (B) to make it clear that any written statements or assurances of the underwriter are to be taken into account under the facts and circumstances test to determine whether the debt obligation was purchased with a view to distribution through resale. The burden of showing satisfaction of that test was also removed from the exclusive realm of the underwriter.

In addition, subdivision (iv) was amended to deal with the situation where restrictions are required to be met in order to comply with United States or foreign law. One such example is the exemption from the Securities and Exchange Commission regis-

[1] This publication of the Treasury Decision contains the full text of the regulations. The individual instructions for modifying the notice of proposed rulemaking have been omitted.

tration requirements for securities which are not sold to United States persons or to persons who will resell to United States persons.

The proposed regulations were also revised by adding two new subparagraphs. The first, new subparagraph (6), provides that the provisions of section 861(a)(1)(G) and these regulations will apply to interest paid on debt obligations, even if the interest equalization tax expires, if such debt obligations are subject to a section 4912(c) election made prior to such expiration. The second, new subparagraph (7), adds a definition of the term "underwriter" by cross referencing to the definition of the term in section 4919(c)(1).

Adoption of amendments to the regulations

On October 12, 1973, a notice of proposed rule making was published in the Federal Register (38 F.R. 28295) to conform the Income Tax Regulations (26 CFR Part 1) to subparagraph (G) of section 861 (a)(1) of the Internal Revenue Code of 1954, relating to the treatment of interest on a section 4912(c) debt obligation, as added by section 3(a) of the Interest Equalization Tax Extension Act of 1971 (85 Stat. 15). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted.

Section 1.861-2(d) is amended to read as follows:

§ 1.861-2 Interest.

* * * * *

(d) *Section 4912(c) debt obligations*—(1) *In general.* Under section 861(a)(1)(G), interest on a debt obligation shall not be treated as income from sources within the United States if—

(i) The debt obligation was part of an issue of debt obligations with respect to which an election has been made under section 4912(c) (relating to the treatment of such debt obligations as debt obligations of a foreign obligor for purposes of the interest equalization tax),

(ii) The debt obligation had a maturity not exceeding 15 years (within the meaning of subparagraph (2) of this paragraph) on the date it (A) is originally issued, or (B) is treated under section 4912(c)(2) as issued by reason of being assumed by a certain domestic corporation,

(iii) The debt obligation, when originally issued, was purchased by one or more underwriters (within the meaning of subparagraph (3) of this paragraph) with a view to distribution through resale (within the meaning of subparagraph (4) of this paragraph), and

(iv) The interest on the debt obligation is attributable to periods after the effective date of an election under section 4912(c) to treat such debt obligations as debt obligations of a foreign obligor for purposes of the interest equalization tax.

(2) *Maturity not exceeding 15 years.* The date the debt obligation is issued or treated as issued is not included in the 15 year computation, while the date of maturity of the debt obligation is included in such computation.

(3) *Purchased by one or more underwriters.* For purposes of this paragraph, the debt obligation when originally issued will not be treated as purchased by one or more underwriters unless the underwriter purchases the debt obligation for his own account and bears the risk of gain or loss on resale. Thus, for example, a debt obligation when originally issued will not be treated as purchased by one or more underwriters if the underwriter acts only in the capacity of an agent of the issuer. Neither will a debt obligation when originally issued be treated as purchased by one or more underwriters if the agreement between the underwriter and issuer is merely for a "best efforts" underwriting, for the purchase by the underwriter of all or a portion of the debt obligations remaining unsold at the expiration of a fixed period of time, or for any other arrangement under the terms of which the debt obligations are not purchased by the underwriter with a view to distribution through resale. The fact that an underwriter is related to the issuer will not prevent the underwriter from meeting the requirements of this paragraph. In determining whether a related underwriter meets the requirements of this paragraph, consideration shall be given to whether the purchase by the underwriter of the debt obligation from the issuer for resale was effected by a transaction subject to conditions similar to those which would have been imposed between independent persons.

(4) *With a view to distribution through resale.* (i) An underwriter who purchased a debt obligation shall be deemed to have purchased it with a view to distribution through resale if the requirements of subdivision (ii) or (iii) of this subparagraph are met.

(ii) The requirement of this subdivision is that—

(A) The debt obligation is registered, approved, or listed for trading in one or more foreign securities exchanges or foreign established securities markets within 4 months after the date on which the underwriter purchases the debt obligation, or by the date of the first interest payment on the debt obligation, whichever is later, or

(B) The debt obligation, or any substantial portion of the issue of which the debt obligation is a part, is actually traded on one or more foreign securities exchanges or foreign established securities markets on or within 15 calendar days after the date on which the underwriter purchases the debt obligation.

For purposes of this subparagraph, a foreign established securities market

includes any foreign over-the-counter market as reflected by the existence of an inter-dealer quotation system for regularly disseminating to brokers and dealers quotations of obligations by identified brokers or dealers, other than quotations prepared and distributed by a broker or dealer in the regular course of his business and containing only quotations of such broker or dealer.

(iii) The requirements of this subdivision are that, except as provided in subdivision (iv) of this subparagraph, the underwriter is under no written or implied restriction imposed by the issuer with respect to whom he may resell the debt obligation, and either—

(A) Within 30 calendar days after he purchased the debt obligation the underwriter or underwriters either (*1*) sold it, or (*2*) sold at least 95 percent of the face amount of the issue of which the debt obligation is a part, or

(B) (*1*) The debt obligation is evidenced by an instrument which, under the laws of the jurisdiction in which it is issued, is either negotiable or transferable by assignment (whether or not it is registered for trading), and (*2*) it appears from all the relevant facts and circumstances, including any written statements or assurances made by the purchasing underwriter or underwriters, that such debt obligation was purchased with a view to distribution through resale.

(iv) The requirements of subdivision (iii) of this subparagraph may be met whether or not the underwriter is restricted from reselling the debt obligation—

(A) To a United States person (as defined in section 7701(a)(30)) or

(B) To any particular person or persons, pursuant to a restriction imposed by, or required to be met in order to comply with, United States or foreign securities or other law.

(5) *Statement with return.* Any taxpayer who is required to file a tax return, and who excludes from gross income interest of the type specified in this paragraph must comply with the requirements of § 1.861-2(c).

(6) *Effect of termination of IET.* If the interest equalization tax expires, the provisions of section 861(a)(1)(G) and this paragraph shall apply to interest paid on debt obligations only with respect to which a section 4912(c) election was made.

(7) *Definition of term "underwriter."* For purposes of section 861(a)(1)(G) and this paragraph, the term "underwriter" shall mean any underwriter as defined in section 4919(c)(1).

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved May 17, 1974.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 22, 1974, 8:45 a.m., and published in the issue of the Federal Register for May 23, 1974, 39 F.R. 18073.)

Section 863.—Items Not Specified in Section 861 or 862

26 CFR 1.863-1: Allocation of gross income under section 863(a).

Whether sign on fees paid to a nonresident alien are to be allocated as income from sources within and sources without the United States. See Rev. Rul. 74-108, page 248.

26 CFR 1.863-2: Income derived partly from sources within and partly from sources without the United States.

Whether a sign on fee paid to a nonresident alien is income partly from sources within and partly from sources without the United States. See Rev. Rul. 74-108, page 248.

Section 864.—Definitions

26 CFR 1.864-2: Trade or business within the United States.

Whether dividends from sources within the United States received by a nonresident alien individual, a Swiss resident engaged in trade or business in the United States, are treated as effectively connected with the conduct of his trade or business in the United States and whether such alien's foreign source income that is effectively connected with the conduct of his trade or business within the United States is exempt from United States tax under the United States-Swiss Confederation Income Tax Convention. See Rev. Rul. 74-63, page 374.

Part II.—Nonresident Aliens and Foreign Corporations
Subpart A.—Nonresident Alien Individuals

Section 871.—Tax on Nonresident Alien Individuals

26 CFR 1.871-1: Taxation of aliens.

Whether amounts attributable to original issue discount and premium payable by reason of redemption prior to maturity, paid by a domestic corporation on its debentures, constitutes interest for purposes of Article VIII(1) of the United States-Netherlands Income Tax Convention. See Rev. Rul. 74-172, page 178.

26 CFR 1.871-7: Tax on nonresident alien individuals.

Whether dividends from sources within the United States received by a nonresident alien individual, a Swiss resident engaged in trade or business in the United States, are treated as effectively connected with the conduct of his trade or business in the United States and whether such alien's foreign source income that is effectively connected with the conduct of his trade or business within the United States is exempt from United States tax under the United States-Swiss Confederation Income Tax Convention. See Rev. Rul. 74-63, page 374.

Section 872.—Gross Income

26 CFR 1.872-2: Exclusions from gross income of nonresident alien individuals.

Whether "earnings derived from the operation of a ship or ships" are excluded from gross income under certain situations. See Rev. Rul. 74-170, page 175.

Subpart B.—Foreign Corporations

Section 881.—Tax on Income of Foreign Corporations not connected with United States Business

26 CFR 1.881-1: Taxation of foreign corporations.

Whether dividends paid to a Swiss corporation, under the circumstances described, will be subject to withholding and taxed at the rate of five percent. See Rev. Rul. 74-171, page 178.

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26 CFR 1.881-1: Taxation of foreign corporations.

Whether amounts attributable to original issue discount and premium payable by reason of redemption prior to maturity, paid by a domestic corporation on its debentures, constitutes interest for purposes of Article VIII(1) of the United States-Netherlands Income Tax Convention. See Rev. Rul. 74-172, page 178.

Section 883.—Exclusions from Gross Income

26 CFR 1.883-1: Exclusions from gross income of foreign corporations.
(Also Section 872; 1.872-2.)

Foreign corporations; shipping business. A foreign corporation's income from leasing its ships under time or voyage charters, and the income of a foreign charterer from the operation of ships under time, voyage, or bareboat charters, qualify for exemption as earnings from the operation of ships within the meaning of section 883 of the Code, provided the foreign registry and equivalent exemption requirements are met. However, the income of an owner from leasing a ship under a bareboat charter is not exempt unless the shipowner is regularly engaged in the shipping business and the lease is merely an incidental activity.

Rev. Rul. 74-170

Advice has been requested whether the earnings of a foreign corporation in the situations described below are "earnings derived from the operation of a ship or ships" within the meaning of the exemption provisions of section 883 of the Internal Revenue Code of 1954.

Situation (1). *X*, a foreign corporation, is actively engaged within the United States in the leasing of bareboat charter vessels to others. During the taxable year it accrues income with respect to such leases. The foreign registry and equivalent exemption requirements of section 883 of the Code are met.

Situation (2). *Y*, a foreign corporation, is actively engaged within the United States in the leasing of time charter and voyage charter vessels to others. During the taxable year it accrues income with respect to such leases. The foreign registry and equivalent exemption requirements of section 883 of the Code are met.

Situation (3). *S*, a time charterer of vessels, was incorporated in a foreign country by stockholders of a domestic corporation *R*. *R* is regularly engaged in business as a freight forwarder on behalf of a foreign government. During the taxable year *R* entered into a contract with *S* for the shipment by *S* of cargo purchased by the foreign government from the United States government. An unrelated domestic corporation acting as agent for *S* time chartered vessels for the actual shipment of the cargo. The foreign registry and equivalent exemptions requirements of section 883 of the Code are met.

Situation (4). The facts are the same as in *Situation (3)* except *S* is a bareboat charterer of vessels.

A bareboat charter is a contract for the use of a vessel whereby the charterer performs functions normally performed by the owner of the vessel such as furnishing of the crew and supplies and the charterer is in complete possession, control, and command of the vessel. The owner of the vessel bears none of the expense or responsibility of operation of the vessel.

A time charter is a contract for the use of space in a vessel for a specified period of time. Under such charter the owner of the vessel remains in control over the navigation and management of the ship, paying and being responsible for the crew, supplies, repairs and maintenance, provisions, insurance, fees, etc. The time charterer, on the other hand, is in control of where the vessel is to go, with what it is to be loaded, and is subject to charges for fuel, port charges, commissions, and expenses connected with the cargo.

A voyage charter is similar to a time charter except that the vessel is chartered for a specified voyage instead of a specified period of time.

Section 883(a)(1) of the Code excludes from Federal income tax the income of a foreign corporation from sources within the United States that is derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

Section 1.883-1(a)(2) of the Income Tax Regulations provides that a foreign country which either imposes no income tax, or in imposing that tax, exempts from taxation so much of the income of a citizen of the United States nonresident in that foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States is considered as granting an equivalent exemption for purposes of the exclusion from gross income of the earnings of a foreign ship or ships.

The term "earnings derived from the operation of a ship or ships" was not defined when the provision was initially enacted. The provision comparable to section 883 of the Code was first enacted by the Revenue Act of 1921 as section 213(b)(8). The Report by the Committee on Finance, S. Rep. No. 275, 67th Cong., 1st Sess. 14 (1921) 1939-1 (Part 2) C.B. 181, 191)

merely stated that the purpose of the provision is to encourage the international adoption of uniform tax laws affecting shipping companies, for the purpose of eliminating double taxation.

In testimony before the House Ways and Means Committee, February 28, 1930, regarding H.R. 10165, Seventy-first Congress, the Secretary of the Treasury made the following statement with respect to the equivalent exemption provisions of shipping profits under section 231(b) of the Revenue Act of 1928: "Thus, American ships today are exempt from tax in many countries in which they embark passengers or freight, and are, therefore, liable only to the income tax of this country." (Legislative History of United States Tax Conventions, Volume 1, page 19.) During the same hearings, the Special Assistant to the Secretary of the Treasury, in describing the reciprocal exemption of shipping profits as having two principal objectives stated: "* * * first, the very practical purposes of simplification by attempting to avoid allocation of the income derived. A ship, for example, carries freight from the United States to Great Britain. How much of the freight charge is derived from the United States and how much is attributable to the voyage to Great Britain, and how should the expenses be allocated, are very difficult questions. Second, * * * the fact that the income should be subject to tax but once. The present law is based on the principle that the United States will tax the American ship on all its income whereever derived and the foreign country will tax its ship on all of its income wherever derived." (Legislative History on United State Tax Conventions, Volume 1, page 23.)

It is apparent, therefore, that what was intended to be exempted from tax under section 883 of the Code are the shipping profits, the income generated by the business of transporting goods and passengers, as distinguished from the income from investment. See, for example Rev. Rul. 274, 1953-2 C.B. 81, which holds that interest on short-term investments purchased with surplus cash does not constitute "earnings derived from the operation of a ship or ships." This is consistent with the equivalent exemption agreements entered into by the United States and foreign governments which define "operation of a ship or ships" to mean the business or enterprise, carried on by owners or charterers of a ship or ships, of transporting persons, articles, mails, and other cargo and which define the term "earnings" to mean the income derived from these activities including the sale of tickets.

Generally, earnings derived by the owner of a time or voyage chartered vessel from the operation of the vessel and profits derived by either a bareboat charterer or a time or voyage charterer from the operation of a vessel are shipping profits and excludable from gross income under section 883 of the Code.

Payments received by the owner of a bareboat chartered vessel are generally treated as rents received from an investment and not as shipping profits and are not excludable from gross income under section 883 of the Code. However, the exclusion provision will apply if such owner is actively engaged in the shipping business and leases a vessel to another as an activity incidental to his shipping business. For example, where a vessel ordinarily used in the owner's shipping business of transporting persons or cargo is chartered during a temporary period when the vessel would, but for such charter be idle, the rental income from such charter is excludable as shipping profits. On the other hand, a person owning vessels and actively engaged in the business of leasing bareboat charter vessels is not engaged in the shipping business and the income from such leases is not shipping profits within the meaning of section 883.

The fact that a charterer acts through an agent does not change his entitlement to the exclusion, the crucial factor being retention by the charterer of the risk of the venture. However, if he subcharters the vessel to another and he is not actively engaged in the shipping business or if he is actively engaged in the shipping business but such subcharter is not incidental to his shipping business then the charterer is not entitled to exclude the profits from the charter from gross income.

The decision whether the owner of a bareboat chartered vessel or the charterer of a subchartered vessel is entitled to the exclusion must be made on a case by case basis and will depend upon such factors as the duration of the charter or subcharter, the frequency with which the taxpayer engages in such leasing activities, and other circumstances tending to demonstrate whether such activities are incidental to the shipping business of the taxpayer or are a separate investment or business of the taxpayer.

Applying the foregoing principles to the factual situations presented above, the following represent the position of the Internal Revenue Service:

Situation (1). Since *X*, which owns vessels, is actively engaged only in the leasing of bareboat charter vessels to others it is not engaged in the shipping business, Accordingly, *X* is not entitled to exclude the income from such business under section 883 of the Code. However, if *X* were to engage in the shipping business and occasionally lease out a vessel under a bareboat charter as an activity incidental to its shipping business, the profits from such lease may be considered shipping profits and excluded from gross income under section 883 of the Code.

Situation (2). Since *Y* is actively engaged in the leasing of vessels to others under time charters and voyage

charters, it is considered engaged in the shipping business and *Y* is entitled to exclude the income from such operations under section 883 of the Code.

Situation (3). Since *S* is a time charterer of vessels its profits from the operation of the vessels are considered shipping profits and *S* is entitled to exclude the income from such operations under section 883 of the Code. It is immaterial for the exclusion to apply whether *S* charters the vessels directly or through agents.

Situation (4). The holding is the same as in Situation (3) since a bareboat charterer of vessels is considered engaged in the shipping business.

Subpart C.—Miscellaneous Provisions

Section 893.—Compensation of Employees of Foreign Governments or International Organizations

26 CFR 1.893-1: Compensation of employees of foreign governments or international organizations.

Jamaican Government employee; tax exemption. A Jamaican national, who is a permanent resident of the U.S. employed by the Jamaican Government, is entitled to the benefits of Article X(2) of the U.S.-United Kingdom Income Tax Convention in effect prior to the Supplementary Protocol to the Convention, and income received from such employment is exempt from income tax notwithstanding whether such individual has executed and filed the waiver provided by section 247(b) of the Immigration and Nationality Act; Rev. Rul. 71-566 modified.

Rev. Rul. 74-135

Advice has been requested whether Revenue Ruling 71-566, 1971-2 C.B. 267, is applicable to a Jamaican national who is a permanent resident of the United States and who is employed in the United States by the Government of Jamaica.

Rev. Rul. 71-566 holds that the execution and filing of a waiver provided by section 247(b) of the Immigration and Nationality Act (8 U.S.C. 1257(b)) by a resident alien individual who is employed by a Government covered by the United States-United Kingdom Income Tax Convention and whose compensation for official services to such government is exempt from Federal income tax under section 893 of the Internal Revenue Code of 1954, would cause such individual to lose such exemption. Rev. Rul 71-566 also implies that subsequent to September 9, 1966 (the effective date of the amendment to Article XIII(1) of the Convention made by Article 9 of the Supplementary Protocol to the Convention as published in 1966-2 C.B. 582), such compensation of a resident alien would not be exempt under Article X(2) of the Convention.

The United States-United Kingdom Income Tax Convention was extended to Jamaica effective January 1, 1959. T.D. 6437, 1960-1 C.B. 767. When Jamaica became an independent country in 1962, it assumed the obligations then existing under the United States-United Kingdom Convention.

Article X(2) of the Convention provides, in effect, exemption from United States tax for salaries paid by the Government of Jamaica to an individual (other than a citizen of the United States who is not also a citizen of Jamaica) in respect of services rendered to Jamaica in the discharge of governmental functions.

Article XIII(1) of the Convention as amended by Article 9 of the Supplementary Protocol to the Convention provides, in part, that the right to tax its residents is reserved unto the United States as if the Convention had not come into effect. However, Treasury Department Release F-328, dated January 5, 1966, provides, in relevant part, that the amendments proposed by the supplementary protocol, effective September 9, 1966, will not effect the application of the treaty to former territories (including Jamaica) outside of the United Kingdom to which the treaty previously had been extended by mutual agreement between the two countries. In the case of such territories, the treaty as in effect on December 31, 1965, will continue to apply. Thus, the Supplementary Protocol is inapplicable to Jamaica.

Section 893 of the Code provides that wages, fees, or salary of any employee of a foreign government or of an international organization (including a consular or other officer, or a nondiplomatic representative), received as compensation for official services to such government or international organization shall not be included in gross income and shall be exempt from taxation if the conditions enumerated therein are met.

Section 1.893-1(a)(5) of the Income Tax Regulations provides that an employee of a foreign government who executes and files with the Attorney General the waiver provided for in section 247(b) of the Immigration and Nationality Act thereby waives the exemption conferred by section 893 of the Code. As a consequence, that exemption does not apply to income received by that alien after the date of filing of the waiver.

Section 1.893-1(c)(2) of the regulations promulgated in 1957 provides, however, that if income tax exemption of compensation paid by a foreign government to its employees is provied by a tax convention and is not dependent upon the provisions of the internal revenue laws, the exemption so conferred is not affected by the execution and filing of a waiver. Reference is made to Article X of the Convention with the United Kingdom for an example of such an exemption. Section 1.893-1(c)(2) of the regulations and section 507.103(e) of the regulations under the Convention do not reflect the amendment to the Convention made by the Supplementary

Protocol and thus are applicable to the facts in the instant case.

Accordingly, a Jamaican national who is a permanent resident of the United States and who is employed in the United States by the Government of Jamaica, and who receives compensation from the Government of Jamaica for services rendered to it in the discharge of its governmental functions, is entitled to the benefits of Article X(2) of the United States-United Kingdom Income Tax Convention, as in effect prior to the Supplementary Protocol to the Convention (brought into force September 9, 1966), notwithstanding whether such individual has executed and filed a waiver provided by section 247(b) of the Immigration and Nationality Act.

Rev. Rul. 71-566 is hereby modified to the extent that it is inconsistent with the position set forth herein.

Rev. Rul. 72-26, 1972-1 C.B. 214, which implies that a Jamaican national resident in the United States would be allowed the benefits of Article X(2) of the Convention as extended to Jamaica effective January 1, 1959, or section 893 of the Code, is not inconsistent with the position set forth herein.

Section 894.—Income Affected by Treaty

26 CFR 1.894-1: Income exempt under treaty.
(Also Section 881; 1.881-1.)

Swiss Convention; dividends paid to Swiss parent; withholding. A Swiss corporation owning 90 percent of the stock of a U.S. corporation and owning all of the stock of a foreign corporation, which in turn owns 10 percent of the stock of the U.S. corporation, satisfies the 95 percent direct or indirect control test of the U.S.-Swiss Confederation Income Tax Convention; dividends paid by the U.S. corporation directly to its Swiss parent are subject to withholding and tax at the reduced rate of 5 percent.

Rev. Rul. 74-171

Advice has been requested whether dividends paid to a Swiss corporation, under the circumstances described below, will be subject to withholding and taxed at the reduced rate of 5 percent as provided in Article VI(2) of the United States-Swiss Confederation Income Tax Convention ("Convention"), T.D. 6149, 1955-2 C.B. 814.

X, a domestic corporation, has 2,000*x* shares of common stock outstanding, 10 percent of which is owned by *Y*, a foreign corporation organized in foreign country *M*, and 90 percent of which is owned by *P*, a corporation organized in Switzerland. *P* owns 100 percent of the issued and outstanding voting stock of *Y*. All of the stock of *P* is owned by three Swiss citizens.

Article VI(2) of the Convention provides for a 5 percent rate of tax on dividends paid by a United States corporation to its Swiss parent if certain conditions are met.

The only issue in the instant case is whether *X* satisfies the requirement of section 509.108(b)(1) of the regulations issued under the Convention that the Swiss parent be a shareholder which controls, directly or indirectly, at the time the dividend is paid, 95 percent or more of the entire voting power in the corporation paying the dividend. More specifically, whether the phrase "directly or indirectly" applies only to entities organized within the same convention country or whether world-wide holdings are to be considered.

Article II(2) of the Convention provides, in substance, that when the United States applies a Convention provision containing any term not defined in the Convention, then that term shall have the meaning which it has under United States tax law, unless the context otherwise requires.

Since *P* owns 90 percent of the stock of *X* directly and owns indirectly the 10 percent stock of *X* owned by *Y* (because *P* owns all the stock of *Y*), *P* satisfies the 95 percent control test of the Convention.

Accordingly, in the instant case, dividends paid by *X* directly to *P* under the circumstances described above will be subject to withholding and taxed at the rate of 5 percent pursuant to Article VI(2) of the Convention provided there is no change in the stock ownership or in the character of the income causing *X* to no longer meet the conditions of Article VI(2) of the Convention.

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26 CFR 1.894-1: Income exempt under treaty.
(Also Sections 871, 881, 1232; 1.871-1, 1.881-1, 1.1232-1.)

Netherlands convention; bond discount and call premium as interest. Amounts representing original issue discount paid by a domestic corporation to the holders of its debentures on redemption are interest for purposes of Article VIII(1) of the U.S.-Netherlands Income Tax Convention for exemption from U.S. tax; however, amounts representing premiums payable by reason of redemption of the debentures prior to maturity do not constitute interest for purposes of Article VIII(1).

Rev. Rul. 74-172

Advice has been requested whether certain amounts paid by a domestic corporation in connection with the redemption of its debentures constitute "interest" for purposes of Article VIII(1) of the Income Tax Convention between the United States and the Netherlands, T.D. 5778, 1950-1 C.B. 92 ("the Convention").

X was a domestic United States corporation which issued debentures to Netherlands corporations and to alien individuals residing in the Netherlands. The debentures in the face amount of 100*x* dollars were issued at a discount of 6*x* dollars and paid in-

terest at the rate of 5 percent. They were subject to redemption prior to maturity at call premiums declining according to the time remaining to maturity from $5x$ dollars to zero.

The question presented is whether amounts paid by X to the debenture holders which represent original issue discount, as described in sections 871(a)(1)(C) and 881(a)(3) of the Internal Revenue Code of 1954 or premium payable by reason of redemption prior to maturity, qualify as interest under the Convention.

Article VIII(1) of the Convention provides, in part and in effect, that interest derived from sources within the United States by a resident or corporation of the Netherlands shall be exempt from United States tax.

Article II(2) of the Convention provides, in part, that any term not defined in the Convention shall, unless the context otherwise requires, have the meaning which that term has under the laws of the Contracting State relating to the taxes which are the subject of the Convention.

In Rev. Rul. 72-587, 1972-2 C.B. 74, the Internal Revenue Service considered the question of whether discount and premium received upon redemption of State bonds prior to maturity represent income which is excludable from the bondholder's gross income under section 103(a)(1) of the Code.

With respect to original issue discount, Rev. Rul. 72-587 relied upon the decision of the Supreme Court of the United States in *United States v. Midland-Ross Corporation,* 381 U.S. 54 (1965), 1965-2 C.B. 474, and held that unearned discount received upon the redemption of State bonds is interest for purposes of section 103(a)(1) of the Code. However, that Revenue Ruling holds that the premium received upon redemption of the State bonds is an amount received in exchange for such bonds under section 1232(a)(1) and not interest for purposes of section 103(a)(1).

The positions expressed in Rev. Rul. 72-587 on original issue discount and premium received upon redemption were not changed by the provisions of the Revenue Act of 1971 dealing with original issue discount. Section 313 of such Act contained certain amendments to sections 871, 881, 1441, and 1442 relating to the taxation and withholding treatment for original issue discount earned by nonresident aliens and foreign corporations. However, the Senate report indicates that the amendments contained in section 313 of the Act would not change the position that discount is treated as interest for purposes of treaty exemptions. See *S. Rep. No. 92-437,* 92nd Cong., 1st Sess. 76 (1972), 1972-1 C.B. 559, 601.

Accordingly, the amounts paid by X to its debenture holders which represent original issue discount, as described in sections 871(a)(1)(C) and 881(a)(3) of the Code, are interest for purposes of the Article VIII(1) of the Convention. However, amounts paid by X to its debenture holders which represent premium payable by reason of redemption prior to maturity are not interest for purposes of such Article.

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26 CFR 1.894-1: Income exempt under treaty.

Whether dividends from sources within the United States received by a nonresident alien individual, a Swiss resident engaged in trade or business in the United States, are treated as effectively connected with the conduct of his trade or business in the United States and whether such alien's foreign source income that is effectively connected with the conduct of his trade or business within the United States is exempt from United States tax under the United States-Swiss Confederation Income Tax Convention. See Rev. Rul. 74-63, page 374.

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26 CFR 1.894-1: Income exempt under treaty.

Whether a citizen of Canada engaged in teaching and pursuing studies in the United States is exempt from Federal income tax. See Rev. Rul. 74-174, page 371.

Part III. Income From Sources Without the United States
Subpart A.—Foreign Tax Credits

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.
(Also Section 902; 1.902-3.)

Liechtenstein coupon tax. The coupon tax imposed by Article 88a of the Liechtenstein Tax Law of December 29, 1966, on coupons attached to securities and paid by the obligor on behalf of the shareholders, is an income tax for which a foreign tax credit is allowable under sections 901 and 902 of the Code.

Rev. Rul. 74-31

Article 88a of the Liechtenstein Tax Law of December 29, 1966, supplements the Liechtenstein Tax Law of January 30, 1961, and imposes a Coupon Tax on coupons attached to securities and equivalent instruments issued by a resident of Liechtenstein. Equivalent instruments, under the Tax Law, are shares of any kind, quotas of limited liability companies, shares in cooperatives, or other equity participations in an association, the capital of which is divided into shares. The tax is computed, in the case of coupons, on the amount paid by the coupon obligor, and in the case of equivalent instruments, on that part of the amount paid out, transferred, set-off, or credited that represents economic gain. The obligor of the coupon or the equivalent instrument is liable for the payment of the tax and such tax is deducted from the amount paid upon presentation of the coupon, or is deducted from the amount paid, in the case of an equivalent instrument, upon the payment, transfer, off-setting, or crediting. Agreements inconsistent with the obligation to shift tax are void and a penalty is imposed on an obligor who does not shift the tax

burden. Although a corporation may deduct taxes in computing its taxable income for purposes of the Liechtenstein Tax Law of January 30, 1961, Article 77(3) of Chapter 4 of that law provides that "coupon taxes paid on behalf of the owners or shareholders" are not deductible by the corporate obligor of the coupon or equivalent instrument.

Held, the above described gross income tax is designed to reach net gain and therefore is an income tax within the meaning of the United States concept of that term and is a creditable tax under section 901 and section 902 of the Internal Revenue Code of 1954, subject to the limitations of section 904.

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26 CFR 1.901-1: Allowance of credit for taxes.

Foreign tax credit; Brazilian taxes. The tax imposed on legal entities by Article 248 of the Brazilian Income Tax Law, as amended, is an income tax creditable under section 901 of the Code. Further, payments to the MOBRAL Foundation of Brazil, a public benefit corporation, to the extent deductible from the Brazilian income tax under Article 1 of Decree Law No. 1,124, September 8, 1970, also qualify for foreign tax credit.

Rev. Rul. 74-58

Advice has been requested whether the tax imposed on legal entities by Article 248 of the Brazilian Income Tax Law, as amended, (hereinafter referred to as "the Law") is an income tax within the United States concept of that term and, therefore, is creditable under section 901 of the Internal Revenue Code of 1954. Advice has also been requested whether amounts deducted from the Brazilian income tax and paid to the MOBRAL Foundation of Brazil are creditable under section 901.

Article 15 of the Law states, in substance, that all legal entities organized, incorporated or registered, in Brazil and doing business therein or all legal entities organized or incorporated abroad and doing business in Brazil either directly or through a qualified agent, qualify as income taxpayers, whatever their purposes or nationality. (Decree Law No. 5,844, Article 27.) Legal entities include but are not limited to individual firms and persons, who, in their individual name, habitually and professionally engage in any economic activity of a commercial or service nature for profit by means of selling goods or services to third parties. (Decree Law No. 4,506, Article 29, 1 and Decree Law No. 56,720, Article 1.)

Article 153 of the Law states that the operational profit constitutes the actual profit (operational profit ascertained) of the legal entities, increased or decreased by the net results of eventual transactions. (Law No. 4,506, Article 37, ss. 2.) Article 156 of the Law states that the "operational profit ascertained" is the gross operational receipts less costs, operating expenses, charges, provisions and losses authorized by these Regulations. (Law No. 4,506, Article 43.) Article 157 of the Law provides that the gross operational receipts are composed of (a) the proceeds of the sale of goods and services in transactions or operations on its own behalf, (b) results obtained in operations on behalf of others, (c) recoveries or reversions of costs, deductions or provisions, and (d) current subsidies for costs or operations received from legal entities, whether public or private, or from individuals. (Law No. 4,506, Article 44.) Articles 161 through 189 of the Law details the costs, operational expenses, charges, etc., referred to in Article 156 of the Law.

Article 248 of the Law, as amended by Decree Law No. 62 of November 21, 1966 provides that legal entities (as described in Article 15 of the Law), whether organized for commercial or civil purposes shall pay income tax on the profits ascertained in conformity with these Regulations. (Law No. 4,506, Art. 37 and Law No. 4,863, Article 28.)

Section 901 of the Code allows a credit against the United States tax of certain persons for foreign income, war profits, and excess profits taxes paid or accrued, or deemed to have been paid or accrued within the taxable year. In order for a tax paid to a foreign country to qualify as an income tax, however, it must be shown that the tax imposed by the foreign country is a tax on income within the U. S. concept thereof. *Biddle v. Commissioner*, 302 U.S. 573 (1938), 1938-1 C.B. 309.

An analysis of the tax imposed on legal entities by Article 248 of the Brazilian Income Tax Law, as amended, shows it is an income tax within the United States concept of that term.

Accordingly, it is held that the tax under Article 248 is creditable under section 901 of the Code subject to the applicable limitations of section 904.

Article 1 of Decree Law No. 1,124 of September 8, 1970, provides that for taxable years from 1971 to 1973, inclusive, juridical presons may deduct from income tax owed the Brazilian Government amounts destined for application in the alphabetization programs approved by the MOBRAL Foundation. MOBRAL is the organization set up by the Government of Brazil under Public Law 5,379 as the executive agency providing for functional literacy training and continued education of adolescents and adults. MOBRAL is a corporation wholly-owned by the government of Brazil and is a public benefit corporation.

Article 2 of Decree Law No. 1,124 provides that the deduction from income tax owed may be taken without prejudicing the fiscal incentives through the following methods:

I. Deduction of the amounts which were donated to the MOBRAL Foundation during the tax year, in the minimum value of

1 percent and maximum of 2 percent of the income tax paid during the tax year;

II. Indication on the return of the amounts that will be paid to the MOBRAL Foundation for application in the specific alphabetization projects, up to 1 percent of the income tax owed.

Article 3 of Decree Law No. 1,124 provides that amounts deducted under Article 2(II) must be paid when the return is filed, or during the period for paying installments on the income tax. Overdue payments of such amounts are subject to the same penalties and monetary corrections which would be due on the income tax owed in an identical situation.

Amounts of taxes paid directly to a public benefit corporation rather than to a government's general revenue fund constitute "taxes" if the corporation has been created for a public purpose and is regarded as performing a governmental function for which public money may be appropriated. See Rev. Rul. 71-49, 1971-1 C.B. 103, which holds that tax equivalency payments made to the New York City Educational Construction Fund by a cooperative housing corporation are real estate taxes deductible by each tenant-shareholder under section 216 of the Code in an amount representing his proportionate share.

Accordingly, it is further held that payments to the MOBRAL Foundation to the extent that they are deductible from the Brazilian income tax pursuant to Decree Law No. 1,124, are creditable under section 901 of the code subject to the applicable limitations of section 904.

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26 CFR 1.901-1: Allowance of credit for taxes.
(Also Section 902; 1.902-3.)

Foreign tax credit; Swiss taxes. That part of the tax imposed by Article 48 of the Swiss National Defense Tax, as amended, as a supplementary tax on capital and reserves is not allowable as a foreign tax credit under sections 901 and 902 of the Code; Rev. Rul. 69-446 modified.

Rev. Rul. 74-82

Advice has been requested whether the supplementary tax on capital and reserves imposed under the Swiss National Defense Tax (Wehrsteuer), as amended, is an income tax within the United States concept of that term and, therefore, is creditable under sections 901 and 902 of the Internal Revenue Code of 1954.

The Swiss National Defense Tax was originally enacted by the Swiss Federal Council on December 9, 1940. Article 2 of the Defense Tax provides, in part, that the tax is imposed on the net profit and the capital plus reserves of corporations and other entities. Article 3 provides, in part, that the tax is levied on legal entities having registered offices in Switzerland. Article 48 provides that the tax comprises a tax on net profits and, in addition, a supplementary tax on the paid-up part of the share capital entered in the Commercial Register and on the open and secret reserves. Article 49 provides, in part and in substance, that, in computing taxable net profit, items considered are the balance of the profit and loss account after eliminating the amount brought forward from the previous year, excessive depreciation, and other charges to the profit and loss account which cannot be regarded as expended in the normal course of business. Article 49 also provides that taxes and certain contributions are deductible for purposes of computing taxable net profit.

Section 901 of the Code allows a credit against the United States income tax of certain persons for foreign income, war profits, and excess profits taxes paid or accrued or deemed to have been paid or accrued within the taxable year. However, in order for a tax of a foreign country to qualify as an income tax, it must be shown that the tax imposed by the foreign country is a tax on income within the United States concept thereof. *Biddle v. Commissioner,* 302 U.S. 573 (1938), 1938-1 C.B. 309. That part of the Swiss Defense Tax imposed by Article 48 which is based on capital and reserves bears no relation to the tax imposed on income or profits. See Rev. Rul. 68-318, 1968-1 C.B. 342, which holds that that part of the Italian Tax on Corporations imposed on taxable capital is not a creditable tax under sections 901 or 902.

Accordingly, that part of the Swiss National Defense Tax imposed by Article 48 as a supplementary tax on capital and reserves is not an income tax and, therefore, is not a creditable tax under sections 901 or 902 of the Code.

That part of Rev. Rul. 69-446, 1969-2 C.B. 150, which holds that the tax imposed by Article 48 of the Swiss National Defense Tax on taxable net profits is a creditable tax under sections 901 and 902 of the Code is hereby modified to also hold that the tax imposed by such Article 48 as a supplementary tax on capital and reserves is not a creditable tax under sections 901 or 902.

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26 CFR 1.901-1: Allowance of credit for taxes.
(Also Section 902; 1.902-3.)

Foreign tax credit; German taxes. Both the income taxes and surcharges on the income taxes imposed under Federal Republic of Germany laws on individuals and corporations are creditable taxes for purposes of the foreign tax credit under section 901 of the Code.

Rev. Rul. 74-90

Advice has been requested as to whether the West German Income Tax Law (Einkommensteuergesetz or EStG) as republished in the Bundessteuerblatt, the official gazette of the West German Federal Ministry of Economics and Finance on December

1, 1971, and as amended; the West German Corporation Income Tax Law (Korperschaftsteuergesetz or KStG) as republished in the Bundessteuerblatt on October 13, 1969, and as amended; and the West German Law on the Imposition of a Surcharge on the Income Tax and Corporation Tax (Gesetz uber eine Erganzungsabgabe zur Einkommensteuer und zur Korperschaftsteuer (Erganzungsabgabegesetz)) enacted December 21, 1967, as amended by the statute of December 23, 1970, are income taxes within the United States concept of that term and, therefore, are creditable under section 901 of the Internal Revenue Code of 1954.

Section (1)(1) of the Einkommensteuergesetz (EStG) provides that individuals who have their domicile or customary abode in West Germany are subject to unlimited tax liability in the sense that both their income from West German and non-West German sources is subject to tax.

Section (1)(2) of the EStG provides that individuals who have neither their domicile nor their customary abode in West Germany are subject to limited tax liability in the sense that only their income from sources in West Germany is subject to tax.

Section 2 of the EStG provides that income tax is imposed on the amount of taxable income that is realized by the taxpayer during a calendar year.

Section (1)(1) of the Korperschaftsteuergesetz (KStG) provides that corporations or other commercial entities that have their place of management or seat in West Germany are subject to unlimited tax liability.

Section 2 of the KStG provides that corporations or other commercial entities that have neither their place of management nor seat in West Germany are subject to limited tax liability.

Section 5(1) of the KStG provides that the corporation tax is computed on the amount of taxable income realized by the taxpayer during a calendar year.

Section 6 of the KStG provides that what constitutes taxable income and how it will be computed shall be determined, in part, under the rules of EStG.

Subject to limitations not here relevant, Sections (1) through (4) of the Erganzungsabgabegesetz impose a 3 percent surcharge on the amount of income tax owed by all individuals under the EStG, or all corporations and other commercial entities under the KStG.

Section 901 of the Code allows a credit against the United States tax of certain persons for foreign income, war profits, and excess profits taxes paid or accrued, or deemed to have been paid or accrued within the taxable year. In order for a tax paid to a foreign country to qualify as an income tax, however, it must be shown that the tax imposed by the foreign country is a tax on income within the United States concept thereof. *Biddle v. Commissioner*, 302 U.S. 573(1938), 1938-1 C.B. 309.

An additional tax imposed as a percentage of the amount of an income tax within the United States concept thereof is itself an income tax. See Rev. Rul. 70-133, 1970-1 C.B. 159, which holds that Austrian surcharges levied on the Austrian income tax are creditable taxes under section 901 of the Code.

Article I(1)(b) of the United States-Federal Republic of Germany Income Tax Convention, as amended, 1966-1 C.B. 360, identifies the "Einkommensteuergesetz (income tax)" and "Korperschaftsteuergesetz (corporation tax)" as categories of Federal Republic taxes that are included within the terms of the Convention. Moreover, Article I(2) provides that the Convention shall apply to any tax of substantially similar character that may subsequently be imposed.

Article XV(1)(a) further provides, in part, that the United States shall allow as a credit against United States tax the appropriate amount of Federal Republic tax paid.

It is held that the Einkommensteuergesetz as republished on December 1, 1971, and as amended; the Korperschafsteuergesetz as republished on October 13, 1969, and as amended; and the Erganzungsabgabegesetz enacted December 21, 1967, as amended by the statute of December 23, 1970, are income taxes within the United States concept of that term, are creditable taxes under section 901 of the Code subject to the limitations of section 904, and are taxes described within Article I of the Convention.

See Rev. Rul 69-593, 1969-2 C.B. 277, which holds similarly with respect to the surcharge (Erganzungsabgabegesetz) prior to its amendment by the statute of December 23, 1970.

Section 902.—Credit for Corporate Stockholder in Foreign Corporation

26 CFR 1.902-1: Taxes of foreign corporations.
(Also Section 482; 1.482-1.)

Foreign tax credit; domestic corporation; distributions from foreign subsidiary. A section 482 allocation of income from a foreign subsidiary to its domestic parent will affect the amount of credit for foreign income taxes deemed paid to the extent the allocation changes the fractions used in the computation required under section 902(a)(1) of the Code.

Rev. Rul. 74-158

Advice has been requested whether, under the circumstances described below, the amount of the credit for foreign income taxes deemed paid under section 902(a)(1) of the Internal Revenue Code of 1954 is affected by an allocation of income from the foreign subsidiary to the domestic parent pursuant to section 482.

X, a corporation that is not a less developed country corporation, is a wholly-owned foreign subsidiary of

domestic corporation *M*. Both corporations use the calendar year as their taxable year. For the taxable year 1972, *X* reported income of 100*x* dollars to foreign country *Y* and paid 40*x* dollars of income taxes to country *Y* with respect thereto. *X* also paid a dividend of 10*x* dollars during 1972 out of accumulated profits of 1972. Pursuant to section 482 of the Code, an increase in income of 30*x* dollars was made with respect to *M*'s 1972 income. Under section 482 and section 1.482-1(d)(2) of the Income Tax Regulations, a correlative adjustment was made to *X*'s 1972 expenses whereby *X*'s 1972 expenses were increased by 30*x* dollars. The income taxes paid to country *Y* by *X* were not changed by the section 482 allocation.

Foreign income taxes deemed paid under section 902(a)(1) of the Code are determined in accordance with the following formula:

$$\frac{\text{Dividends (without regard to section 78)}}{\text{Accumulated profits (as defined in section 902(c)(1)(A)) in excess of income taxes paid}} \times \text{Foreign income taxes} = \text{Foreign income taxes deemed paid}$$

Application of the formula to the facts of the instant case (without taking into account the 482 allocation) results in foreign income taxes deemed paid as follows:

$$\frac{10x \text{ dollars}}{60x \text{ dollars}} \times 40x \text{ dollars} = 6.67x \text{ dollars}$$

(100*x* dollars — 40*x* dollars)

Application of the formula to the facts of the instant case (taking into account the 482 allocation) results in foreign income taxes deemed paid as follows:

$$\frac{10x \text{ dollars}}{30x \text{ dollars}} \times 40x \text{ dollars} = 13.33x \text{ dollars}$$

(100*x* dollars — 30*x* dollars — 40*x* dollars)

If *X*, in the instant case had been a less developed country corporation, the principles set forth above would also apply in the computation of the foreign taxes deemed paid under section 902(a)(2) of the Code and based on the facts of the instant case would result as follows:

$$\frac{10x \text{ dollars}}{30x \text{ dollars}} \times \frac{30x \text{ dollars } (70x \text{ dollars} - 40x \text{ dollars})}{70x \text{ dollars } (100x \text{ dollars} - 30x \text{ dollars})}$$

(70*x* dollars — 40*x*)

$$\times 40x \text{ dollars, or } \frac{10x \text{ dollars}}{70x \text{ dollars}} \times 40x \text{ dollars} = 5.71x \text{ dollars}$$

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26 CFR 1.902-3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).
(Also Sections 551, 561, 565; 1.551-2, 1.561-1, 1.565-1.)

Dividend received by foreign personal holding company; foreign tax credit of U.S. parent. A dividend received by a foreign personal holding company from its wholly-owned Canadian subsidiary and includible in the gross income of its U.S. parent corporation as undistributed foreign personal holding company income under section 551 of the Code is not treated as a dividend received by the parent for purposes of the foreign tax credit under section 902. However, a consent dividend utilized by a domestic corporate shareholder and a foreign personal holding company qualifies for foreign tax credit.

Rev. Rul. 74-59

Advice has been requested whether a dividend received by a foreign personal holding company and included in the gross income of its United States parent corporation as undistributed foreign personal holding company income will be treated as a dividend received by the United States parent corporation for purposes of the foreign tax credit provisions of section 902 of the Internal Revenue Code of 1954.

P, a domestic corporation, is the sole shareholder of *Y*, a holding company organized under the laws of Canada. During the current taxable year *Y*'s wholly-owned Canadian subsidiary *S* made a dividend distribution to *Y* from its accumulated earnings and profits. No dividends were paid to *P*. During the year in question *Y* was a foreign personal holding company within the meaning of section 552(a) of the Code.

Section 551 of the Code provides the manner and extent that undistributed foreign personal holding company income shall be included in the gross income of a domestic corporation which is a shareholder in such foreign personal holding company.

Section 551(b) of the Code provides, in part and in effect, that in the case of a foreign personal holding company controlled for the entire taxable year by a United States group each United States shareholder shall include in his gross income, as a dividend, the amount he would have received as a dividend if on the last day of its taxable year there had been distributed by the company, and received by the shareholder, the undistributed foreign personal holding

company income of the company for the taxable year.

Section 556(a) of the Code provides that the term "undistributed foreign personal holding company income" means the taxable income (including dividends received) of a foreign personal holding company, with certain adjustments, minus the dividends paid deduction. Among the adjustments provided in section 556(b) is a deduction for Federal income and excess profit taxes, and income, war profits, and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4).

Section 561 of the Code provides, in part, that the deduction for dividends paid includes the dividends paid during the taxable year and the consent dividends for the taxable year (determined under section 565).

Section 565(a) of the Code provides, in general, that if any person owns consent stock (as defined in section 565(f)(1)) in a corporation on the last day of the taxable year of such corporation, and such person agrees, in a consent filed with the return of such corporation, to treat as a dividend the amount specified in such consent, the amount so specified shall constitute a consent dividend for the purpose of section 561.

Section 565(c)(1) and (2) of the Code provides that the amount of a consent dividend shall be considered, for the purpose of subtitle A of the Code, (1) as distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation, and (2) as contributed to the capital of the corporation by the shareholder on such day.

Section 902(a) of the Code provides, in general, that a domestic corporation that owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year that were paid out of accumulated profits shall be deemed to have paid a certain portion of any creditable income tax paid or deemed to have been paid by such foreign corporation to any foreign country or to any possession of the United States on or with respect to such accumulated profits.

Section 902(b) of the Code provides, in general, that if the foreign corporation described in section 902(a) (first foreign corporation) owns 10 percent or more of a second foreign corporation from which it receives dividends in any taxable year, it shall be deemed to have paid a certain portion of any creditable income tax paid or deemed to be paid by such second corporation to any foreign country, or any possession of the United States on or with respect to the accumulated profits of the second corporation from which such dividends were paid.

The foreign personal holding company provisions, originally enacted as part of the Revenue Act of 1937, were based on proposals of the Joint Committee on Tax Evasion and Avoidance of the Congress of the United States. The Report of the Joint Committee, H.R. Doc. No. 337, 75th Cong., 1st Sess., proposed, in part, that the United States shareholders of foreign personal holding companies should have gross income as if they had received a hypothetical dividend. However, the Report also specifically recommended at page 18 as follows:

> The American shareholders should not be allowed any credit against their Federal income taxes for foreign income taxes, if any, paid by the foreign personal holding company in respect to the undistributed adjusted net income returned by them.

See also, Testimony of Assistant General Counsel, Treasury Department, *Hearing on Tax Evasion and Avoidance Before the House Committee on Ways and Means*, 75th Cong., 1st Sess., at 77 (1937). Congress enacted the Joint Committees' proposals without substantial alteration.

Accordingly, it is held that the dividend paid to *Y* by its subsidiary *S* which constitute undistributed foreign personal holding company income includible in the gross income of *P* under section 551 of the Code will not be considered a dividend received by *P* for purposes of the allowance of a foreign tax credit under section 902. However, where a consent dividend is utilized by a domestic corporate shareholder and a foreign personal holding company the consent dividend will be considered a dividend received for purposes of the allowance of a foreign tax credit under section 902.

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26 CFR 1.902-3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).
(Also Section 963; 1.963-4.)

Foreign tax credit; controlled less developed country corporation. Formulas are set forth for the computation of the deemed paid foreign tax credit under section 902(a)(2) of the Code by a domestic corporate shareholder making a chain or group election to receive a minimum distribution of earnings and profits from its controlled less developed country corporation and distributions in excess of the required minimum distribution; Rev. Ruls. 68-522 and 68-640 modified; Rev. Rul. 71-406 revoked.

Rev. Rul. 74-83

Advice has been requested concerning the proper method of computing the deemed paid credit, under section 902(a)(2) of the Internal Revenue Code of 1954, by a domestic corporate shareholder making a chain or group election to receive a minimum distribution from its controlled less developed country corporation (LDCC) in a situation involving distributions in excess of the required minimum distribution.

Section 902(a)(2) of the Code provides that a corporation which owns at least 10 percent of the voting stock of a foreign corporation from

which it receives dividends in any taxable year shall, to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in section 902(c)(1)(B)) of a year for which such foreign corporation is a LDCC, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country on such accumulated profits, which the amount of such dividends bears to the amount of such accumulated profits.

Section 963 of the Code operates in conjunction with section 951. Section 951(a)(1)(A)(i), in pertinent part, requires a United States shareholder of a controlled foreign corporation to include in its gross income for its taxable year its pro rata share of the subpart F income for the taxable year of the foreign corporation.

Section 963(a) of the Code provides, in pertinent part, that in the case of a United States shareholder which is a domestic corporation and which consents to all the regulations prescribed by the Secretary or his delegate, no amount shall be included in gross income under section 951(a)(1)(A)(i) for the taxable year with respect to the subpart F income of a controlled foreign corporation, if in the case of controlled foreign corporations described in section 963(c)(2) and (3), the United States shareholder receives a minimum distribution of the consolidated earnings and profits for the taxable year of all such controlled foreign corporations.

Rev. Rul. 68-522, 1968-2 C.B. 320, holds that an amount received in excess of the distribution required under section 963 of the Code does not qualify as a minimum distribution.

Rev. Rul. 68-640, 1968-2 C.B. 321, holds that the special rules of section 1.963-4(b) and (c) of the Income Tax Regulations do not apply to distributions in excess of the minimum distribution required pursuant to an election made under section 963(a) of the Code. It further holds that the rules of section 902 apply with respect to such excess distributions.

Under section 963 of the Code, a chain or group election may permit a domestic corporate shareholder a substantial acceleration of the deemed paid foreign tax credit whenever one or more members of the chain or group have a deficit of earnings and profits for the year of the election. Sections 1.963-4(b)(2)(i) and 1.963-4(c)(2)(i)(c) of the regulations specify that under a minimum distribution election, the deficits of unprofitable foreign subsidiaries shall be allocated against and reduce the earnings and profits of profitable foreign subsidiaries in the chain or group calculating the section 902 credit. Thus, the denominator of the section 902 foreign tax credit fraction of each profitable member of the chain or group may be decreased. Therefore, each dollar of dividends paid by the profitable foreign corporation will generate a higher deemed paid foreign tax credit than if no chain or group election had been made. But, sections 1.963-4(b)(2)(i) and 1.963-4(c)(2)(i)(c) of the regulations offer no specific examples of how they are to be applied in the case of a LDCC.

The LDCC formula for the deemed paid section 902 credit is:

$$\frac{\text{Dividends}}{\text{(accumulated) earnings and profits}} \times \frac{\text{(accumulated) earnings and profits}}{\text{Pretax earnings}} \times \text{Foreign income taxes pad} = \text{Deemed paid credit}$$

or by canceling out the (accumulated) earnings and profits denominator and numerator, the simplified formula of:

$$\frac{\text{Dividends}}{\text{Pretax earnings}} \times \text{Foreign income taxes paid} = \text{Deemed paid credit}$$

Thus, in the LDCC formula there are no accumulated earnings and profits to allocate and reduce by unprofitable subsidiaries. However, Rev. Rul. 71-406, 1971-2 C.B. 269, holds that allocated deficits may reduce a profitable LDCC's *pretax earnings*. The formula provided is:

$$\frac{\text{Dividends from subsidiaries earnings for any given year for which subsidiary was a less developed country corporation}}{\text{Accumulated profits of subsidiary after allocation of deficit and after foreign income taxes paid for the same year used in numerator}} \times \frac{\text{Accumulated profits of subsidiary after allocation of deficit and after foreign income taxes paid for the same year}}{\text{Total profits of subsidiary, before foreign income taxes paid for the same year and after allocation of the deficit}} \times \text{Foreign income taxes paid}$$

The use of the formula in Rev. Rul. 71-406 when a distribution in excess of the required minimum distribution has been made is inconsistent with answer number 3 in Rev. Rul. 73-182, 1973-1 C.B. 350.

In Rev. Rul. 73-182, it was held that the method under section 902 of the Code, as modified, should be used for the computation of the foreign tax credit on excess distributions.

Therefore, to prevent the necessity of using different formulas depending on whether an excess distribution or a required minimum distribution is involved, Rev. Rul. 71-406 is hereby revoked.

The formula for determining the deemed paid credit on all required minimum distributions by LDCC's is:

Step 1: Determine maximum deemed paid credit available without regard to section 963 of the Code.

$$\frac{\text{Dividends (maximum amount available for distribution)}}{\text{Pretax earnings}} \times \text{Foreign income taxes paid} = \text{Maximum deemed paid credit}$$

Step 2:

$$\frac{\text{Required minimum distribution}}{\text{Adjusted consolidated earnings and profits}} \times \text{Maximum deemed paid foreign tax credit, Step 1} = \text{Deemed paid credit on required minimum distributions}$$

When any LDCC makes a distribution in excess of the required minimum distribution the formula for computing the deemed paid credit on all excess distributions is:

Step 3:

$$\frac{\text{Excess dividend}}{\text{Remaining accumulated profits (regardless of deficit)}} \times \text{Remaining maximum deemed paid foreign tax credit after subtraction of deemed paid credit, Step 2} = \text{Deemed paid credit on excess distributions}$$

By use of these formulas an LDCC can never exceed the total deemed paid credit allowable under section 902 of the Code.

The application of Steps 1, 2, and 3 is illustrated in the following example:

M, a domestic corporation, wholly owns foreign corporation P, a LDCC. P wholly owns S, which is also a LDCC. M makes a chain or group election for the purpose of section 963 of the Code. P's and S's earnings and profits and foreign income taxes are as follows:

	P	S	Total
Pretax and predistribution earnings and profits (deficit)	$200	($45)	$155
Foreign income tax	50	0	50
Earnings and profits	150	(45)	105
Allocation of deficits	(45)	0	
Adjusted consolidated earnings and profits	105	0	105
Effective foreign tax rate under section 963(d)(2)			
$\frac{\$50 \text{ (foreign income tax)}}{\$105 \text{ (adjusted consolidated earnings and profits)} + 50 \text{ (foreign income tax)}}$			32%
Statutory percentage under section 963(b)(3)			63%

	P	S	Total
Minimum distribution required (63% × 105)			$ 66.15
Amount distributed	$120	-----	120.00
Excess distribution			53.85

Step 1:

$\frac{\$150}{\$200} \times \$50 = \$37.50$ Maximum deemed paid credit

Step 2:

$\frac{\$66.15}{\$105} \times \$37.50 = \$23.63$ Deemed paid credit on required minimum distribution

Step 3:

$\frac{\$53.85}{\$83.85\ (150 - 66.15)} \times \$13.87\ (37.50 - 23.63) = \$8.91$ Deemed paid credit on excess distribution

When the remaining $30 (150 —120) is distributed by P the deemed paid credit will be computed under Step 3 as follows:

Step 3:

$\frac{\$30}{\$83.85} \times \$13.87 = \$4.96$ Deemed paid credit on excess distribution

Rev. Ruls. 68-522 and 68-640 are modified. Rev. Rul. 71-406 is revoked.

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26 CFR 1.902-3: Credit for domestic corporate shareholders of a foreign corporation (after amendment by Revenue Act of 1962).
(Also Sections 78, 963, 964; 1.78-1, 1.963-1, 1.964-1.)

Controlled foreign corporation; foreign tax credit; rate of exchange. In 1971 a dividend was paid in foreign currency by a wholly-owned foreign corporation, which had no earnings and profits for that year, to its domestic parent out of earnings and profits for 1970. For 1970 the parent elected to exclude subpart F income and no minimum distribution was required. **Held**, the earnings and profits and the dividends paid therefrom which produce the fraction to be used in computing the foreign tax credit under section 902 of the Code must be translated into U.S. dollars at the average rate of exchange used in computing the earnings and profits for 1970 under section 1.964-1 of the regulations. However, the foreign taxes used in computing the foreign tax credit must be translated into U.S. dollars at the rate of exchange prevailing at the date the dividend was paid.

Rev. Rul. 74-230

Advice has been requested as to the appropriate foreign exchange rate for translating foreign currency into United States dollars for the purpose of computing the foreign tax credit under section 902 of the Internal Revenue Code of 1954, where an election under section 963 has been made.

P, a domestic corporation, is the parent of *S*, a wholly-owned controlled foreign corporation organized in a foreign country that is not a less developed country. Both *P* and *S* use the calendar year as their taxable year. For the taxable year 1970, *S* had earnings and profits before foreign taxes, determined pursuant to the provisions of section 1.964-1 of the Income Tax Regulations, of 1,000,000 units of foreign currency of the country in which it conducted business operations. Based on the effective foreign tax rate of 45 percent, the foreign income taxes accrued in 1970 on this income were 450,000 units.

P made a timely election under section 963 of the Code to exclude from its gross income for the taxable year 1970 the subpart F income of *S* for such year. Under section 963, no minimum distribution was required for 1970. On March 1, 1971, *S* paid *P* a dividend of 300,000 units of foreign currency out of the 1970 earnings and profits. *S* had no earnings and profits for 1971.

As determined under section 1.964-1(d) of the regulations one unit of foreign currency was worth $3 at the prevailing foreign exchange rate for taxable year 1970. However, at the time the foreign income tax due for 1970 was paid in 1971 and at the time the dividend was distributed, the prevailing foreign exchange rate was $2 for each unit of foreign currency.

Section 1.902-3(c)(5)(i) of the regulations provides, in effect, that with respect to a taxable year to which section 963 of the Code does not apply, the translation of earnings and profits shall be made at the proper exchange rate for the date of distribution.

Section 1.902-3(c)(5)(ii) of the regulations provides that for any taxable year of a foreign corporation with respect to which there applies under section 1.963-1(c)(1) an election by a corporate United States shareholder to exclude from its gross income for the taxable year the subpart F income of a controlled foreign corporation, the earnings and profits of such foreign corporation for such

year with respect to such shareholder must be determined, for purposes of section 902 of the Code, under the rules provided by section 1.964-1, even though the amount of the minimum distribution required under section 1.963-2(a) to be received by such shareholder from such earnings and profits of such foreign corporation, or from the consolidated earnings and profits of the chain or group which includes such foreign corporation, is zero.

Section 1.963-1(c)(1) of the regulations provides that a corporate United States shareholder may for any taxable year exercise the election to secure an exclusion from subpart F income under section 963 of the Code with respect to foreign corporations.

Section 1.964-1(a) of the regulations provides, in pertinent part, that for the purpose of sections 951 through 964 of the Code, the earnings and profits of a foreign corporation for its taxable year shall, except as provided in section 1.964-1(a)(f), be computed substantially as if such corporation were a domestic corporation by preparing a profit and loss statement with respect to such year from books of account regularly maintained by the corporation for the purpose of accounting to its shareholders and translating the amounts shown on such adjusted statements into United States dollars in accordance with section 1.964-1(d).

Section 1.964-1(d) of the regulations provides, in part, that the amount to be shown on the profit and loss statement adjusted pursuant to the provisions of section 1.964-1(b) and (c) shall be translated into United States dollars at the appropriate exchange rate for the translation period to which they relate.

Section 1.964-1(d)(6)(i) of the regulations provides, in part, that the translation period shall be a taxable year.

Section 1.964-1(e)(1) of the regulations provides that the exchange gain or loss determined in accordance with section 1.964-1(e)(2) shall be applied against and reduce, or applied to and increase, as the case may be, the amount of profit or loss shown on the profit and loss statement prepared pursuant to section 1.964-1(a)(1), as adjusted and translated pursuant to section 1.964-1(a)(2), (3), and (4).

In computing the tax credit under section 902 of the Code, section 1.902-3(c)(5)(ii) of the regulations makes the application of section 1.964-1 mandatory when an election under section 963 has been made. As previously indicated section 1.964-1(d) requires that the earnings and profits of the foreign corporation shall be translated into United States dollars at the appropriate exchange rate for the translation period to which they relate, that is, an average rate of exchange prevailing during the period for which the earnings and profits are computed.

Since the earnings and profits, the denominator of the fractional portion of the "section 902" formula, are translated at the average rate of exchange, as determined by section 1.964-1(d) of the regulations, the dividend paid out of such earnings and profits, the numerator of the fractional portion of the "section 902" formula, must also be translated at the same rate. By translating these two elements at the same rate of exchange, the relationship of the dividends paid to earnings and profits remains consistent and, thus, the fractional portion of the "section 902" formula will always reflect the true percentage of earnings and profits distributed in the form of dividends.

Under section 902 of the Code, the domestic shareholder is, in effect, deemed to have paid that portion of the foreign taxes that the dividend distributed by the foreign corporation bears to the earnings and profits of such foreign corporation. Thus, a direct relationship exists between the dividend received by the domestic shareholder and the foreign taxes paid by the foreign subsidiary. Under section 1.301-1(b) of the regulations, the domestic shareholder must include the dividend from the foreign corporation in gross income on the date such dividend is received. Thus, the dividend must be translated from foreign currency into United States dollars at the rate of exchange prevailing on the date of payment. See Rev. Rul. 74-222, page 21, this Bulletin, which holds that income reportable for Federal income tax purposes should be translated at the exchange rate in effect at the time the income is received. Also. see *Frank W. Ross*, 44 B.T.A. 1 (1941). Since the domestic shareholder must include the dividend at the rate prevailing on the date of payment, the foreign tax paid must be translated into United States dollars at the same rate inasmuch as such tax is directly connected to the dividend received. See *Bon Ami Company*, 39 B.T.A. 825 (1939), which stands for the proposition that in determining the foreign taxes deemed to have been paid by the domestic corporation, the foreign taxes paid relative to the dividends out of earnings and profits of prior taxable years may not be translated into United States dollars at the rate of exchange prevailing in such prior taxable year but must be translated into United States dollars at the rate of exchange prevailing in the taxable year in which the deemed paid credit is taken.

Section 78 of the Code provides, in part, that if a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a)(1) for such taxable year shall be treated as a dividend received by such domestic corporation from the foreign corporation for the purposes of the

Internal Revenue Code (other than section 245).

Accordingly, where an election under section 963 of the Code has been made, *S*'s earnings and profits and the dividends paid therefrom, which constitute the fractional element in computing the foreign tax credit under section 902, must be translated into United States dollars at the rate of exchange used in computing the earnings and profits under section 1.964-1 of the regulations for the taxable year to which they relate, that is, the taxable year 1970. However, the foreign taxes used in computing the foreign tax credit under section 902 must be translated into United States dollars at the rate of exchange prevailing on the date the dividend was paid, that is, March 1, 1971.

The computations, in the instant case, of the foreign tax deemed paid and the amount includible in *P*'s taxable income for 1971 are as follows:

	Foreign Currency	*Rate*	*U.S. Dollars*
Dividend	300,000 Units	1:3	900,000
Earnings & Profits (after tax)	550,000 Units	1:3	1,650,000
Foreign taxes	450,000 Units	1:2	900,000

Formula for foreign tax deemed paid under section 902(a)(1) of the Code:

$$\frac{\text{Dividend}}{\text{Earnings \& Profits (After tax)}} \times \text{Foreign Tax Paid} = \text{Foreign tax deemed to have been paid on profits distributed as dividends}$$

Application of the formula to the facts in the instant case:

$$\frac{\$\ 900{,}000}{\$1{,}650{,}000} \times \$\ 900{,}000 = \$\ 490{,}909 \quad \text{(foreign tax deemed paid)}$$

Computation of the amount includible in *P*'s taxable income for 1971 (taking into consideration the requirements of sections 61, 78, and 301 of the Code):

Code Section	*Foreign Currency*	*Rate*	*U.S. Dollars*
61 and 301	300.000 Units	1:2	600,000
Gross-up under section 78 (foreign tax deemed paid under section 902(a)(1), as above)			490,909
Amount includible in *P*'s taxable income for 1971:			1,090,909

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26 CFR 1.902-3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).

Creditability of the Coupon Tax imposed by Article 88a of the Liechtenstein Law of December 29, 1966. See Rev. Rul. 74-31, page 179.

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26 CFR 1.902-3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).

Whether the Swiss National Defense Tax is an income tax for the purposes of sections 901 and 902 of the Code. See Rev. Rul. 74-82, page 181.

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26 CFR 1.902-3: Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).

Whether the German Income Tax, the German Corporation Income Tax, and the Surcharge on the Income Tax and Corporation Income Tax are income taxes for purposes of sections 901 and 902 of the Code. See Rev. Rul. 74-90, page 181.

Section 904.—Limitation on Credit

26 CFR 1.904-2: Carryback and carryover of unused foreign tax.

Whether the foreign tax reduction under section 1503(b)(1) of the Code qualifies for carryback and carryover. See Rev. Rul. 74-72, page 253.

Subpart C.—Western Hemisphere Trade Corporations

Section 921.—Definition of Western Hemisphere Trade Corporations

26 CFR 1.921-1: Definition of Western Hemisphere trade corporation.

Western Hemisphere trade corporations; title to goods retained until foreign delivery. Sales of goods by a domestic corporation engaged in selling goods purchased in the U.S. to customers in Western Hemisphere countries under straight bills of lading naming the customer as consignee, but subject to a written agreement providing that title to the goods, responsibility for shipment, and risk of loss remain with the domestic corporation until the goods reach their destination, constitutes a clear expression of intent to pass title in the country of destination and, accordingly, gross income from such sales will be considered gross income from sources without the U.S. for purposes of section 921 of the Code.

Rev. Rul. 74-249

Advice has been requested whether, under the circumstances described below, a taxpayer's gross income from the sale of goods will be considered gross income from sources without the United States for purposes of section 921 of the Internal Revenue Code of 1954.

The taxpayer, a domestic corporation, is engaged in the business of selling goods purchased in the United States to customers in various countries in the Western Hemisphere (other than the United States). For the taxable years in question, the tax-

payer claimed the special deduction for Western Hemisphere trade corporations provided by section 922 of the Code. During such taxable years, the taxpayer shipped the goods to its foreign customers under straight bills of lading naming the customer as consignee. However, it was the customary procedure of the taxpayer to enter into a written agreement with its customers providing that title to the goods, responsibility for shipment, and risk of loss would remain with the taxpayer until the shipment physically reached the country of destination.

One of the requirements for Western Hemisphere trade corporation status is set forth in section 921(1) of the Code. That section provides, in effect, that 95 percent or more of the gross income of the domestic corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States.

In Rev. Rul. 64-198, 1964-2 C.B. 189, the Internal Revenue Service announced that it would follow the decisions in the cases of *Commissioner v. Pfaudler Inter-American Corp.*, 330 F. 2d 471 (2d Cir. 1964), and *Commissioner v. Hammond Organ Western Export Corp.*, 327 F. 2d 964 (7th Cir. 1964). These decisions held, in pertinent part, that the place of sale, for purposes of section 921 of the Code, is determined by the place where the title to the property and other incidents of ownership passed to the buyer.

In *A. P. Green Export Co. v. United States*, 284 F. 2d 383 (Ct. Cl. 1960), the United States Court of Claims considered a situation where an exporter, organized as a Western Hemisphere trade corporation, shipped its goods to its customers under a straight bill of lading naming the buyer as consignee. The shipments were subject to a contractural arrangement that title to the goods and responsibility for their shipment and safe carriage were in the exporter until delivery to the customer at destination. The court held that, under these circumstances, the intent of the parties as to passage of title was controlling, and that title passed without the United States for purposes of section 921 of the Code.

In view of the decision in *A. P. Green Export Co.*, it is held that the agreement as to passage of title, responsibility for shipment, and risk of loss between the taxpayer and its customers in the instant case constitutes a clear expression of intent that title to the goods passes in the country of destination.

Accordingly, in the instant case, the taxpayer's procedure of shipping the goods under a straight bill of lading with the customer named as consignee will not result in title passing in the United States and the taxpayer's gross income from the sale of goods will be considered gross income from sources without the United States for purposes of section 921 of the Code.

Subpart F.—Controlled Foreign Corporations

Section 956.—Investment of Earnings in United States Property

26 CFR 1.956-1: Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property.

Controlled foreign corporations; pension plan investment in U.S. securities. Contributions by a controlled foreign corporation to a trusteed pension plan satisfying the requirements of section 401(a) of the Code and invested by the trustee in stock of domestic corporations and obligations of U.S. persons are not earnings invested in U.S. property within the meaning of section 956.

Rev. Rul. 74-41

Advice has been requested whether, under the circumstances described below, contributions by a foreign subsidiary to a trust will constitute earnings invested in United States property within the meaning of section 956 of the Internal Revenue Code of 1954.

Y, a controlled foreign corporation within the meaning of section 957(c) of the Code, is a wholly-owned subsidiary of *X*, a domestic corporation. *Y* adopted a plan to provide retirement pension benefits to its employees, and incident to such plan has created a trust for the management and administration of pension funds. The plan satisfies the requirements for qualification under section 401(a) and, therefore, the trust is exempt from taxation under section 501(a).

Under the plan *Y*'s contributions to the trust are for the exclusive benefit of its employees and their beneficiaries. *Y* has no beneficial interest in the trust corpus except for its reversionary interest that is limited to funds remaining in the trust upon termination due solely to erroneous actuarial computation.

The cash contribution of *Y* is invested by the trustees in stocks of domestic corporations and obligations of United States persons. *Y*'s contributions did not result in an over-funding of the trust (other than through an erroneous actuarial computation), and no amount of the trust income or corpus was diverted to *Y*.

The specific question is whether such investments, by the trustees, constitute investment of earnings in United States property within the meaning of section 956 of the Code.

Section 956 of the Code provides that United States shareholders of controlled foreign corporations are taxed on their pro rata share of the corporation's increase in earnings invested in United States property.

Section 956(a)(1) of the Code provides, in part, that the amount of earnings of a controlled foreign corporation invested in United States property at the close of any taxable year is the aggregate amount of such property held, directly or indirectly, by the controlled foreign corporation at the close of the taxable year, to the

extent such amount would have constituted a dividend if it had been distributed.

Section 956(b) of the Code defines the term "United States property," in relevant part, as any property acquired after December 31, 1962, which is stock of a domestic corporation or an obligation of a United States person.

Section 1.956-1(b)(3), of the Income Tax Regulations provides, in part, that a controlled foreign corporation will be considered to hold indirectly the investments in United States property held *on its behalf* by a trustee.

A qualified trust within the meaning of section 401 of the Code, is a trust created by an employer for the exclusive benefit of his employees and their beneficiaries, and not for the benefit of the employer-donor.

Since the trust in the instant case is a qualified trust under section 401(a) of the Code, the stocks of domestic corporations and obligations of United States persons held in trust will not be deemed to be held by the trustee on behalf of *Y* within the meaning of section 1.956-1(b)(3) of the regulations, unless *Y*'s contributions result in an over-funding of the trust (other than erroneous actuarial computation), or unless amounts of trust income or corpus are diverted to *Y*.

Accordingly, it is held that amounts contributed by *Y* to the trust are not earnings invested in United States property within the meaning of section 956 of the Code, because none of *Y*'s contributions result in an overfunding of the trust (other than through an erroneous actuarial computation), and no amounts of trust income or corpus are diverted to *Y*.

Section 963.—Receipt of Minimum Distributions by Domestic Corporations

26 CFR 1.963-1: Exclusion of subpart F income upon receipt of minimum distribution.

Controlled foreign corporations; minimum distribution. The minimum distribution under section 963 of the Code with respect to a dividend distribution made to a wholly-owned first-tier controlled foreign corporation, a member of a chain election, from previously taxed Subpart F income of a wholly-owned second-tier foreign corporation, not included in the chain election, is set forth.

Rev. Rul. 74-6

Advice has been requested as to the treatment under section 963 of the Internal Revenue Code of 1954 of dividends received by a first-tier controlled foreign corporation (a member of a chain election) from the previously taxed subpart F income of a second-tier foreign corporation which is not included in the chain election.

Specifically, it has been requested whether for purposes of section 963 of the Code (1) the earnings and profits of *Y*, a wholly-owned first-tier foreign subsidiary of a United States corporation (included in a chain election), for the taxable year to which the election relates are determined by excluding dividends (together with any foreign income taxes paid in respect thereto) received from *Z*, a wholly-owned second-tier foreign subsidiary (not included in the chain election), and which were paid out of previously taxed subpart F income, (2) the amount of the minimum distribution, the earnings and profits, and the effective foreign tax rate for the chain is determined without regard to such dividends and the foreign income taxes applicable thereto, and (3) a minimum distribution by *Y* is considered to be first out of earnings and profits other than earnings and profits attributable to the previously taxed subpart F income received from *Z*.

Z has no earnings and profits attributable to investments in United States property and both *Y* and *Z* are not less developed country corporations.

Section 1.963-3(c)(2) of the Income Tax Regulations provides, in relevant part, that in the case of a chain or group election a distribution received by a foreign corporation in the chain or group from another foreign corporation in such chain or group shall be taken into account as earnings and profits of the recipient corporation for the taxable year of the recipient to which the election relates, but only to the extent that (1) the distribution is received by the recipient corporation during the distribution period for the taxable year of such recipient corporation to which the election relates, (2) if the distribution had been received by the United States shareholder, it would have constituted a distribution qualifying as counting toward a minimum distribution, i.e., *not* a distribution excludable from gross income, and (3) the distribution is made from the earnings and profits of the distributing corporation for the taxable year of such distributing corporation to which the election relates.

Thus, for purposes of section 963 of the Code, if *Y* had received a distribution from one of its subsidiaries included in the chain election, and such distribution, if received by the United States shareholder, would be excluded from its gross income, such distribution would *not* be taken into account as earnings and profits of *Y* for the taxable year of *Y* to which the election relates.

Based on this principle of exclusion from earnings and profits, the earnings and profits for the taxable year of election of *Y* (included in a chain election) should be determined by excluding the distribution of previously taxed subpart F income received from *Z* (not included in the chain election) which was included in the United States shareholder's gross income.

Accordingly, it is held that for purposes of section 963 of the Code the earnings and profits of *Y* for the

taxable year of election shall be determined by excluding dividends consisting of previously taxed subpart F income received from *Z*. It follows that any foreign income taxes paid with respect to such dividends should also be excluded for such purposes.

Since the dividend received by *Y* from *Z* consisted entirely of subpart F income previously taxed to the United States shareholder and is therefore excludable by *Y* from its earnings and profits for purposes of section 963 of the Code, and since the foreign income tax paid on such dividend does not reduce the earnings and profits of *Y*, neither the dividend nor the tax is included in determining the minimum distribution, the earnings and profits, or the effective foreign tax rate for the chain.

Section 1.963-3(a) of the regulations provides, in part, that a distribution to a United States shareholder by a foreign corporation included in a chain shall count toward a minimum distribution for the taxable year of such shareholder to which the section 963 election relates *only* to the extent it is a distribution of the type described in section 1.963-3(b).

Section 1.963-3(b) of the regulations excludes from distributions counting toward a minimum distribution, any distribution to the extent it is excludable from gross income (except distributions from earnings and profits for the taxable year attributable to amounts required to be included in gross income of such shareholder as an increase in United States property for such year). See also section 1.963-3(e).

The dividend received by *Y* from the previously taxed subpart F income of *Z* is excludable from the gross income of both the United States shareholder and *Y*. Section 959(a) and (b) of the Code. Therefore, such distribution will not count toward a minimum distribution by *Y* to the United States shareholder under section 963 and section 1.963-3(b) and (e) of the regulations.

Accordingly, for purposes of section 963 of the Code, a minimum distribution by *Y* to the United States shareholder is considered to be first out of current earnings and profits of the type described in section 959(c)(1), then out of current earnings and profits of the type described in section 959(c)(2), and last out of other earnings and profits. Therefore, such minimum distribution would not include (because of the exclusion from gross income under section 1.963-3(b) of the regulations) the distribution of previously taxed subpart F income to *Y* by *Z*. Such minimum distribution is considered to be first out of earnings and profits other than earnings and profits attributable to the previously taxed subpart F income received by *Y* from *Z*.

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26 CFR 1.963-1: Exclusion of subpart F income upon receipt of minimum distribution.

Whether in the case of an election under section 963 of the Code, the dividends paid by the foreign corporation which constitute the fractional element in computing the foreign tax credit under section 902 must be translated into United States dollars at the rate of exchange used in computing the earnings and profits under section 1.964-1 of the regulations for the taxable year to which they relate. See Rev. Rul. 74-230, page 187.

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26 CFR 1.963-4: Limitations on minimum distribution from a chain or group.

For method of computing the deemed paid credit under section 902(a)(2) of the Internal Revenue Code of 1954 under a chain or group election for the purposes of section 963 of the Code. See Rev. Rul. 74-83, page 184.

Section 964.—Miscellaneous Provisions

26 CFR 1.964-1: Determination of the earnings and profits of a foreign corporation.
(Also Section 1248; 1.1248-1.)

Controlled foreign corporations; timely election to adopt accounting method. A written statement filed on July 14, 1967, on behalf of a controlled foreign corporation by its U.S. shareholders to elect certain alternative accounting methods and practices regarding exploration and development expenses incurred prior to November 1, 1963, was timely filed under section 1.964-1(c)(6) of the regulations with respect to an exchange of stock made on July 17, 1967 which required the determination of the corporation's earnings and profits under section 1248 of the Code.

Rev. Rul. 74-272

Advice has been requested whether, under the circumstances described below, an election filed on July 14, 1967, was timely filed under section 1.964-1(c)(6) of the Income Tax Regulations.

In a written statement filed with the Internal Revenue Service on July 14, 1967, the United States shareholders of *X*, a foreign corporation, elected certain alternative accounting methods and practices for computing the hypothetical United States taxable income of *X* for purposes of determining its earnings and profits and the Federal income taxes payable under section 1248 of the Internal Revenue Code of 1954 relating to gain from certain sales or exchanges of stock in certain foreign corporations. An exchange of *X* shares was made on July 17, 1967, which would require the determination under section 1248. No previous elections had been made or were required to have been made. *X* had been a controlled foreign corporation since 1960. The elections included in the written statement were those under section 615(b) and 616(b) whereby exploration and development expenses incurred prior to November 1, 1963, were to be amortized and deducted for the years beginning on and after November 1, 1963.

Section 1248(a) of the Code provides, in general, that if a United

States person sells or exchanges stock in a foreign corporation or receives a distribution from such foreign corporation which, under section 302 or 331, is treated as in exchange for stock, and such person owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation, as defined in section 957, then the gain recognized shall be included in the gross income of such person as a dividend to the extent of the earnings and profits of the foreign corporation attributable to such stock which were earnings and profits accumulated in taxable years beginning after December 31, 1962, and during the period or periods that stock sold was held by such person while the corporation was a controlled foreign corporation.

Section 1248(c) of the Code provides, in general, that for purposes of section 1248 the earnings and profits of any foreign corporation for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary or his delegate.

Sections 1.1248-2(d)(1) and 1.1248-3(b)(1) of the regulations provide, in general, that for purposes of section 1248 of the Code the earnings and profits accumulated for a taxable year of a foreign corporation shall be the earnings and profits for such year computed in accordance with the rules prescribed in section 1.964-1, subject to adjustments for certain described circumstances. If the stock in the corporation is sold or exchanged before any action is taken by or on behalf of the corporation under section 1.964-1(c), the computation of earnings and profits under section 1.964-1 for purposes of section 1248 shall be made as if no election had been made and no accounting method had been adopted.

Section 1.964-1(c)(2), of the regulations provides that for the first taxable year beginning after December 31, 1962, in which the foreign corporation is a controlled foreign corporation or for which it is included in a chain or group under section 963(c)(2)(B) or (3)(B) of the Code or has a deficit in earnings and profits sought to be taken into account under section 952(d), there may be adopted or made by such corporation or on its behalf any method of accounting or election provided under the Code for which it can satisfy the requirements, just as though it were a domestic corporation, notwithstanding that in previous years its earnings and profits were computed or its books or financial statements prepared, on a different basis and notwithstanding that such election is required by the Code and regulations to be made in a prior taxable year.

Section 1.964-1(c)(3) of the regulations provides, in pertinent part, that an election or an adoption or change in method of accounting shall be deemed made on behalf of the foreign corporation only if its controlling U.S. shareholders (among other things) file a written statement at the place specified in the regulations within 180 days after the close of the taxable year of the foreign corporation with respect to which the election is made or before May 1, 1965 (extended to September 15, 1965, by Rev. Rul. 65-148, 1965-1 C.B. 355), whichever is later.

Section 1.964-1(c)(6) of the regulations provides, in pertinent part, that notwithstanding any other provision of this paragraph (c), action by or on behalf of a foreign corporation (other than a foreign corporation subject to tax under section 882 of the Code) to make an election shall not be required until 180 days after the close of the first taxable year for which (i) an amount is includible in gross income with respect to such corporation under section 951(a); (ii) it is sought to be established that the corporation is a less developed country corporation; (iii) an amount is excluded from subpart F income by sections 952(c), 952(d), or 970(a); or (iv) an election under section 963 has been made with respect to such corporation. Where the action necessary to make an election is undertaken by or on behalf of the foreign corporation in accordance with section 1.964-1(c)(6), such election shall be deemed to have been made for the first taxable year of the foreign corporation beginning after December 31, 1962, in which such foreign corporation is a controlled foreign corporation, or for which it is included in a chain or group election under section 963, or has a deficit in earnings and profits sought to be taken into account under section 952(d).

Section 1.964-1(c)(6) of the regulations modifies the general rule set forth in section 1.964-1(c)(3) by permitting an election or adoption of an accounting method to be deferred until 180 days after the close of the taxable year in which one of the significant events set forth in that regulation occurs. While the exchange of stock on July 17, 1967 is not one of these significant events, there is no requirement that one of the events occur before an election can be made. Rather, an election can be made at any time prior to the event and for up to 180 days following the end of the taxable year in which the event occurs.

Accordingly, the election or adoption of accounting method made on July 14, 1967, by or on behalf of the foreign corporation *X* was timely filed under section 1.964-1(c)(6) of the regulations.

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26 CFR 1.964-1: Determination of the earnings and profits of a foreign corporation.

Whether in the case of an election under

section 963 of the Code, the dividends paid by the foreign corporation which constitute the fractional element in computing the foreign tax credit under section 902 must be translated into United States dollars at the rate of exchange used in computing the earnings and profits under section 1.964-1 of the regulations for the taxable year to which they relate. See Rev. Rul. 74-230, page 187.

Part IV.—Domestic International Sales Corporations
Subpart A.—Treatment of Qualifying Corporations

Section 993.—Definitions

DISC; producer's loans. A domestic corporation in the business of growing and selling apples that organizes a DISC to export its apples and make producer's loans to it may take into account as "supporting production facilities" for purposes of section 993(d)(2)(A) of the Code its present lands with apple orchards and underground irrigation facilities as well as additional land in the U.S. to be purchased for growing apples.

Rev. Rul. 74-105

Advice has been requested whether certain properties will qualify as "supporting production facilities" within the meaning of section 993(d)(2)(A) of the Internal Revenue Code of 1954.

The taxpayer is a domestic corporation engaged in the business of growing and selling apples.

The taxpayer proposes to organize a Domestic International Sales Corporation (DISC). The DISC will export all apples grown by the taxpayer and will make producer's loans, within the meaning of section 993(d)(1) of the Code, to the taxpayer.

The taxpayer owns land which contains apple orchards thereon as well as irrigation systems situated below ground. The taxpayer intends to purchase additional land in the United States which will be used to grow apples. Some of the land will be undeveloped and unimproved. Such undeveloped and unimproved land will be cleared, prepared, and planted with apple trees within a year of the acquisition of such land.

Section 993(d)(2)(A) of the Code provides that an obligation shall be treated as arising out of a producer's loan only to the extent that such loan, when added to the unpaid balance of all other producer's loans to the borrower outstanding at the time such loan is made, does not exceed an amount determined by multiplying the sum of the borrower's export-related assets by a percentage described in such section. The amount of the borrower's export-related assets includes the borrower's adjusted basis, determined at the beginning of the borrower's taxable year in which the loan is made, in plant, machinery, and equipment, and supporting production facilities in the United States.

The term "supporting production facilities" as used in section 993(d)(2)(A) of the Code includes all property used primarily in connection with the manufacture, production, growth, or extraction or storage, handling, transportation or assembly of property by the borrower.

Accordingly, in the instant case, the lands presently owned by the taxpayer and the lands which are to be purchased for the purpose of growing apples, together with any apple trees thereon, and any irrigation systems below ground will qualify as supporting production facilities within the meaning of section 993(d)(2)(A).

DISC; export receipts; commissions on fees received for conversion of raw materials. Amounts received from a foreign corporation by a domestic corporation that proposes to organize a DISC to act as the domestic corporation's commission agent for its activities in connection with converting the foreign corporation's raw materials into liquid extract prior to export will not be "qualified export receipts" under section 993(a)(1) of the Code.

Rev. Rul. 74-216

Advice has been requested as to the application, under the circumstances described below, of certain definitions contained in section 993 of the Internal Revenue Code of 1954.

X, a foreign corporation, acquires raw materials in the United States from various United States corporations and, prior to exporting such raw materials, delivers them to a domestic corporation which converts the raw materials into liquid extract. *X* makes payment directly to the domestic corporation for the conversion process. The domestic corporation proposes to organize a DISC and intends to pay a commission to the proposed DISC for its activities in connection with the arrangements between the domestic corporation and *X*.

The question is whether the receipts received by the domestic corporation for the conversion process with respect to which the DISC acts as a commission agent are "qualified export receipts" within the meaning of section 993(a)(1) of the Code.

Section 993(c)(1)(A) of the Code provides that the term export property means property manufactured, produced, grown, or extracted in the United States by a person other than a DISC.

Section 993(a)(1) of the Code provides, in part, that gross receipts from the sale, exchange, or other disposition of export property will constitute qualified export receipts.

Gross receipts of a DISC will constitute qualified export receipts under section 993(a)(1)(A) only if such receipts are realized through a sale, exchange, or other disposition of export property. Amounts received solely as fees for manufacturing, producing, growing, or extracting property are not receipts realized through the sale, exchange, or other disposition of export property.

Since the amounts received by the domestic corporation for conversion of raw materials are not receipts from the sale, exchange, or other disposition of export property, the receipts will not be qualified export receipts under section 993(a)(1) of the Code.

DISC; export property and qualified export receipts. Gross receipts of a newly-formed, wholly-owned DISC after the DISC began acting as commission agent for all export sales and leases of its parent's products are qualified export receipts under section 993(a)(1) of the Code, irrespective of when the products were ordered. Products leased to foreign marketing subsidiaries for sublease to foreign customers are not excluded from the definition of "export property."

Rev. Rul. 74-217

Advice has been requested as to the application, under the circumstances described below, of certain definitions contained in section 993 of the Internal Revenue Code of 1954.

X, a domestic corporation, organized a wholly-owned subsidiary, *S*, as a Domestic International Sales Corporation (DISC) on March 31, 1972. *S* has its own bank account and separate books and records. *S* has no employees on its payroll. *X* markets, and will continue to market, its products to foreign customers through its wholly-owned foreign marketing subsidiaries who sell or lease *X*'s products to foreign customers. In rare instances, *X* sells directly to foreign customers. All of *X*'s products sold or leased to foreign customers are in their entirety produced, manufactured, and assembled in the United States.

X proposes to have *S* act as its commission agent with respect to all export sales and leases. *X* will continue to sell or lease its products to its foreign marketing subsidiaries who, in turn, will continue to resell or sublease *X*'s products to foreign customers.

The specific questions presented are (1) whether the receipts arising from shipments of *X*'s products on or after April 1, 1972, with respect to which *S* acts as commission agent are "qualified export receipts" irrespective of the date on which such products may have been ordered, provided that the receipts otherwise qualify as "qualified export receipts" under section 993(a)(1) of the Code; and (2) whether property is excluded from the definition of "export property" contained in section 993(c), if the property is leased by *X* to a foreign marketing subsidiary that subleases the products to an unrelated party for use outside the United States.

With respect to question (1) above, section 993(a)(1) of the Code provides, in relevant part, that the qualified export receipts of a corporation include (A) gross receipts from the sale, exchange, or other disposition of export property, (B) gross receipts from the lease or rental of export property, which is used by the lessee of such property outside the United States, and (C) gross receipts for services that are related and subsidiary to any qualified sale, exchange, lease, rental, or other disposition of export property by such corporation.

Section 993(f) of the Code provides, in part, that in the case of commissions on the sale, lease, or rental of property, the amount taken into account as gross receipts shall be the gross receipts on the sale, lease, or rental of the property on which such commissions arose.

Announcement 72-23, 1972-1 C.B. 679, 690, provides that receipts arising on or after January 1, 1972, from export properties shipped on or after January 1, 1972, even though the contract to sell the property was entered into before January 1, 1972, can be income of the DISC giving rise to qualified export receipts, if there is an appropriate assignment under which the DISC participates in the transaction as principal or agent.

Accordingly, in the instant case the gross receipts arising from the shipments of *X*'s products on or after April 1, 1972, are qualified export receipts of *S* irrespective of the date on which such products may have been ordered, provided that *S* participates in the transaction as agent and the receipts otherwise qualify as "qualified export receipts" under section 993(a)(1) of the Code. In connection with export lease transactions, the DISC must act as *X*'s agent at the beginning of the lease term and qualify as a DISC for its taxable year in which the lease term begins.

With respect to question (2) above, section 993(c)(2)(A) of the Code provides that the term "export property" does not include property leased or rented by a DISC or used by any member of a controlled group which includes the DISC.

Section 993(c)(2)(A) of the Code was designed to prevent United States corporations from using a DISC to convert substantial amounts of what otherwise would be manufacturing or operational income, as distinguished from selling income, into tax deferred income. This could occur if property, which otherwise would be used outside the United States in the parent's operations, was sold by the parent to a DISC subsidiary and then leased back from the DISC, since this would permit taxable operational profits to be converted into tax-deferred rental income. Thus, any property leased to a corporation which is a member of the same group of controlled corporations as the DISC for its ultimate use is not to be considered export property in the hands of the DISC. See *S. Rep. No. 92-437*, 92d Cong., 1st Sess. (1971), 1972-1 C.B. 559, 616.

Accordingly, property is not excluded from the definition of export property contained in section 993(c) of the Code, solely because the product is leased by *X* to a foreign mar-

keting subsidiary that subleases the product to an unrelated party for use outside the United States.

Subchapter O. Gain or Loss on Disposition of Property
Part I.—Determination of Amount of and Recognition of Gain or Loss

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Section 1001.—Determination of Amount of and Recognition of Gain Or Loss

26 CFR 1.1001-1: Computation of gain or loss.
(Also Section 1014; 1.1014-2.)

Appreciated stock transferred in settlement of claim against decedent's estate. A decedent's estate transferring appreciated stock in settlement of a claim against the estate realizes gain measured by the excess of the amount of the claim over the estate's basis in the stock. Had the estate's basis in the stock exceeded the amount of the claim it would have sustained a deductible loss.

Rev. Rul. 74-178

Advice has been requested whether, under the circumstances described below, a decedent's estate realizes gain upon the transfer of appreciated property to satisfy a claim against the estate.

At the time of his death on February 1, 1973, the decedent owned 150 shares of common stock in a domestic corporation. These shares were acquired from the decedent by his estate and valued for Federal estate tax purposes at $70 per share, which was the fair market value of a share at the date of his death. On the Federal estate tax return filed on behalf of the decedent's estate, the executor did not elect the alternate valuation date prescribed by section 2032 of the Internal Revenue Code of 1954. An unrelated creditor of the decedent subsequently filed a claim against the estate for $8,000. The claim was based upon an indebtedness of $8,000 that the decedent owed the creditor at the date of his death. In an arm's-length transaction the executor of the estate transferred 100 shares of the stock to the creditor in satisfaction of the claim. The fair market value of a share at the time of the transfer was $80.

Section 1001(a) of the Code provides, in part, that the gain from the disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain.

Section 1011(a) of the Code provides, in part, that the adjusted basis for determining the gain from the disposition of property shall be the basis determined under the applicable provisions of the Code.

Section 1014(a) of the Code provides, generally, that the basis of property in the hands of a person acquiring the property from a decedent shall be the fair market value of the property at the date of the decedent's death or, where there is an appropriate election, at the alternate valuation dates as provided in section 2032.

Section 1.1014-2(a)(1) of the Income Tax Regulations provides, in part, that property acquired by the decedent's estate from the decedent is considered to have been acquired from a decedent.

Rev. Rul. 66-207, 1966-2 C.B. 243, holds, in part, that where an executor distributes appreciated property in partial satisfaction of a pecuniary legacy, the estate realizes gain to the extent of the difference between the amount of the bequest satisfied and the estate's basis in the property. That Revenue Ruling states that the effect of the distribution will be the same as if the executor sold the assets of the estate and distributed the proceeds.

In the instant case the fair market value of the shares of stock at the time such stock was transferred to the creditor is equal to the amount of the claim satisfied ($8,000). However, since the executor did not elect the alternate valuation date, the estate's basis in the shares transferred is the fair market value of the shares at the date of the decedent's death ($7,000). Accordingly, it is held that upon such transfer the estate realized a gain of $1,000, which is the excess of the amount of the claim satisfied by the transfer over the estate's basis in the shares. Had the estate's basis in the shares of stock transferred exceeded the amount of the claim satisfied, the estate would have sustained a loss deductible to the extent allowed in sections 1211 and 1212 of the Code.

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26 CFR 1.1001-1: Computation of gain or loss.

Liquidation of loaned securities. An individual who executed in favor of a corporation a collateral agreement and a noninterest-bearing demand note secured by cash and securities held for more than six months, received preferred stock of a successor corporation when the collateral was liquidated to satisfy the note, and sold the preferred stock at a loss after holding it for more than six months must treat the transaction as two transactions resulting in (1) a long-term capital gain to the extent the proceeds from the liquidation of the securities exceeded the basis, and (2) a long-term capital loss to the extent the total collateral proceeds used to satisfy the note exceeded the selling price of the preferred stock.

Rev. Rul. 74-301

Advice has been requested concerning the treatment, for Federal income tax purposes, of the transaction described below.

An individual taxpayer entered into a subordinated loan arrangement with a corporate stockbrokerage firm in order to provide the corporation with sufficient cash and securities to satisfy the capital requirements of the New

York Stock Exchange. In addition to a collateral agreement, the taxpayer executed a noninterest-bearing secured note to the corporation. Under the terms of the note, the taxpayer promised to pay the corporation, on demand, the sum of $200,000. The note was secured by a pledge of cash and securities owned by the taxpayer but in the possession of the corporation. Under the agreement the assets pledged were at all times to have a fair market value equal to the face amount of the note ($200,000). The taxpayer was not personally liable on the note since the corporation would look for payment solely to the cash and securities pledged. The securities pledged represented capital assets held by the taxpayer for a period in excess of six months. The basis of the securities to the taxpayer was $159,000.

The collateral agreement provided that the taxpayer was to receive annually a cash payment equal to five percent of the principal amount of the note ($200,000). Subject only to the prior rights of the corporation as pledgee, the taxpayer retained full legal and beneficial ownership of the pledged assets. He had the sole right to vote any of the pledged stock and the sole right to any income therefrom.

The corporation, as holder of the note and pledgee of the assets, was entitled to liquidate and sell the pledged assets (other than cash) and to apply the proceeds of such sale in payment of the indebtedness if the note was not paid upon demand. In the event of such liquidation of his securities, the taxpayer had the right to receive a registered debenture in exchange for the corporation's right to apply the proceeds of the sale and the cash pledged to satisfy the indebtedness evidenced by the note.

Although neither insolvent nor bankrupt, the corporation determined that it required additional funds to meet its maturing obligations and, therefore, demanded payment of the note. When payment was not made by the taxpayer, the securities pledged were liquidated. The liquidation of the securities pledged resulted in the receipt of $190,000 by the corporation and it was necessary to use the $10,000 cash pledged to satisfy the note.

In order to keep the corporation solvent and enable it to enter into a reorganization, the taxpayer exchanged his right to receive a registered debenture of the corporation for 2,000 shares of preferred stock of the corporation's successor. The taxpayer sold all of the preferred stock for $150,000 in August of the subsequent tax year.

The taxpayer engaged in no other capital asset transactions during his taxable year in which the corporation liquidated the pledged securities or during his subsequent taxable year.

In order to ascertain the Federal income tax consequences, each transaction must be analyzed independently of the other. The first transaction was the liquidation of the pledged securities. The second transaction was the sale of the preferred stock.

Section 1001(a) of the Internal Revenue Code of 1954 provides, in part, that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 of the Code for determining gain. Unless otherwise provided in subtitle A of the Code, such realized gain shall be recognized under section 1002 of the Code.

Since the execution of the collateral agreement by the taxpayer, in effect, merely gave the corporation the authority to sell the securities pledged and since all other rights to such securities were retained by the taxpayer at the time of the sale, the liquidation of such securities gave rise to a taxable event by or on behalf of the taxpayer.

Accordingly, it is held, in the instant case, that the gain of $31,000 (liquidation price of $190,000 less adjusted basis of $159,000) realized upon the liquidation and sale of the taxpayer's securities must be recognized by the taxpayer in the taxable year of the taxpayer in which the sale occurred. The gain qualifies as a long-term capital gain within the meaning of section 1222(3) of the Code.

The basis of the preferred stock to the taxpayer was equal to the sum of the proceeds realized upon the liquidation of the securities pledged, $190,000, plus the amount of cash required to satisfy the note in full, $10,000, a total of $200,000. Thus, the taxpayer realized a loss of $50,000 (the excess of the basis of $200,000 over the selling price of $150,000) upon the sale of the preferred stock in the following year. The loss qualified as a long-term capital loss within the meaning of section 1222(4) of the Code.

Part II.—Basis Rules of General Application

Section 1012.—Basis of Property—Cost

26 CFR 1.1012-1: Basis of property.

Basis of new residence partially acquired with replacement housing payments. See Rev. Rul. 74-205, page 20.

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26 CFR 1.1012-1: Basis of property.

Whether storage and other charges accruing against whiskey warehouse receipts are capital expenditures. See Rev. Rul. 74-264, page 40.

Section 1014.—Basis of Property Acquired From A Decedent

26 CFR 1.1014-2: Property acquired from a decedent.

Basis of property acquired by the decedent's estate from the decedent. See Rev. Rul. 74-178, page 196.

Section 1017.—Discharge of Indebtedness

26 CFR 1.1017-1: Adjusted basis; discharge of indebtedness; general rule.

Whether a reduction in basis of section 38 property, pursuant to section 1017 of the Internal Revenue Code of 1954 resulting from an election under section 108 requires a recomputation of the investment credit. See Rev. Rul. 74-184, page 8.

Part III.—Common Nontaxable Exchanges

Section 1031.—Exchange of Property Held for Productive Use or Investment

26 CFR 1.1031(a)-1: Property held for productive use in trade or business or for investments.
(Also Section 1221; 1.1221-1.)

Foreign currency reconverted into U.S. dollars. The reconversion of a foreign country's currency into U.S. dollars after a visit to that country by a U.S. citizen, not a dealer in foreign currency or engaged in a trade or business in that country, is not a like kind exchange under section 1031(a) of the Code. The foreign currency is a capital asset and any gain or loss realized on the reconversion is a capital gain or loss. I.T. 3810 superseded.

Rev. Rul. 74-7 [1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 3810, 1946-2 C.B. 55.

The question presented is whether, after the conversion of United States dollars into foreign currency by a United States citizen traveling in the foreign country, the reconversion of the foreign currency into dollars may be treated as an exchange of property held for productive use in trade or business or for investment for property of a like kind to be held for productive use in trade or business or for investment, under section 1031 of the Internal Revenue Code of 1954. If not, the further question presented is whether the gain or loss realized on such a transaction by a taxpayer, who is not a dealer in foreign currency, constitutes capital gain or loss under section 1221 of the Code.

The taxpayer, a United States citizen, while traveling in a foreign country deposited United States dollars in a bank in that country. At his request, the bank converted these dollars to that country's currency for the taxpayer's personal use. The taxpayer was not a dealer in foreign currency and was not engaged in trade or business in the foreign country. During his travels there were no transactions in the foreign bank account. At the conclusion of his stay, the taxpayer requested the bank to reconvert the foreign currency to dollars and close his account. The value of the foreign currency, measured in terms of dollars, differed at the time the account was closed from the value when the account was opened.

Section 1031(a) of the Code provides, in part, that no gain or loss shall be recognized if property held for productive use in trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

In the instant case, the foreign currency does not constitute property held for productive use in trade or business or for investment, and therefore the reconversion is not a like kind exchange under section 1031(a) of the Code.

Section 1221 of the Code provides, in part, that the term "capital asset" means property held by the taxpayer, but does not include certain specified property. Section 1.1221-1(a) of the Income Tax Regulations provides, in part, that the term "capital assets" includes all classes of property not specifically excluded by section 1221.

In the instant case, the foreign currency is not excluded from the definition of capital assets contained in section 1221 of the Code.

Accordingly, the foreign currency is a capital asset and any gain or loss realized on the reconversion by the taxpayer is a capital gain or capital loss.

I.T. 3810 is hereby superseded, since the position stated therein is restated under the current law in this Revenue Ruling.

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.

Section 1032.—Exchange of Stock for Property

26 CFR 1.1032-1: Disposition by a corporation of its own capital stock.

Whether gain or loss is recognized upon the transfer of the assets of a tax-exempt fraternal beneficiary society to a taxable mutual life insurance company in exchange for the taxable company's stock. See Rev. Rul. 74-277, page 88.

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)-1: Involuntary conversion; nonrecognition of gain.
(Also Sections 111, 165; 1.111-1, 1.165-1.)

Condemnation of residential property subject to prior casualty loss deduction. A Pennsylvania taxpayer whose residence was destroyed by a flood and who was not insured against the loss claimed a casualty loss deduction that resulted in a tax benefit. The following year his property was condemned by the State and in accordance with State law he was awarded the pre-casualty fair market value of the land and residence. He purchased a replacement residence in that year at a cost in excess of the condemnation award. **Held,** gain realized on the award must be reported as ordinary income to the extent the casualty loss deduction resulted in a tax benefit. The remainder of the gain may be deferred under section 1033 of the Code.

Rev. Rul. 74-206 [1]

Advice has been requested as to the Federal income tax consequences of a condemnation award received by a taxpayer in the circumstances set out below.

On January 1, 1972, the taxpayer, an individual, owned a residence lo-

[1] Also released as Technical Information Release No. 1285, dated April 10, 1974.

cated in the State of Pennsylvania having a fair market value of $40,000, of which $12,000 was attributable to the land. The taxpayer's adjusted basis, as determined under section 1011 of the Internal Revenue Code of 1954, was $20,000 for the house and $5,000 for the land.

In June 1972, the taxpayer's house was completely destroyed by a flood. The house was not insured against a loss by flooding. Shortly thereafter the taxpayer was granted a disaster loan of $10,000, of which $5,000 was forgiven, by the Small Business Administration in accordance with section 7(b) of the Small Business Act (15 U.S.C. 636 (B)).

On his Federal income tax return for 1972, the taxpayer claimed, and was allowed, a casualty loss deduction of $15,000 (adjusted basis of house ($20,000) less forgiveness of the Small Business Administration loan ($5,000)) under section 165(c)(3) of the Code. The entire deduction effected a reduction of the taxpayer's 1972 Federal income tax liability. The taxpayer's basis in his house was reduced by $20,000 ($15,000 casualty loss deduction plus $5,000 Small Business Administration loan forgiveness) under section 1016(a). See Rev. Rul. 71-161, 1971-1 C.B. 76. The taxpayer's adjusted basis in his land was $5,000 as of January 1, 1973, as determined under section 1011.

In August 1973, the taxpayer's land was condemned by the local Redevelopment Authority and he received a condemnation award of $40,000, the pre-flood fair market value of the condemned property, pursuant to *Pa. Stat. Ann.* tit. 26 Section 1-602(c) (1972), as amended September 27, 1973. Section 1-602(c), as amended, provides, in pertinent part, that in the case of a condemnation of property in connection with any program or project in which property is damaged by floods, the damage resulting therefrom shall be excluded in determining the fair market value of the condemnee's entire property interest therein immediately before the condemnation.

In December 1973, the taxpayer purchased a new residence for $45,000.

The specific questions raised in the instant case are whether any portion of the condemnation award is required to be included in the taxpayer's gross income in 1973 as a reimbursement for the casualty loss under section 1.165-1(d)(2)(iii) of the Income Tax Regulations, and whether recognition of any gain realized from the involuntary conversion of the property may be deferred in accordance with section 1033 of the Code.

Section 165(a) of the Code allows as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 1.165-1(d)(2)(iii) of the regulations provides, in pertinent part, that if a taxpayer deducted a loss in accordance with the provisions of section 165 of the Code and in a subsequent taxable year receives reimbursement for such loss, he does not recompute the tax for the taxable year in which the deduction was taken but includes the amount of such reimbursement in his gross income for the taxable year in which received, subject to the provisions of section 111, relating to recovery of amounts previously deducted.

Section 1.111-1 of the regulations provides that income attributable to the recovery during any taxable year of losses or of other section 111 items, made the basis of the deductions from gross income for prior taxable years, shall be excluded from gross income to the extent of the "recovery exclusion." The term "recovery exclusion" means an amount equal to the portion of the losses or other section 111 items that when deducted or credited for a prior taxable year did not result in a reduction of any tax under the Code.

As the Pennsylvania statute excludes the flood damage from the determination of the fair market value of the property for condemnation purposes, it is apparent that it is designed to provide, in addition to fair compensation for the property, a reimbursement for loss resulting from the flood damage. Under the facts of the instant case, the $40,000 proceeds from the condemnation are attributable to $12,000 compensation for the land and $28,000 reimbursement for the destruction of the house.

With respect to the portion of the condemnation proceeds that constitutes reimbursement for the destruction of the house ($28,000), the taxpayer realized under section 1001 of the Code a gain of $28,000 ($28,000 less $0 (adjusted basis of the house)) of which $15,000 represents a recovery of an amount previously deducted for Federal income tax purposes and is taxable as ordinary income pursuant to section 1.165-1(d)(2)(iii) of the regulations because of the prior tax benefit. The treatment of the remaining $13,000 realized gain ($28,000 less $15,000) is discussed below.

With respect to the portion of the condemnation proceeds that constitutes compensation for the land ($12,000), the taxpayer realized under section 1001 of the Code a gain of $7,000 ($12,000—5,000 (adjusted basis of the land)).

Section 1033(a)(3)(A) of the Code provides, in part, that if property is involuntarily converted as a result of its destruction in whole or in part or as a result of condemnation and the taxpayer purchases, within the specified replacement period (described in section 1033(a)(3)(B)), other property similar or related in service or use, the taxpayer may elect to have the gain realized upon the conversion recognized only to the extent that the amount realized exceeds the cost of the replacement property.

Since (1) the taxpayer's property was involuntarily converted as a result of its destruction (flood damage to house) and condemnation (taking of land) and (2) the cost ($45,000) of

qualified replacement property exceeded the amount realized ($40,000) from the involuntary conversion, he may elect under section 1033(a)(3)(A) of the Code not to recognize any of the $20,000 gain (excluding recovery of amount previously deducted as a casualty loss) attributable to the land ($7,000) and the house (the remaining $13,000).

Section 1033(c) of the Code provides that in the case of property purchased by the taxpayer in a transaction described in section 1033(a)(3) which resulted in the nonrecognition of any part of the gain realized as a result of the involuntary conversion, the basis of the replacement property shall be the cost of such property decreased by the amount of the gain not recognized. Thus, the basis of the new residence under section 1033(c) is $25,000 ($45,000 cost less $20,000 gain not recognized).

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26 CFR 1.1033(a)-2: Involuntary conversion where disposition of the converted property occurred after December 31, 1950.

Involuntary conversion; condemnation threat. Sale of property to an agent for a public utility following negotiations in which the identity of the utility was disclosed and the agent indicated that the utility would condemn the property if necessary was an involuntary conversion even though the utility did not have, but could readily obtain, condemnation authority. However, if the identity of the utility was not disclosed to the seller prior to his entering into the binding sales contract, the sale was not an involuntary conversion. Rev. Ruls. 58-557 and 63-221 modified.

Rev. Rul. 74-8

Advice has been requested whether, under the circumstances described below, land, acquired by a trustee on behalf of a public utility lacking condemnation authority at the time of sale, was compulsorily or involuntarily converted under threat or imminence of condemnation within the meaning of the involuntary conversion provisions of section 1033 of the Internal Revenue Code of 1954.

X, a corporate trustee for a public utility engaged in the production of electric power (power company), purchased various tracts of land on behalf of the power company. In some instances, *X* indicated to the sellers that condemnation proceedings would be instituted if they did not sell. In some of these cases, *X* indicated who the condemning authority would be. In other instances, *X* did not reveal the identity of the public utility, which was the condemning authority, prior to or at the time of consummation of the sales.

Shortly after the land was acquired by *X*, the power company publicly announced its plans to construct an electric generating station on such land. Following this public announcement, the power company applied for and was granted a certificate of public convenience and necessity pursuant to state law which required that such a certificate be obtained before property can be acquired by public utilities through the exercise of eminent domain.

In the instant case, the power company did not have legal authority to condemn the seller's land at the time such land was sold to *X*, but it, generally, could readily obtain the power to condemn by application to the appropriate state official. There was no reason to believe that such power to condemn the various tracts of land purchased would be denied.

The question is whether the land acquired by *X*, on behalf of the power company, was compulsorily or involuntarily converted under threat or imminence of condemnation for purposes of allowing, pursuant to section 1033(a) of the Code, nonrecognition of any gain realized by the sellers of the land.

Section 1033(a)(3)(A) of the Code provides, in effect, that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money, no gain shall be recognized if the taxpayer during the period specified in section 1033(a)(3)(B), for the purpose of replacing the property so converted, purchases with the amount realized, other property similar or related in service or use to such converted property.

Rev. Rul. 58-557, 1958-2 C.B. 402, and Rev. Rul. 63-221, 1963-2 C.B. 332, hold that, generally, the threat or imminence of condemnation is considered to exist for purposes of section 1033 of the Code when the property owner is informed, either orally or in writing by a representative of a governmental body or public official authorized to acquire property for public use, that such body or official has decided to acquire his property, and from the information conveyed to him has reasonable grounds to believe that his property will be condemned if a voluntary sale is not arranged.

A sale of land to a person who, unknown to the seller, represented a condemning authority, is not made under threat or imminence of condemnation. Cf. *Edward Warner et al.*, 56 T.C. 1126 (1971).

Based on the facts in the instant case, it is held as follows:

(1) Where during the negotiations prior to the time a seller entered into a binding contract to sell his property, *X* indicated to the seller that his property would be condemned if a sale agreement were not reached and revealed the identity of the public utility which was the condemning authority, the seller had reasonable grounds to believe that condemnation was threatened or imminent. Accordingly, such sale was an involuntary conversion subject to the nonrecognition provisions of section 1033(a) of the Code.

Since there were no reasonable grounds to believe the utility might not obtain the power to condemn the property, the sale was made under threat or imminence of condemnation, notwithstanding that the utility did not yet have the legal power to condemn.

(2) In those instances where *X* did not reveal the identity of the condemning authority in the negotiations prior to the seller's entering into a binding contract to sell, the sale will not be treated as an involuntary conversion under section 1033(a) of the Code, whether or not *X* indicated to the seller that his property would be condemned if a voluntary sale was not arranged. Without knowledge of the identity of the condemning authority, the seller does not have reasonable grounds to believe that a condemnation will occur if a voluntary sale is not arranged. In such instances, gain realized by the sellers on the sale of property to *X* is not subject to the nonrecognition of gain provisions of section 1033(a).

Rev. Rul. 63-221, 1963-2 C.B. 332, and Rev. Rul. 58-557, 1958-2 C.B. 402, are hereby modified to provide that a threat or imminence of condemnation may also exist for purposes of section 1033 of the Code even if the named condemning authority does not have actual authority to condemn property for public use prior to or at the time of sale if the named condemning authority could readily obtain such authority in the event that a voluntary sale is not arranged.

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26 CFR 1.1033(a)-2. Involuntary conversion where disposition of the converted property occurred after December 31, 1950.

Involuntary conversion; treatment of proceeds of usufruct. A taxpayer who owned an undivided one-half interest in a piece of real property and a usufructuary interest in the other half may elect, as to each separate interest, to treat the gain from the involuntary conversion of the property pursuant to section 1033 of the Code; however, if he does not elect to have the proceeds from the usufructuary interest treated under section 1033, he must report the gain on a Fiduciary Income Tax Return and pay any tax due.

Rev. Rul. 74-273

Advice has been requested whether section 1033(a) of the Internal Revenue Code of 1954 will apply to the reinvestment of the proceeds from an involuntary conversion of real property under the circumstances described below.

The taxpayer, an individual, owned an undivided one-half interest in a piece of real property and had a usufructuary interest in the other one-half of the property located in the State of Louisiana. The property was purchased under a forced sale by an agency of the United States government, for an amount in excess of the basis of the two interests.

A usufruct under Louisiana Civil Code corresponds to the life estate in common law. However, while the life tenant at common law actually owns an estate for the duration of his life concurrent with the ownership in fee simple absolute vested in the remainderman, the usufructuary has only the right to use and enjoy the property, subject to complete ownership in another person. During the existence of the usufruct, all the profits and fruits derived from the property belong to the usufructuary.

If property in usufruct can be used and enjoyed without changing its substance or form (that is, a tract of land) there exists a perfect usufruct. Under a perfect usufruct, the usufructuary has a right to the profits and fruits derived from the object of the usufruct, but must restore the object at the termination of the usufruct.

Louisiana Civil Code Art. 535 provides, in part, that a perfect usufruct does not transfer to the usufructuary the ownership of the things subject to the usufruct; the usufructuary is bound to use them as a prudent administrator would do, to preserve them as much as possible, in order to restore them to the owner as soon as the usufruct terminates.

Section 1033(a) of the Code provides for the nonrecognition of gain when property is involuntarily converted as a result of condemnation and the taxpayer, within the prescribed period of time, purchases other property similar or related in service or use for purposes of replacing the condemned property.

Rev. Rul. 61-102, 1961-1 C.B. 245, provides, in pertinent part, that a taxpayer who has the power to sell property in which he has a life interest but who is required, under the terms of the will creating his life interest, to reinvest and conserve the proceeds for future distribution to remaindermen, is considered, for Federal income tax purposes, as acting in a fiduciary capacity with respect to the proceeds of any such sale. Therefore, if the taxpayer voluntarily sells the property under such circumstances, he must report any gain from the sale in a U.S. Fiduciary Income Tax Return, Form 1041, and pay the tax due thereon.

In the instant case, where the taxpayer possesses two separate interests in the same property, he may elect, as to each separate interest, to have the gain from the sale treated under section 1033 of the Code.

Accordingly, it is held that the taxpayer can, for his one-half undivided interest in the property, elect to have his gain from such involuntary conversion treated pursuant to section 1033 of the Code.

Further, it is held that since the taxpayer was acting in a fiduciary capacity with respect to the proceeds subject to usufruct, he can elect in such capacity to treat the proceeds from the involuntary conversion of that part of the property subject to

the usufruct as provided under section 1033 of the Code.

Finally, the taxpayer must either elect to have the proceeds of the usufructuary interest treated under section 1033 of the Code or report the gain in the regular manner on a Form 1041 and pay any tax thereon.

Section 1034.—Sale or Exchange of Residence

26 CFR 1.1034-1: Sale or exchange of residence.

Residence replaced by two residences; husband and wife separated. The nonrecognition provisions of section 1034(a) of the Code apply separately to the gains realized by a husband and wife from the sale of their principal residence where they have agreed to live apart and each purchased and occupied a separate replacement residence.

Rev. Rul. 74-250

A husband and wife purchased residential property in 1960. They owned the property as tenants by the entirety and used it solely as their principal residence. On July 1, 1972, the husband and wife, agreeing to live apart, executed a contract of sale with respect to their principal residence and continued to occupy the property until the sale was completed on September 1, 1972. Under state law, the husband and wife were each entitled to one-half of the proceeds from the sale of the residence. On this basis, both realized a gain from the sale of their residence.

During the period of time between the execution of the sales contract and the completion of the sale of their principal residence, the husband and wife individually executed purchase contracts for separate residences. The cost of each new residence exceeded the husband's and wife's respective shares of the adjusted sales price of the old residence. The purchases were completed and the new residences were occupied and used as separate principal residences by the husband and wife, respectively, prior to the end of 1972.

Held, the nonrecognition provisions of section 1034(a) of the Internal Revenue Code of 1954 apply separately to the gains realized by the husband and by the wife from the sale of their principal residence.

Section 1036.—Stock for Stock of Same Corporation

26 CFR 1.1036-1: Stock for stock of the same corporation.

Whether a disqualifying disposition of stock occurs under section 425(c) of the Internal Revenue Code of 1954 where stock is transferred to a trust and then returned to the taxpayer upon termination of the trust. See Rev. Rul. 74-243, page 106.

Part VII.—Wash Sales of Stock or Securities

Section 1091.—Loss From Wash Sales of Stock or Securities

26 CFR 1.1091-1: Loss from wash sales of stock or securities.
(Also Section 1236; 1.1236-1.)

Wash sales; foreign currency converted into U.S. dollars. Foreign currencies are not securities within the meaning of section 1091 of the Code, and losses resulting either from the disposition of foreign currencies purchased in transactions entered into for profit or from their conversion into U.S. dollars are not subject to the wash sale provisions; I.T. 1552 superseded.

Rev. Rul. 74-218[1]

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 1552, II-1 C.B. 96 (1923).

The specific question is whether foreign currencies are "securities" within the meaning of section 1091 of the Internal Revenue Code of 1954, relating to losses from wash sales of stock or securities.

On June 1, 1973, the taxpayer purchased currency of foreign country *M* in a transaction entered into for profit. On June 22, 1973, the taxpayer converted the currency of *M* into United States dollars, incurring a loss on the exchange. On July 10, 1973, the taxpayer purchased more currency of country *M*.

Section 1091(a) of the Code and the Income Tax Regulations thereunder provide, in part, that in the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or *securities* where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange on which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 165(c)(2); nor shall such deduction be allowed a corporation under section 165(a) unless it is a dealer in stocks or securities, and the loss is sustained in a transaction made in the ordinary course of its business.

The wash sale provision first appeared as section 214(a)(5) of the Revenue Act of 1921. It was intended to prevent a broker from selling securities one day and buying the securities back several days thereafter in order to establish a loss. See Congressional Proceedings and Debates on *H. R. 8245,* 67th Cong., 1st Sess., 61 Cong. Rec. 5203 (1921).

The term "security" is defined in section 1236(c) of the Code to mean any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to sub-

[1] Prepared pursuant to Rev. Proc. 67-6, 1967-1, C.B. 576.

scribe to or purchase any of the foregoing.

Currency in its usual and ordinary acceptation means gold, silver, other metals or paper used as a circulating medium of exchange, and does not embrace bonds, evidences of debt, or other personal property or real estate.

It is held that foreign currencies are not securities within the meaning of section 1091 of the Code. Therefore, any loss resulting from the disposition of, or conversion of, foreign currency into United States dollars is not subject to the provisions of section 1091.

I.T. 1552, II-1 C.B. 96 (1923), is hereby superseded, since the position set forth therein is updated and restated under the current statute and regulations in this Revenue Ruling.

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26 CFR 1.1091-1: Losses from wash sales of stock or securities.

Whether deduction for loss on sale of stock from general assets of life insurance company is allowed where substantially identical stock is purchased by the company for its segregated asset account within the 61 day period. See Rev. Rul. 74-4, page 51.

Subchapter P. Capital Gains and Losses

Part II.—Treatment of Capital Losses

Section 1211.—Limitation on Capital Losses

26 CFR 1.1211: Statutory provisions; limitation on capital losses.
(Also Sections 1212, 6411, 6501, 6511, 6601, 6611; 1.1212, 1.6411, 301.6501(h), 301.6501(j), 301.6501(m), 301.6501(o), 301.6511(d), 301.6601, 301.6611.)

T.D. 7301 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Capital losses

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

By a notice of proposed rule making appearing in the Federal Register for October 23 and November 17, 1971 (36 F.R. 20517, 21894), amendments to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 165, 246, 381, 481, 1211, 1212, 1222, 1314, 6411, 6501, 6511, 6601 and 6611 of the Internal Revenue Code of 1954 were proposed in order to revise the rules applicable to the deductibility of capital losses and for other purposes. These proposed amendments would reflect the amendment of the Internal Revenue Code by sections 512 and 513 of the Tax Reform Act of 1969 (83 Stat. 638, 642) [Pub. L. 91-172 1969-3 C.B. 10, 98, 100] relating to capital losses and various other statutory amendments relating to procedure and administration. Also, by a notice of proposed rule making appearing in the Federal Register for October 3, 1972 (37 F.R. 20700), amendments to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 6411, 6501, 6511, 6601 and 6611 of the Internal Revenue Code of 1954 were proposed in order to revise certain of the regulations relating to procedure and administration rules pertaining to the credit for certain expenses incurred in work incentive programs. The substantive rules relating to the credit for certain expenses incurred in work incentive programs are the subject of another Treasury decision. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments of the regulations as proposed are adopted by this document, subject to certain changes of a relatively minor nature.

In the case of losses sustained in taxable years beginning after December 31, 1969, in the case of individuals, only 50 percent of the excess of loss from the sale or exchange of capital assets held for longer than six months over the gain from the sale or exchange of capital assets held for six months or less may be deducted from ordinary income. However, a net capital loss deduction is generally subject to a maximum of $1,000. Any such excess loss sustained in taxable years beginning before January 1, 1970, which is carried forward into taxable years beginning after 1969 (because it exceeds the $1,000 maximum) may still be deducted in full. Section 1.1211-1(b) of the amendment to the regulations provides rules for determining the deduction in taxable years beginning after December 31, 1969, where losses sustained before 1970 and losses sustained after 1969 are involved. A net capital loss attributable to sales or exchanges of capital assets held for six months or less may still be deducted in full subject to the $1,000 limitation discussed below.

The $1,000 maximum amount of an allowable deduction for a net capital loss has not been changed except in the case of a married person who files a separate return. As under prior law, corporations are not allowed a deduction against ordinary income for a net capital loss. Section 1.1212-1(b) of the amendment to the regulations provides the new rules for determining the amount of a capital loss carryover.

Effective for taxable years begin-

[1] The publication of this Treasury Decision in 39 F.R. 962, dated January 4, 1974, contains (1) instructions for modifying the notices of proposed rulemaking published in 36 F.R. 20517, dated October 23, 1971, 36 F.R. 21894, dated November 17, 1971, and 37 F.R. 20700, dated October 3, 1972, and (2) the full text of the regulations with such modifications. As here published, the Treasury Decision reflects the full text of such regulations with modifications. The individual instructions have been omitted.

ning after December 31, 1969, married persons filing separate returns may only deduct a net capital loss up to $500 rather than the $1,000 applicable to taxable years beginning before January 1, 1970. However, the $1,000 limit applies in taxable years beginning after 1969 to the extent losses sustained in taxable years beginning before 1970 are involved. Section 1.1211-1(b)(7) of the amendment to the regulations provides rules for applying the $500 and $1,000 limits to taxable years beginning after 1969 where both losses sustained after 1969 and losses sustained before 1970 are involved.

The Tax Reform Act of 1969 allows corporations to carry back a net capital loss to the three taxable years preceding the taxable year in which the loss was sustained. Prior law did not allow corporations a capital loss carryback but only a carryover of 5 years. To be eligible for the new carryback provisions, the net capital loss must be sustained in a taxable year beginning after December 31, 1969. Under § 1.1212-1(a)(3) of the amendment to the regulations hereby adopted, if a corporation has a capital loss carryback to a taxable year to which a net operating loss has also been carried, the corporation must use the capital loss first to offset a net capital gain sustained in the taxable year to which the loss is carried, and then apply the net operating loss deduction to the extent it may be applied under section 172 and the regulations thereunder.

Form 4798, Capital Loss Carryover, is to be used by individuals to compute a capital loss carryover. This form is available at local IRS offices.

Adoption of amendments to the regulations

On October 23 and November 17, 1971, notice of proposed rule making with respect to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 165, 246, 381, 481, 535, 1211, 1212, 1222, 1314, 6411, 6501, 6511, 6601, and 6611 of the Internal Revenue Code of 1954 to conform such regulations to sections 214(b)(2), 230(a), and 232(d)(4) of the Revenue Act of 1964 (78 Stat. 55, 99, 111) [Pub. L. 88-272, 1964-1 (Part 2) C.B. 6], section 23(a) of the Act of February 26, 1964 (Pub. L. 88-272, 78 Stat. 19), sections 3(b), (c), (d), and (e) and 7(a) of the Act of September 2, 1964 (Pub. L. 88-571, 78 Stat. 857, 858, 861) [1964-2 C.B. 649], sections 2(b) and (f) and 3(a) of the Act of November 2, 1966 (Pub. L. 89-721, 80 Stat. 1150, 1151) [1966-2 C.B. 643], section 2(b), (c), (d), (e), and (f) of the Act of December 27, 1967 (Pub. L. 90-225, 81 Stat. 731, 732) [1968-1 C.B. 640], and sections 512 and 513 of the Tax Reform Act of 1969 (83 Stat. 638, 642) [Pub. L. 91-172, 1969-3 C.B. 10], relating to capital losses, was published in the Federal Register (36 F.R. 20517, 21894). Also, on October 3, 1972, notice of proposed rule making with respect to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 6411, 6501, 6511, 6601, and 6611 of the Internal Revenue Code of 1954 to conform such regulations to section 601(d) and (e) of the Revenue Act of 1971 (85 Stat. 558) [Pub. L. 92-178, 1972-1 C.B. 443, 477], relating to the credit for certain expenses incurred in work incentive programs, was published in the Federal Register (37 F.R. 20700). After consideration of all relevant matter presented by interested persons regarding the proposed rules, the following amendments of regulations are hereby adopted:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. Paragraph (c)(3) of § 1.165-1 is amended to read as follows:

§ 1.165-1 Losses.

* * * * *

(c) *Amount deductible.* * * *

(3) A loss from the sale or exchange of a capital asset shall be allowed as a deduction under section 165(a) but only to the extent allowed in section 1211 (relating to limitation on capital losses) and section 1212 (relating to capital loss carrybacks and carryovers), and in the regulations under those sections.

* * * * *

Par. 2. Section 1.246-2 is amended by revising paragraph (a) to read as follows:

§ 1.246-2. Limitation on aggregate amount of deductions.

(a) *General rule.* The sum of the deductions allowed by sections 243(a)(1) (relating to dividends received by corporations), 244(a) (relating to dividends received on certain preferred stock), and 245 (relating to dividends received from certain foreign corporations), except as provided in section 246(b)(2) and in paragraph (b) of this section, is limited to 85 percent of the taxable income of the corporation. The taxable income of the corporation for this purpose is computed without regard to the net operating loss deduction allowed by section 172, the deduction for dividends paid on certain preferred stock of public utilities allowed by section 247, any capital loss carryback under section 1212(a)(1), and the deductions provided in sections 243(a)(1), 244(a), and 245. For definition of the term "taxable income", see section 63.

* * * * *

Par. 3. Section 1.381(b) is amended by revising paragraph (3) of section 381(b) and the historical note to read as follows:

§ 1.381 Statutory provisions; carryovers in certain corporate acquisitions; operating rules.

Sec. 381. *Carryovers in certain corporate acquisitions.* * * *

(b) *Operating rules.* * * *

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss or a net capital loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

[Sec. 381(b) as amended by sec. 512(c), Tax Reform Act 1969 (83 Stat. 639)]

Par. 4. Section 1.481 is amended by revising paragraph (3)(A) of section 481(b) and the historical note to read as follows:

§ 1.481 Statutory provisions; adjustments required by changes in method of accounting.

Sec. 481. *Adjustments required by changes in method of accounting.* * * *

(b) *Limitation on tax where adjustments are substantial.* * * *

(3) *Special rules for computations under paragraphs (1) and (2).* For purposes of this subsection—

(A) There shall be taken into account the increase or decrease in tax for any taxable year preceding the year of the change to which no adjustment is allocated under paragraph (1) or (2) but which is affected by a net operating loss (as defined in section 172) or by a capital loss carryback or carryover (as defined in section 1212), determined with reference to taxable years with respect to which adjustments under paragraph (1) or (2) are allocated.

* * * * *

[Sec. 481 as amended by sec. 29, Technical Amendments Act 1958 (72 Stat. 1626), sec. 512(f)(4), Tax Reform Act 1969 (83 Stat. 641)]

Par. 5. Section 1.481-2 is amended by revising paragraph (c)(2) and (3)(iii) to read as follows:

§ 1.481-2 Limitation on tax.

* * * * *

(c) *Rules for computation of tax.* * * *

(2) The next step is to compute under section 481(b)(1) the tax attributable to the adjustments referred to in subparagraph (1) of this paragraph for the taxable year of the change and the two preceding taxable years as if an amount equal to one-third of the net amount of such adjustments had been received or accrued in each of such taxable years. The increase in tax attributable to the adjustments for each such taxable year is the excess of the tax for such year computed with the allocation of one-third of the net adjustments to such taxable year over the tax computed without the allocation of any part of the adjustments to such year. For the purpose of computing the aggregate increase in taxes for such taxable years, there shall be taken into account the increase or decrease in tax for any taxable year preceding the taxable year of the change to which no adjustment is allocated under section 481(b)(1) but which is affected by a net operating loss under section 172 or by a capital loss carryback or carryover under section 1212, determined with reference to taxable years with respect to which adjustments under section 481(b)(1) are allocated.

* * * * *

(3) * * *

(iii) Any taxable year preceding the taxable year of the change to which no adjustment is allocated under section 481(b)(2), but which is affected by a net operating loss or by a capital loss carryback or carryover determined with reference to taxable years with respect to which such adjustments are allocated.

* * * * *

Par. 6. Section 1.535 is amended by revising paragraphs (6) and (7) of section 535(b) and the historical note to read as follows:

§ 1.535 Statutory provisions; accumulated taxable income.

Sec. 535. *Accumulated taxable income.* * * *

(b) *Adjustments to taxable income.* * * *

(6) *Long-term capital gains.* There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (determined without regard to the capital loss carryback or carryover provided in section 1212) minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

(A) The taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) Such taxes computed for such year without including in taxable income the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (determined with regard to the capital loss carryback or carryover provided in section 1212).

(7) *Capital loss.* No allowance shall be made for the capital loss carryback or carryover provided in section 1212.

* * * * *

[Sec. 535 as amended by sec. 31, Technical Amendments Act 1958 (72 Stat. 1631) [Pub. L. 85-866, 1958-3 C.B. 254]; sec. 205, Small Business Tax Revision Act 1958 (72 Stat. 1680); sec. 9(d)(2), Rev. Act 1962 (76 Stat. 1001) [Pub. L. 87-834, 1962-3 C.B. 111]; sec. 512(f)(5), Tax Reform Act 1969 (83 Stat. 641) [Pub. L. 91-172, 1969-3 C.B. 10, 98]]

Par. 7. Section 1.535-2 is amended by revising paragraph (g) to read as follows:

§ 1.535-2 Adjustments to taxable income.

* * * * *

(g) *Capital loss carrybacks and carryovers.* Capital losses carried to a

taxable year under section 1212(a) shall have no application for purposes of computing accumulated taxable income for such year.

Par. 8. Section 1.1211 is amended by revising subsection (b) of section 1211 and by adding a historical note. The amended and added provisions read as follows:

§ 1.1211 Statutory provisions; limitation on capital losses.

Sec. 1211. *Limitation on capital losses.* * * *

(b) *Other taxpayers*—(1) *In general.* In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) whichever of the following is smallest:

(A) The taxable income for the taxable year,

(B) $1,000, or

(C) The sum of—

(i) The excess of the net short-term capital loss over the net long-term capital gain, and

(ii) One-half of the excess of the net long-term capital loss over the net short-term capital gain.

(2) *Married individuals.* In the case of a husband or wife who files a separate return, the amount specified in paragraph (1)(B) shall be $500 in lieu of $1,000.

(3) *Computation of taxable income.* For purposes of paragraph (1), taxable income shall be computed without regard to gains or losses from sales or exchanges of capital assets and without regard to the deductions provided in section 151 (relating to personal exemptions) or any deduction in lieu thereof. If the taxpayer elects to pay the optional tax imposed by section 3, "taxable income" as used in this subsection shall read as "adjusted gross income".

[Sec. 1211 as amended by sec. 513(a), Tax Reform Act 1969 (83 Stat. 642)]

Par. 9. Section 1.1211-1 is amended to read as follows:

§ 1.1211-1 Limitation on capital losses.

(a) *Corporations* — (1) *General rule.* In the case of a corporation, there shall be allowed as a deduction an amount equal to the sum of—

(i) Losses sustained during the taxable year from sales or exchanges of capital assets, plus

(ii) The aggregate of all losses sustained in other taxable years which are treated as a short-term capital loss in such taxable year pursuant to section 1212(a)(1),

but only to the extent of gains from such sales or exchanges of capital assets in such taxable year.

(2) *Banks.* See section 582(c) for modification of the limitation under section 1211(a) in the case of a bank, as defined in section 581.

(b) *Taxpayers other than corporations*—(1) *General rule.* In the case of a taxpayer other than a corporation, there shall be allowed as a deduction an amount equal to the sum of—

(i) Losses sustained during the taxable year from sales or exchanges of capital assets, plus

(ii) The aggregate of all losses sustained in other taxable years which are treated either as a short-term capital loss or as a long-term capital loss in such taxable year pursuant to section 1212(b),

but only to the extent of gains from sales or exchanges of capital assets in such taxable year, plus (if such losses exceed such gains) the additional allowance or transitional additional allowance deductible under section 1211(b) from ordinary income for such taxable year. The additional allowance deductible under section 1211(b) shall be determined by application of subparagraph (2) of this paragraph, and the transitional additional allowance by application of subparagraph (3) of this paragraph.

(2) *Additional allowance.* Except as otherwise provided by subparagraph (3) of this paragraph, the additional allowance deductible under section 1211(b) for taxable years beginning after December 31, 1969, shall be the least of—

(i) The taxable income for the taxable year,

(ii) $1,000, or

(iii) The sum of the excess of the net short-term capital loss over the net long-term capital gain, plus one-half of the excess of the net long-term capital loss over the net short-term capital gain.

(3) *Transitional additional allowance*—(i) *In general.* If, pursuant to the provisions of § 1.1212-1(b) and subdivision (iii) of this subparagraph, there is carried to the taxable year from a taxable year beginning before January 1, 1970, a long-term capital loss, and if for the taxable year there is an excess of net long-term capital loss over net short-term capital gain, then, in lieu of the additional allowance provided by subparagraph (2) of this paragraph, the transitional additional allowance deductible under section 1211(b) shall be the least of—

(*a*) The taxable income for the taxable year,

(*b*) $1,000, or

(*c*) The sum of the excess of the net short-term capital loss over the net long-term capital gain; that portion of the excess of the net long-term capital loss over the net short-term capital gain computed as provided in subdivision (ii) of this subparagraph; plus one-half of the remaining portion of the excess of the net long-term capital loss over the net short-term capital gain.

(ii) *Computation of specially treated portion of excess long-term capital loss over net short-term capital gain.* In determining the transitional additional allowance deductible as pro-

vided by this subparagraph, there shall be applied thereto in full on a dollar-for-dollar basis the excess of net long-term capital loss over net short-term capital gain (computed with regard to capital losses carried to the taxable year) to the extent that the long-term capital losses carried to the taxable year from taxable years beginning before January 1, 1970, as provided by § 1.1212-1(b) and subdivision (iii) of this subparagraph, exceed the sum of (*a*) the portion of the net capital gain actually realized in the taxable year (*i.e.*, computed without regard to capital losses carried to the taxable year) which consists of net long-term capital gain actually realized in the taxable year, plus (*b*) the amount by which the portion of the net capital gain actually realized in the taxable year (*i.e.*, computed without regard to capital losses carried to the taxable year) which consists of net short-term capital gain actually realized in the taxable year exceeds the total of short-term capital losses carried to the taxable year from taxable years beginning before January 1, 1970, as provided by § 1.1212-1(b) and subdivision (iv) of this subparagraph. The amount by which the net long-term capital losses carried to the taxable year from taxable years beginning before January 1, 1970, exceeds the sum of (*a*) plus (*b*) shall constitute the "transitional net long-term capital loss component" for the taxable year for the purpose of this subparagraph.

(iii) *Carryover of certain long-term capital losses not utilized in computation of transitional additional allowance.* If for a taxable year beginning after December 31, 1969, the transitional net long-term capital loss component determined as provided in subdivision (ii) of this subparagraph exceeds the amount of such component applied to the transitional additional allowance for the taxable year as provided by subdivision (i) of this subparagraph and subparagraph (4)(ii) of this paragraph, then such excess shall for the purposes of this subparagraph be carried to the succeeding taxable year as long-term capital losses from taxable years beginning before January 1, 1970, for utilization in the computation of the transitional additional allowance in the succeeding taxable year as provided in subdivisions (i) and (ii) of this subparagraph. In no event, however, shall the amount of such component carried to the following taxable year as otherwise provided by this subdivision exceed the total of net long-term capital losses actually carried to such succeeding taxable year pursuant to section 1212(b) and § 1.1212-1(b).

(iv) *Carryover of certain short-term capital losses not utilized in computation of additional allowance or transitional additional allowance.* If for a taxable year beginning after December 31, 1969, the total short-term capital losses carried to such year from taxable years beginning before January 1, 1970, as provided by § 1.1212-1(b) and this subdivision exceed the sum of—

(*a*) The portion of the net capital gain actually realized in the taxable year (*i.e.*, computed without regard to capital losses carried to the taxable year) which consists of net short-term capital gain actually realized in the taxable year, plus

(*b*) The amount by which the portion of the net capital gain actually realized in the taxable year (*i.e.*, computed without regard to capital losses carried to the taxable year) which consists of net long-term capital gain actually realized in the taxable year exceeds the total long-term capital losses carried to the taxable year from taxable years beginning before January 1, 1970, as provided in § 1.1212-1(b) and subdivision (iii) of this subparagraph,

then such excess shall constitute the "transitional net short-term capital loss component" for the taxable year, and to the extent such component also exceeds the net short-term capital loss applied to the additional allowance (as provided in subparagraph (2) and (4)(i) of this paragraph) or the transitional additional allowance (as provided by subdivision (i) of this subparagraph and subparagraph (4)(i) of this paragraph) for the taxable year shall be carried to the succeeding taxable year as short-term capital losses from taxable years beginning before January 1, 1970, for utilization in such succeeding taxable year in the computation of the additional allowance (as provided by subparagraph (2) of this paragraph) or the transitional additional allowance (as provided by subdivision (i) and (ii) of this subparagraph). In no event, however, shall the amount of such component so carried to the following taxable year as otherwise provided by this subdivision exceed the total of net short-term capital losses actually carried to such succeeding taxable year pursuant to section 1212 (b) and § 1.1212-1(b).

(v) *Scope of rules.* The rules provided by this subparagraph are for the purpose of computing the amount of the transitional additional allowance deductible for the taxable year pursuant to the provisions of section 1212(b)(3) and this subparagraph. More specifically, their operation permits the limited use of a long-term capital loss carried to the taxable year from a taxable year beginning before December 31, 1969, in full on a dollar-for-dollar basis in computing the transitional additional allowance deductible for the taxable year. These rules have no application to, or effect upon, a determination of the character or amount of net capital gains and losses reportable in the taxable year. See paragraph (b)(1) of this section and § 1.1212-1 for the determination of the amount and character of capital gains and losses reportable in the taxable year. Further, except to the extent that their application may

affect the amount of the transitional additional allowance deductible for the taxable year and thus the amount to be treated as short-term capital loss for carryover purposes under section 1212(b) and § 1.1212-1(b)(2), these rules have no effect upon a determination of the character or amount of capital losses carried to or from the taxable year pursuant to section 1212 (b) and § 1.1212-1(b).

(4) *Order of application of capital losses to additional allowance or transitional additional allowance.* In applying the excess of the net short-term capital loss over the net long-term capital gain and the excess of the net long-term capital loss over the net short-term capital gain to the additional allowance or transitional additional allowance deductible under section 1211(b) and this paragraph, such excesses shall, subject to the limitations of subparagraph (2) or (3) of this paragraph, be used in the following order:

(i) First, there shall be applied to the additional allowance or transitional additional allowance the excess, if any, of the net short-term capital loss over the net long-term capital gain.

(ii) Second, if such transitional additional allowance exceeds the amount so applied thereto as provided in subdivision (i) of this subparagraph, there shall next be applied thereto as provided in subparagraph (3) of this paragraph the excess, if any, of the net long-term capital loss over the net short-term capital gain to the extent of the transitional net long-term capital loss component for the taxable year computed as provided by subdivision (ii) of subparagraph (3) of this paragraph.

(iii) Third, if such additional allowance or transitional additional allowance exceeds the sum of the amounts so applied thereto as provided in subdivisions (i) and (ii) of this subparagraph, there shall be applied thereto one-half of the balance, if any, of the excess net long-term capital loss not applied pursuant to the provisions of subdivision (ii) of this subparagraph.

(5) *Taxable years beginning prior to January 1, 1970.* For any taxable year beginning prior to January 1, 1970, subparagraphs (2) and (3) of this paragraph shall not apply and losses from sales or exchanges of capital assets shall be allowed as a deduction only to the extent of gains from such sales or exchanges, plus (if such losses exceed such gains) the taxable income of the taxpayer or $1,000, whichever is smaller.

(6) *Special rules.* (i) For purposes of section 1211(b) and this paragraph, taxable income is to be computed without regard to gains or losses from sales or exchanges of capital assets and without regard to the deductions provided in section 151 (relating to personal exemptions) or any deduction in lieu thereof. For example, the deductions available to estates and trusts under section 642(b) are in lieu of the deductions allowed under section 151, and, in the case of estates and trusts, are to be added back to taxable income for the purposes of section 1211(b) and this paragraph.

(ii) In case the tax is computed under section 3 and the regulations thereunder (relating to optional tax tables for individuals), the term "taxable income" as used in section 1211 (b) and this paragraph shall be read as "adjusted gross income".

(iii) In the case of a joint return, the limitation under section 1211(b) and this paragraph, relating to the allowance of losses from sales or exchanges of capital assets, is to be computed and the net capital loss determined with respect to the combined taxable income and the combined capital gains and losses of the spouses.

(7) *Married taxpayers filing separate returns*—(i) *In general.* In the case of a husband or a wife who files a separate return for a taxable year beginning after December 31, 1969, the sum of $1,000 specified in subdivisions (ii) and (i)(b) of subparagraphs (2) and (3), respectively, of this paragraph shall instead be $500.

(ii) *Special rule.* If, pursuant to the provisions of § 1.1212-1(b) and subparagraph (3)(iii) or (iv) of this paragraph there is carried to the taxable year from a taxable year beginning before January 1, 1970, a short-term capital loss or a long-term capital loss, the $500 specified in subdivision (i) of this subparagraph shall instead be an amount not in excess of $1,000, equal to $500 plus the total of the transitional net long-term capital loss component for the taxable year computed as provided by subparagraph (3)(ii) of this paragraph and the transitional net short-term capital loss component for the taxable year computed as provided by subparagraph (3)(iv) of this paragraph.

(8) *Examples.* The provisions of section 1211(b) may be illustrated by the following examples:

Example (1). A, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1970:

Taxable income exclusive of capital gains and losses		$4,400
Deduction provided by section 151		625
Taxable income for purposes of section 1211(b)		$5,025
Long-term capital gain	$1,200	
Long-term capital loss	(5,300)	
Net long-term capital loss	($4,100)	
Losses to the extent of gains	($1,200)	
Additional allowance deductible under section 1211 (b)		$1,000

The net long-term capital loss of $4,100 is deductible in 1970 only to

the extent of an additional allowance of $1,000 which is smaller than the taxable income of $5,025. Under section 1211(b) and subparagraph (2) of this paragraph, $2,000 of excess net long-term capital loss was required to produce the $1,000 additional allowance. Therefore, a net long-term capital loss of $2,100 ($4,100 minus $2,000) is carried over under section 1212(b) to the succeeding taxable year.

Example (2). B, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1970:

Taxable income exclusive of capital gains and losses	$ 90
Deduction provided by section 151	625
Taxable income for purposes of section 1211(b)	$715
Long-term capital gain	$1,200
Long-term capital loss	(5,200)
Net long-term capital loss	($4,000)
Losses to the extent of gains	($1,200)
Additional allowance deductible under section 1211(b)	$715

The net long-term capital loss of $4,000 is deductible in 1970 only to the extent of an additional allowance of $715, since the $715 of taxable income for purposes of section 1211 (b) is smaller than $1,000. Under section 1211(b) and subparagraph (2) of this paragraph, $1,430 of net long-term capital loss was required to produce the $715 additional allowance. Therefore, a net long-term capital loss of $2,570 ($4,000 minus $1,430) is carried over under section 1212(b) to the succeeding taxable year. For illustration of the result if the net capital loss for the taxable year is smaller than both $1,000 and taxable income for the purposes of section 1211(b), see examples (3) and (4) of this subparagraph. For carryover of a net capital loss, see § 1.1212-1.

Example (3). A, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1971:

Taxable income exclusive of capital gains and losses		$13,300
Deduction provided by section 151		675
Taxable income for purposes of section 1211(b)		$13,975
Long-term capital gain	$ 400	
Long-term capital loss	(600)	
Net long-term capital loss	($ 200)	
Short-term capital gain	$ 900	
Short-term capital loss	(1,400)	
Net short-term capital loss	($ 500)	
Losses to extent of gains	($1,300)	
Additional allowance deductible under section 1211 (b)		$ 600

The $600 additional allowance deductible under section 1211(b) is the least of: (i) taxable income of $13,975, (ii) $1,000, or (iii) the sum of the excess of the net short-term capital loss of $500 over the net long-term capital gain, plus one-half of the excess of the net long-term capital loss of $200 over the net short-term capital gain. The $600 additional allowance, therefore, consists of the net short-term capital loss of $500, plus $100 (one-half of the net long-term capital loss of $200), the total of which is smaller than both $1,000 and taxable income for purposes of section 1211(b). No amount of net capital loss remains to be carried over under section 1212(b) to the succeeding taxable year since the entire amount of the net short-term capital loss of $500 plus the entire amount of the net long-term capital loss of $200 required to produce $100 of the deduction was absorbed by the additional allowance deductible under section 1211(b) for 1971.

Example (4). A, a married individual filing a separate return with one exemption allowable as a deduction under section 151, has the following transactions in 1971:

Taxable income exclusive of capital gains and losses		$12,000
Deduction provided by section 151		675
Taxable income for purposes of section 1211(b)		$12,675
Long-term capital loss	($800)	
Long-term capital gain	300	
Net long-term capital loss	($500)	
Short-term capital loss	($500)	
Short-term capital gain	600	
Net short-term capital gain	$100	
Losses to the extent of gains		$ (900)
Additional allowance deductible under section 1211 (g)		$ 200

The excess net long-term capital loss of $400 (net long-term capital loss of $500 minus net short-term capital gain of $100) is deductible in 1971 only to the extent of an additional allowance of $200 (one-half of $400) which is smaller than both $500 (married taxpayer filing a separate return for a taxable year beginning after December 31, 1969) and taxable income for purposes of section 1211(b). Since there is no net short-term capital loss in excess of net long-term capital gains for the taxable year, the $200 additional allowance deductible

under section 1211(b) consists entirely of excess net long-term capital loss. No amount of net capital loss remains to be carried over under section 1212(b) to the succeeding taxable year.

Example (5). A, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1970:

Taxable income exclusive of capital gains and losses	$13,300
Deduction provided by section 151	625
Taxable income for purposes of section 1211(b)	$13,925
Long-term capital loss	($6,000)
Long-term capital gain	2,000
Net long-term capital loss	($4,000)
Short-term capital gain	$3,000
Short-term capital loss carried to 1970 from 1969 under section 1212(b)(1)	($3,000)
Net short-term capital loss	—0—
Losses to the extent of gains	($5,000)
Additional allowance deductible under section 1211(b)	$1,000

The $1,000 additional allowance deductible under section 1211(b) is the least of (i) taxable income of $13,925, (ii) $1,000, or (iii) the sum of the net short-term capital loss ($0) plus one-half of the net long-term capital loss of $4,000. The $1,000 additional allowance, therefore, consists of net long-term capital loss. Since $2,000 of the net long-term capital loss of $4,000 was required to produce the $1,000 additional allowance, the $2,000 balance of the net long-term capital loss is carried over under section 1212(b) to 1971.

Example (6). A, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1970:

Taxable income exclusive of capital gains and losses	$13,300
Deduction provided by section 151	625
Taxable income for purposes of section 1211(b)	$13,925
Long-term capital gain	$5,000
Long-term capital loss	($7,000)
Long-term capital loss carried to 1970 from 1969 under section 1212(b)(1)	($ 500)
Net long-term capital loss	($2,500)
Short-term capital gain	$1,100
Short-term capital loss	(1,400)
Net short-term capital loss	($ 300)
Losses to extent of gains	($6,100)
Transitional additional allowance deductible under section 1211(b)	$1,000

Because a component of the net long-term capital loss for 1970 is a $500 long-term capital loss carried to 1970 from 1969, the transitional additional allowance deductible under section 1211(b) and subparagraph (3) of this paragraph is the least of (i) taxable income of $13,925, (ii) $1,000, or (iii) the sum of the net short-term capital loss of $300, plus the net long-term capital loss for 1970 to the extent of the $500 long-term capital loss carried to 1970 from 1969 and one-half of the $2,000 balance of the net long-term capital loss. The entire $500 long-term capital loss carried to 1970 from 1969 is applicable in full to the transitional additional allowance because there was no net capital gain actually realized in 1970. The $1,000 transitional additional allowance, therefore, consists of the net short-term capital loss of $300, the $500 long-term capital loss carried to 1970 from 1969, plus one-half of enough of the balance of the 1970 net long-term capital loss ($400) to make up the $200 balance of the $1,000 transitional additional allowance. A long-term capital loss of $1,600 ($2,500 minus $900), all of which is attributable to 1970, is carried over under section 1212(b) to 1971.

Example (7). A, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1970:

Taxable income exclusive of capital gains and losses	$13,300
Deduction provided by section 151	625
Taxable income for purposes of section 1211(b)	$13,925
Long-term capital loss	($2,000)
Long-term capital loss carried to 1970 from 1969 under section 1212(b)(1)	(500)
Net long-term capital loss	($2,500)
Short-term capital gain	$2,600
Short-term capital loss carried to 1970 from 1969 under section 1212(b)(1)	($3,000)
Net short-term capital loss	($ 400)
Losses to the extent of gains	($2,600)
Transitional additional allowance deductible under section 1211(b)	$1,000

Because a component of the net long-term capital loss for 1970 is a $500 long-term capital loss carried to 1970 from 1969, the transitional additional allowance deductible under section 1211(b) and subparagraph (3) of this paragraph is the least of (i) taxable income of $13,925, (ii) $1,000, or (iii) the sum of the net short-term capital loss of $400, plus the net long-term capital loss for 1970 to the extent of the $500 long-term capital loss carried to 1970 from 1969, and one-half of the $2,000 balance of the net long-term capital loss. The entire $500 long-term capital loss carried to 1970 from 1969 is applicable in full to the transitional additional allowance because the net capital gain for the taxable year (computed without regard to capital losses carried to the taxable year) consisted entirely of net short-term capital gain not in excess of the short-term capital loss carried to 1970 from 1969. The $1,000 transitional additional allowance, therefore, consists of the net short-term capital loss of $400, the $500 long-term capital loss carried to 1970 from 1969, plus one-half of enough of the balance of the 1970 net long-term capital loss ($200) to make up the $100 balance of the $1,000 transitional additional allowance. A long-term capital loss of $1,800 ($2,500 minus $700), all of which is attributable to 1970, is carried over under section 1212(b) to 1971.

Example (8). Assume the facts in Example (7) but assume that the individual with one exemption allowable as a deduction under section 151 is married and files a separate return for 1970. The maximum transitional additional allowance to which the individual would be entitled for 1970 pursuant to subparagraph (7)(ii) of this paragraph would be the sum of $500 plus (i) $2,400 of the short-term capital loss of $3,000 carried to 1970 from 1969 (the amount by which such carryover exceeds the $600 net capital gain actually realized in 1970, all of which is net short-term capital gain) and (ii) the $500 long-term capital loss carried to 1970 from 1969. However, since this sum ($3,400) exceeds $1,000, the maximum transitional additional allowance to which the individual is entitled for 1970 is limited to $1,000. If for 1971, the same married individual had taxable income of $13,925 for purposes of section 1211(b) and no capital transactions, and filed a separate return, the additional allowance deductible under section 1211(b) for 1971 would be limited to $500 by reason of subdivision (i) of subparagraph (7) of this paragraph, since, as illustrated in Example (7), no part of the capital loss carried over to 1971 under section 1212(b) is attributable to 1969.

Example (9). B, an unmarried individual with one exemption allowable as a deduction under section 151, has the following transactions in 1971:

Taxable income exclusive of capital gains and losses		$10,000
Deduction provided by section 151		675
Taxable income for purposes of section 1211(b)		$10,675
Long-term capital gain	$2,500	
Long-term capital loss treated under § 1.1211-1(b)(3)(iii) as carried over from 1969	(5,000)	
Net long-term capital loss	($2,500)	
Short-term capital gain	$2,700	
Short-term capital loss carried to 1971 from 1970 under section 1212(b)(1)	(1,000)	
Short-term capital loss treated under § 1.1211-1(b)(3)(iv) as carried over from 1969	(2,000)	
Net short-term capital loss	($ 300)	
Losses to extent of gain	($5,200)	
Transitional additional allowance deductible under section 1211(b)	$1,000	

Because a component of the net long-term capital loss for 1971 is a long-term capital loss treated under subparagraph (3)(iii) of this paragraph as carried over from 1969, the rules for computation of the transitional additional allowance under subparagraph (3)(i) and (ii) of this paragraph apply. The "transitional net long-term capital loss component" for 1971 under subparagraph (3)(ii) of this paragraph is $1,800, that is, the amount by which the $5,000 long-term loss treated as carried over from 1969 to 1971 exceeds (*a*) the net long-term capital gain of $2,500 actually realized in 1971 plus (*b*) the $700 excess of the $2,700 net short-term capital gain actually realized in 1971 over the $2,000 short-term capital loss treated as carried over to 1971 from 1969. The transitional additional allowance for 1971 consists of the $300 net short-term capital loss plus $700 of the net long-term capital loss attributable to 1969. A net long-term capital loss of $1,800 ($2,500 minus $700) is carried over to 1972 under section 1212(b). Only $1,100 of the $1,800 will be treated in 1972 as carried over from 1969 since under subparagraph (3)(iii) of this paragraph the "transitional net long-term capital loss component" of $1,800 is reduced by the amount ($700) applied to the transitional additional allowance for 1971.

Par. 10. Section 1.1212 is amended by revising the heading of such section, by revising the heading and subsections (a)(1) and (b) of section

1212, by adding new paragraphs (3) and (4) to section 1212(a), and by revising the historical note. The amended and added provisions read as follows:

§ 1.1212 Statutory provisions; capital loss carrybacks and carryovers.

Sec. 1212. *Capital loss carrybacks and carryovers*—(a) *Corporations*—(1) *In general.* If a corporation has a net capital loss for any taxable year (hereinafter in this paragraph referred to as the "loss year"), the amount thereof shall be—

(A) A capital loss carryback to each of the 3 taxable years preceding the loss year, but only to the extent—

(i) Such loss is not attributable to a foreign expropriation capital loss, and

(ii) The carryback of such loss does not increase or produce a net operating loss (as defined in section 172(c)) for the taxable year to which it is being carried back; and

(B) A capital loss carryover to each of the 5 taxable years (10 taxable years to the extent such loss is attributable to a foreign expropriation capital loss) succeeding the loss year,

and shall be treated as a short-term capital loss in each such taxable year. The entire amount of the net capital loss for any taxable year shall be carried to the earliest of the taxable years to which such loss may be carried, and the portion of such loss which shall be carried to each of the other taxable years to which such loss may be carried shall be the excess, if any, of such loss over the total of the net capital gains for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the net capital gain for any such prior taxable year shall be computed without regard to the net capital loss for the loss year or for any taxable year thereafter. In the case of any net capital loss which cannot be carried back in full to a preceding taxable year by reason of clause (ii) of subparagraph (A), the net capital gain for such prior taxable year shall in no case be treated as greater than the amount of such loss which can be carried back to such preceding taxable year upon the application of such clause (ii).

* * * * *

(3) *Electing small business corporations.* Paragraph (1)(A) shall not apply to the net capital loss of a corporation for any taxable year for which it is an electing small business corporation under subchapter S, and a net capital loss of a corporation (for a year for which it is not such an electing small business corporation) shall not be carried back under paragraph (1)(A) to a taxable year for which it is an electing small business corporation.

(4) *Special rules on carrybacks.* A net capital loss of a corporation shall not be carried back under paragraph (1)(A) to a taxable year—

(A) For which it is a foreign personal holding company (as defined in section 552);

(B) For which it is a regulated investment company (as defined in section 851);

(C) For which it is a real estate investment trust (as defined in section 856); or

(D) For which an election made by it under section 1247 is applicable (relating to election by foreign investment companies to distribute income currently).

(b) *Other taxpayers*—(1) *In general.* If a taxpayer other than a corporation has a net capital loss for any taxable year—

(A) The excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss in the succeeding taxable year, and

(B) The excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss in the succeeding taxable year.

(2) *Special rules.* (A) For purposes of determining the excess referred to in paragraph (1)(A), an amount equal to the amount allowed for the taxable year under section 1211(b)(1)(A), (B), or (C) shall be treated as a short-term capital gain in such year.

(B) For purposes of determining the excess referred to in paragraph (1)(B), an amount equal to the sum of—

(i) The amount allowed for the taxable year under section 1211(b)(1)(A), (B), or (C), and

(ii) The excess of the amount described in clause (i) over the net short-term capital loss (determined without regard to this subsection) for such year,

shall be treated as a short-term capital gain in such year.

(3) *Transitional rule.* In the case of any amount which, under paragraph (1) and section 1211(b) (as in effect for taxable years beginning before January 1, 1970), is treated as a capital loss in the first taxable year beginning after December 31, 1969, paragraph (1) and section 1211(b) (as in effect for taxable years beginning before January 1, 1970) shall apply (and paragraph (1) and section 1211(b) as in effect for taxable years beginning after December 31, 1969, shall not apply) to the extent such amount exceeds the total of any net capital gains (determined without regard to this subsection) of taxable years beginning after December 31, 1969.

[Sec. 1212 as amended by sec. 230(a), Rev. Act 1964 (78 Stat. 99) [Pub. L. 88-272, 1964-1 (Part 2) C.B. 6]; sec. 7(a), Act of Sept. 2, 1964 (Pub. L. 88-571, 78 Stat. 861) [1964-2 C.B. 649]; sec. 512(a) and (b) and sec. 513(b), Tax Reform Act 1969 (83 Stat. 638, 639, 642) [Pub. L. 91-172, 1969-3 C.B. 10, 98, 100]]

Par. 11. Section 1.1212-1 is amended by revising the heading of such

section, by revising subdivision (i) of paragraph (a)(1), by adding a new subparagraph (3) to paragraph (a), and by revising paragraph (b). The amended and added provisions read as follows:

§ 1.1212-1 Capital loss carryovers and carrybacks.

(a) *Corporations; other taxpayers for taxable years beginning before January 1, 1964*—(1) *Regular net capital loss sustained for taxable years beginning before January 1, 1970.* (i) A corporation sustaining a net capital loss for any taxable year beginning before January 1, 1970, and a taxpayer other than a corporation sustaining a net capital loss for any taxable year beginning before January 1, 1964, shall carry over such net loss to each of the five succeeding taxable years and treat it in each of such five succeeding taxable years as a short-term capital loss to the extent not allowed as a deduction against any net capital gains of any taxable years intervening between the taxable year in which the net capital loss was sustained and the taxable year to which carried. The carryover is thus applied in each succeeding taxable year to offset any net capital gain in such succeeding taxable year. The amount of the capital loss carryover may not be included in computing a new net capital loss of a taxable year which can be carried over to the next five succeeding taxable years. For purposes of this subparagraph, a net capital gain shall be computed without regard to capital loss carryovers or carrybacks. In the case of nonresident alien individuals, see section 871 for special rules on capital loss carryovers. For the rules applicable to the portion of a net capital loss of a corporation which is attributable to a foreign expropriation capital loss sustained in taxable years beginning after December 31, 1958, see subparagraph (2) of this paragraph. For the rules applicable to a taxpayer other than a corporation in the treatment of that amount of a net capital loss which may be carried over under section 1212 and this subparagraph as a short-term capital loss to the first taxable year beginning after December 31, 1963, see paragraph (b) of this section.

* * * * *

(3) *Regular net capital loss sustained by a corporation for taxable years beginning after December 31, 1969*—(i) *General rule.* A corporation sustaining a net capital loss for any taxable year beginning after December 31, 1969 (hereinafter in this paragraph referred to as the "loss year"), shall—

(*a*) Carry back such net capital loss to each of the three taxable years preceding the loss year, but only to the extent that such net capital loss is not attributable to a foreign expropriation capital loss and the carryback of such net capital loss does not increase or produce a net operating loss (as defined in section 172(c)) for the taxable year to which it is carried back; and

(*b*) Carry over such net capital loss to each of the five taxable years succeeding the loss year,

and, subject to subdivision (ii) of this subparagraph, treat such net capital loss in each of such three preceding and five succeeding taxable years as a short-term capital loss.

(ii) *Amount treated as a short-term capital loss in each year.* The entire amount of the net capital loss for any loss year shall be carried to the earliest of the taxable years to which such net capital loss may be carried, and the portion of such net capital loss which shall be carried to each of the other taxable years to which such net capital loss may be carried shall be the excess, if any, of such net capital loss over the total of the net capital gains (computed without regard to the capital loss carryback from the loss year or any taxable year thereafter) for each of the prior taxable years to which such net capital loss may be carried.

(iii) *Special rules.* (*a*) In the case of a net capital loss which is not a foreign expropriation capital loss and which cannot be carried back in full to a preceding taxable year by reason of section 1212(a)(1)(A)(ii) and subdivision (i)(*a*) of this subparagraph because such loss would produce or increase a net operating loss in such preceding taxable year, the net capital gain for such preceding taxable year shall in no case be treated as greater than the amount of such net capital loss which can be carried back to such preceding taxable year upon the application of section 1212(a)(1)(A)(ii) and subdivision (i)(*a*) of this subparagraph.

(*b*) For the rules applicable to the portion of a net capital loss of a corporation which is attributable to a foreign expropriation capital loss sustained in a taxable year beginning after December 31, 1958, see section 1212(a)(2) and subparagraph (2) of this paragraph.

(*c*) Section 1212(a)(1)(A) and subdivision (i)(*a*) of this subparagraph shall not apply to (and no carryback shall be allowed with respect to) the net capital loss of a corporation for any taxable year for which such corporation is an electing small business corporation under subchapter S. See § 1.1372-1.

(*d*) A net capital loss of a corporation for a year for which it is not an electing small business corporation under subchapter S shall not be carried back under section 1212(a)(1)(A) and subdivision (i)(*a*) of this subparagraph to a taxable year for which such corporation is an electing small business corporation. See section 1212(a)(3).

(*e*) A net capital loss of a corporation shall not be carried back under section 1212(a)(1)(A) and subdivision (i)(*a*) of this subparagraph to a taxable year for which the corporation

was a foreign personal holding company, a regulated investment company, or a real estate investment trust, or for which an election made by the corporation under section 1247 is applicable. See section 1212(a)(4).

(*f*) A taxable year to which a net capital loss of a corporation cannot, by reason of (*d*) or (*e*) of this subdivision, be carried back under section 1212(a)(1)(A) and subdivision (i)(*a*) of this subparagraph shall nevertheless be treated as one of the 3 taxable years preceding the loss year for purposes of section 1212(a)(1)(A) and such subdivision (i)(*a*); but any net capital gains for such taxable year to which such net capital loss cannot be carried back shall be disregarded for purposes of subdivision (ii) of this subparagraph.

(iv) The application of this subparagraph may be illustrated by the following examples, in each of which it is assumed that the corporation is not, and never has been, a corporation described in subdivision (iii)(*c*) or (*d*) of this subparagraph, that the corporation files its tax returns on a calendar year basis, and that no capital loss sustained is a foreign expropriation capital loss:

Example (1). A corporation has a net capital loss for 1970 which section 1212(a)(1)(A) permits to be carried back. The entire net capital loss for 1970 may be carried back to 1967, but only to the extent that a net operating loss for 1967 would not be produced or increased. The amount of the carryback to 1968 is the excess of the net capital loss for 1970 over the net capital gain for 1967, computed without regard to a capital loss carryback from 1970 or any taxable year thereafter. The amount of the carryback to 1969 is in excess of the net capital loss for 1970 over the sum of the net capital gains for 1967 and 1968, computed without regard to a capital loss carryback from 1970 or any taxable year thereafter. The amount of the carryover to 1971 is the excess of the net capital loss for 1970 over the sum of the net capital gains for 1967, 1968 and 1969, computed without regard to a capital loss carryback from 1970 or any taxable year thereafter. Similarly, the amount of the carryover to 1972, 1973, 1974 and 1975, respectively, is the excess of the net capital loss for 1970 over the sum of the net capital gains for taxable years prior to 1972, 1973, 1974, or 1975, as the case may be, to which the net capital loss for 1970 may be carried, computed without regard to a capital loss carryback from 1970 or any year thereafter.

Example (2). For the taxable years 1967 to 1975, inclusive, a corporation is assumed to have net capital loss, net capital gain, and taxable income (computed without regard to capital gains and losses) as follows:

	1967	1968	1969	1970	1971	1972	1973	1974	1975
Taxable income (Computed without regard to capital gains or losses)	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000
Net capital loss	----	----	($ 1,000)	($29,500)	($16,000)	($ 500)	----	----	----
Net capital gain (computed without regard to carrybacks or carryovers)	$14,000	$16,000	----	----	----	----	$ 8,000	$ 7,500	$ 6,500
Carryback or carryover:									
From 1969:	----	----	----	----	----	----	($ 1,000)	----	----
From 1970:	($14,000)	($15,500)	----	----	----	----	----	----	----
From 1971:	----	($ 500)	----	----	----	----	($ 7,000)	($ 7,500)	($ 1,000)
From 1972:	----	----	----	----	----	----	----	----	($ 500)

The net capital loss of 1969, under the rules of subparagraph (1) of this paragraph, may not be carried back. Thus, the net capital loss for 1970 is carried back and partially absorbed by the net capital gain for 1967, and a portion of the net capital losses of both 1970 and 1971 are carried back to 1968. The net capital loss for 1969 is the oldest that may be carried to 1973, and thus, it is the first carried over and absorbed by the net capital gain for 1973. The net capital loss for 1972 (which is not carried back because of the net capital losses in the three years preceding 1972) may be carried over to 1973.

Example (3). For the taxable years 1967 to 1970, inclusive, a corporation which was organized on January 1, 1967, realized operating income and net capital gains and sustained operating losses and net capital losses as follows:

	Operating Income or Loss (Exclusive of Capital Gain or Loss)	Capital Gain or Loss
1967	$20,000	$24,000
1968	$20,000	–0–
1969	$20,000	–0–
1970	($25,000)	($20,000)

The net capital loss of $20,000 for 1970 is carried back to 1967 and applied against the $24,000 net capital gain realized in that year, reducing such net capital gain to $4,000. The net operating loss of $25,000 for 1970 is then carried back to 1967 and applied first to eliminate the $20,000 of operating income for that year and then to eliminate the net capital gain for that year of $4,000 (as reduced by the 1970 capital loss carryback).

Example (4). Assume the same facts as in Example (3) but substitute the following figures:

	Operating Income or Loss (Exclusive of Capital Gain or Loss)	Capital Gain or Loss
1967	($20,000)	$24,000
1968	$20,000	–0–
1969	$20,000	–0–
1970	($25,000)	($20,000)

The net capital loss of $20,000 for 1970 is carried back to 1967 and applied against the $24,000 net capital gain realized in that year only to the extent of $4,000, the maximum amount to which the 1970 capital loss carryback can be applied without producing a net operating loss for 1967. The unused $16,000 balance of the 1970 net long-term capital loss can be carried forward to 1971 and subsequent taxable years to the extent provided in subdivision (i)(*b*) of this subparagraph.

Example (5). Assume the same facts as in Example (3) but substitute the following figures:

	Operating Income or Loss (Exclusive of Capital Gain or Loss)	Capital Gain or Loss
1967	–0–	–0–
1968	($20,000)	–0–
1969	–0–	$24,000
1970	$20,000	($24,000)

The net capital loss of $24,000 for 1970 is carried back to 1969 and applied against the $24,000 net capital gain realized in that year to the extent of $24,000. The application of the capital loss carryback is not limited as it was in Example (4) because such carryback neither increases nor produces a net operating loss, as such, for 1969. The $20,000 net operating loss for 1968 is then carried forward to 1970 to eliminate the $20,000 of operating income for that year.

Example (6). Assume the same facts as in Example (3) but substitute the following figures:

	Operating Income or Loss (Exclusive of Capital Gain or Loss)	Capital Gain or Loss
1967	–0–	–0–
1968	–0–	–0–
1969	($20,000)	($24,000)
1970	$20,000	$20,000

The net capital loss of $24,000 for 1969 is carried forward to 1970 and applied against the $20,000 net capital gain realized in that year. The unused $4,000 balance of the 1969 net capital loss can be carried forward to 1971 and subsequent taxable years to the extent provided in subdivision (i) (*b*) of this subparagraph.

(b) *Taxpayers other than corporations for taxable years beginning after December 31, 1963*—(1) *In general.* If a taxpayer other than a corporation sustains a net capital loss for any taxable year beginning after December 31, 1963, the portion thereof which is a short-term capital loss carryover shall be carried over to the succeeding taxable year and treated as a short-term capital loss sustained in such succeeding taxable year, and the portion thereof which constitutes a long-term capital loss carryover shall be carried over to the succeeding taxable year and treated as a long-term capital loss sustained in such succeeding taxable year. The carryovers are included in the succeeding taxable year in the determination of the amount of the short-term capital loss, the net short-term capital gain or loss, the long-term capital loss, and the net long-term capital gain or loss in such year, the net capital loss in such year, and the capital loss carryovers from such year. For purposes of this subparagraph—

(i) A short-term capital loss carryover is the excess of the net short-term capital loss for the taxable year over the net long-term capital gain for such year, and

(ii) A long-term capital loss carryover is the excess of the net long-term capital loss for the taxable year over the net short-term capital gain for such year.

(2) *Special rules for determining a net short-term capital gain or loss for purposes of carryovers*—(i) *Taxable years beginning after December 31, 1963, and before January 1, 1970.* In determining a net short-term capital gain or loss of a taxable year begin-

ning after December 31, 1963, and before January 1, 1970, for purposes of computing a short-term or long-term capital loss carryover to the succeeding taxable year, an amount equal to the additional allowance deductible under section 1211(b) for the taxable year (determined as provided in section 1211(b), as in effect for taxable years beginning before January 1, 1970) and § 1.1211-1(b)(5)) is treated as a short-term capital gain occurring in such year.

(ii) *Taxable years beginning after December 31, 1969.* In determining a net short-term capital gain or loss of a taxable year beginning after December 31, 1969—

(*a*) For purposes of computing a short-term capital loss carryover to the succeeding taxable year, an amount equal to the additional allowance for the taxable year (determined as provided in section 1211(b) and § 1.1211-1(b)(2)) is treated as a short-term capital gain occurring in such year, and

(*b*) For purposes of computing a long-term capital loss carryover to the succeeding taxable year, an amount equal to the sum of the additional allowance for the taxable year (determined as provided in section 1211 (b) and § 1.1211-1(b)(2)), plus the excess of such additional allowance over the net short-term capital loss (determined without regard to section 1212(b)(2) for such year) is treated as a short-term capital gain in such year.

The rules provided in this subdivision are for the purpose of taking into account the additional allowance deductible for the current taxable year under section 1211(b) and § 1.1211-1 (b)(2) in determining the amount and character of capital loss carryovers from the current taxable year to the succeeding taxable year. Their practical application to a determination of the amount and character of capital loss carryovers from the current taxable year to the succeeding taxable year involves identification of the net long-term and net short-term capital loss components of the additional allowance deductible in the current taxable year as provided by § 1.1211-1(b)(2)(iii). To the extent that the additional allowance is composed of net short-term capital losses, such losses are treated as a short-term capital gain in the current taxable year in determining the capital loss carryovers to the succeeding year. To the extent that the additional allowance is composed of net long-term capital losses applied pursuant to the provisions of § 1.1211-1(b)(2)(iii), an amount equal to twice the amount of such component of the additional allowance is treated as a short-term capital gain in the current taxable year. See paragraph (4) of this section for transitional rules if any part of the additional allowance is composed of net long-term capital losses carried to the current taxable year from a taxable year beginning before January 1, 1970.

(3) *Transitional rule for net capital losses sustained in a taxable year beginning before January 1, 1964.* A taxpayer other than a corporation sustaining a net capital loss for any taxable year beginning before January 1, 1964, shall treat as a short-term capital loss in the first taxable year beginning after December 31, 1963, any amount which would be treated as a short-term capital loss in such year under subchapter P of chapter 1 of the Code as in effect immediately before the enactment of the Revenue Act of 1964.

(4) *Transitional rule for net long-term capital losses sustained in a taxable year beginning before January 1, 1970.* In the case of a net long-term capital loss sustained by a taxpayer other than a corporation in a taxable year beginning prior to January 1, 1970 (referred to in this section as a "pre-1970 taxable year") which is carried over and treated as a long-term capital loss in the first taxable year beginning after December 31, 1969 (referred to in this section as a "post-1969 taxable year"), the transitional additional allowance deductible under section 1211(b) for the taxable year shall be determined by application of section 1211(b) as in effect for pre-1970 taxable years and § 1.1211-1(b)(3), and the amount of such long-term capital loss carried over and treated as a long-term capital loss in the succeeding taxable year shall be determined by application of section 1212(b)(1) as in effect for pre-1970 taxable years and subparagraph (2)(i) of this paragraph (instead of under sections 1211(b) and 1211(b)(1) as in effect for post-1969 taxable years and § 1.1211-1(b)(2) and subparagraph (2)(ii) of this paragraph, respectively) but only to the extent that such pre-1970 long-term capital loss constitutes a "transitional net long-term capital loss component" (determined as provided in § 1.1211-1 (b)(3)(ii)) in the taxable year to which such pre-1970 long-term capital loss is carried. Thus, for purposes of paragraph (2) of this section, to the extent that a component of the transitional additional allowance deductible for a post-1969 taxable year under section 1211(b) and § 1.1211-1(b)(3)(i) is a transitional net long-term capital loss component carried over to such post-1969 taxable year, such component shall be treated as a short-term capital gain in determining the amount and character of capital loss carryovers from such post-1969 taxable year to the succeeding taxable year. Such component shall be so treated as a short-term capital gain in full on a dollar-for-dollar basis and shall not be doubled for this purpose as is provided by subdivision (ii) of paragraph (2) of this section in the case of a component of the additional allowance made up of net long-term capital losses applied pursuant to the provisions of § 1.1211-1(b)(2)(iii). The transi-

tional rule provided in this paragraph does not apply to a determination of the character of capital losses (as long-term or short-term) actually deductible for the current taxable year under section 1211(b) and § 1.1211-1(b).

(5) *Examples.* The application of this paragraph can be illustrated by the following examples:

Example (1). For the taxable year 1971, an unmarried individual has taxable income for purposes of section 1211(b) of $8,000, a long-term capital loss of $2,000, and no other capital gains or losses. $1,000 (one-half) of the net long-term capital loss is deductible in 1971 as the additional allowance deductible under section 1211(b). No amount of capital loss remains to be carried over to the succeeding taxable year.

Example (2). For the taxable year 1972, the same unmarried individual has taxable income for purposes of section 1211(b) of $8,000, a long-term capital loss of $3,000 and no other capital gains or losses. $1500 (one-half of the excess net capital loss) is deductible in 1972, but limited to the $1,000 maximum additional allowance deductible under section 1211(b). By application of section 1212(b)(1), he will carry over to 1973 a long-term capital loss of $1,000 determined as follows:

Net long-term capital loss		($3,000)
Additional allowance deductible under section 1211(b)	$1,000	
Excess of additional allowance over net short-term capital loss (determined without regard to section 1212(b)(2)(B)(i))	$1,000	
Total amount treated as short-term capital gain under 1212(b)(2)(B) for purposes of determining carryover		$2,000
Long-term capital loss carryover to 1973		($1,000)

If, in 1973, he had taxable income for purposes of section 1211(b) of $8,000, but no capital gains or losses, $500 (one-half) of the net long-term capital loss carryover from 1972 would be deductible in 1973 as the additional allowance deductible under section 1211(b). No amount of capital loss would be carried over to 1974.

Example (3). For the taxable year 1971, an unmarried individual has taxable income for purposes of section 1211(b) of $9,000, a $500 short-term capital gain, a $700 short-term capital loss, a $1,000 long-term capital gain and a $1,700 long-term capital loss. He will offset $1,500 of capital losses against capital gains. The excess net capital loss of $900 is deductible in 1971 to the extent of a $550 additional allowance deductible under 1211(b) which is smaller than both $1,000 and taxable income for purposes of section 1211(b), determined as follows:

Losses allowed to the extent of gains		($1,500)
Amount allowed under section 1211(b)(1)(C)		
(i) excess of net short-term capital loss over net long-term capital gain	$ (200)	
(ii) one-half of the excess of net long-term capital loss over net short-term capital gain	(350)	
Additional allowance deductible under section 1211(b)		$ 550

The total amount treated as short-term capital gain under section 1212(b)(2)(B) for purposes of determining any carryover to the succeeding taxable year exceeds $900. No amount of net capital loss remains to be carried over to the succeeding taxable year.

Example (4). If in example (3) above, the long-term capital loss had been $2,800, the taxpayer would carry over $200 of long-term capital loss to 1972, determined as follows:

Losses allowed to extent of gains		($1,500)
Amount allowed under section 1211(b)(1)(B) and (C):		
(i) excess of net short-term capital loss over net long-term capital gain	$ (200)	
(ii) one-half the excess of net long-term capital loss over net short-term capital gain	$ (900)	

as limited by 1211(b)(1)(B) to an additional allowance of $1,000.

Carryover under section 1211(b)(1):		
Net long-term capital loss for 1971		($1,800)
Additional allowance under section 1211(b)(1)(B)	$1,000	
Excess of additional allowance deductible under section 1211(b) over net short-term capital loss determined without regard to section 1212(b)(2)(B)(i) ($1,000 less $200)		$ 800

Total amount treated as short-term capital gain under section 1212(b)(2)(B) for purposes of determining carryover	$1,800
Short-term capital gain for 1971	500
Total short-term capital gain	$2,300
Short-term capital loss for 1971	(700)
Net short-term capital gain	$1,600
Long-term capital loss carryover ($1,800 less $1,600)	$ 200

Example (5). For 1969, an unmarried individual has taxable income for purposes of section 1211(b) of $8,000, a long-term capital loss of $3,000, and no other capital gains or losses. He is allowed to deduct in 1969 $1,000 as the additional allowance deductible under section 1211(b) (as in effect for pre-1970 taxable years) and to carry over to 1970, a long-term capital loss of $2,000 under section 1212(b) (as in effect for pre-1970 taxable years).

If, in 1970, the same unmarried individual with taxable income for purposes of section 1211(b) of $8,000, has no capital gains or losses, he would deduct $1,000 of his pre-1970 capital loss carryover as the transitional additional allowance deductible under section 1211(b) (as in effect for pre-1970 years) and carry over under section 1212(b)(1) (as in effect for pre-1970 taxable years) to 1971 the remaining $1,000 as a pre-1970 long-term capital loss.

If, in 1970, the same individual instead has a long-term capital gain of $2,500, and a long-term capital loss of $1,500, he would net these two items with the $2,000 carried to 1970 as a long-term capital loss. Thus, he would have a net long-term capital loss for 1970 of $1,000 which is deductible in 1970 as the transitional additional allowance deductible under section 1211(b). He would have no amount to carry over under section 1212(b)(1) to 1971.

If, in 1970, the same individual instead has a long-term capital loss of $1,200, and a long-term capital gain of $200, resulting in a net long-term capital loss of $3,000 when netted with the $2,000 carried to 1970 as a long-term capital loss, he would deduct $1,000 in respect of his pre-1970 long-term capital loss carryover as the transitional additional allowance deductible under section 1211(b) (as in effect for pre-1970 taxable years) and carry over under section 1212(b)(1) (as in effect for pre-1970 taxable years) to 1971 the remaining $1,000 of the pre-1970 component of his long-term capital loss carryover, and the $1,000 net long-term capital loss actually sustained in 1970 as the second component of his long-term capital loss carryover.

Example (6). For 1970 a married individual filing a separate return has taxable income of $8,000, a long-term capital loss of $3,500 and a short-term capital gain of $3,000. He also has a pre-1970 short-term capital loss of $2,000 which is carried to 1970. The $3,000 short-term capital gain realized in 1970 would first be reduced by the $2,000 short-term capital loss carryover, and then the remaining $1,000 balance of the short-term capital gain would be offset against the $3,500 long-term capital loss, producing a net long-term capital loss of $2,500, no part of which is a net long-term capital loss carried over from 1969. However, under the special rule in § 1.1211-1(b)(7)(ii) in 1970, the taxpayer would deduct as the additional allowance deductible under section 1211(b), the $500 limitation in § 1.1211-1(b)(2)(ii) in the case of a married taxpayer filing a separate return in a taxable year ending after December 31, 1969, plus the "transitional net short-term capital loss component" of $2,000 computed under § 1.1211-1(b)(3)(iv), but limited to a total deduction of $1,000. The $1,000 additional allowance deductible under section 1211(b) would absorb $2,000 of the $2,500 net long-term capital loss, and he would carry the unused $500 balance of such loss to 1971 for use in that year.

Example (7). For 1970, an unmarried individual filing a separate return has taxable income for purposes of section 1211(b) of $8,000, and a long-term capital loss of $2,000. He also has a pre-1970 long-term capital loss of $2,500 which is carried to 1970. In 1970, the taxpayer would deduct as the transitional additional allowance deductible under section 1211(b) $1,000, absorbing $1,000 of the pre-1970 long-term capital loss of $2,500. He would carry to 1971 the unused $1,500 balance of his pre-1970 long-term capital loss plus the 1970 long-term capital loss of $2,000, or a total of $3,500, for use in 1971. For 1971, the same taxpayer filing a separate return with taxable income for purposes of section 1211(b) of $8,000, has a $3,600 long-term capital gain and a $2,400 long-term capital loss. When these gains and losses are combined with the long-term capital loss carryover from 1970 of $3,500, a net long-term capital loss of $2,100 results. He would deduct $1,000 as the transitional additional allowance deductible under section 1211(b). The $1,000 additional allowance would absorb $100 of the unused pre-1970 long-term capital loss carryover of $1,500 plus $1,800 of the unused post-1969 long-term capital loss carryover of $2,100 (the amount of the 1971 net long-term capital loss necessary to make up the remaining $900 balance of the additional allowance). Although a component of the 1971 net long-term capital loss is the unused pre-1970 long-term capital loss carryover of $1,500, only $100 of this carryover is available for use in full on a dollar-for-dollar basis in computing the transitional additional allowance for 1971 since it only exceeds by

that amount the $1,400 net capital gain actually realized in 1971 all of which is net long-term capital gain (long-term capital gain of $3,600 reduced by long-term capital loss of $2,200). See § 1.1211-1(b)(3)(ii). The taxpayer would carry over to 1972 as a long-term capital loss the remaining $200 of the 1971 long-term capital loss.

Example (*8*). For 1970, an unmarried individual has taxable income for purposes of section 1211(b) of $8,000 and a short-term capital loss of $700. He also has a pre-1970 long-term capital loss carryover of $1,200. He would deduct $1,000 as the transitional additional allowance deductible under section 1211(b). The $1,000 transitional additional allowance would be composed of the 1970 short-term capital loss of $700 and $300 of the pre-1970 long-term capital loss carryover. He would carry over to 1971 the unused $900 balance of his $1,200 pre-1970 long-term capital loss carryover for use in 1971.

Par. 13. Section 1.1222 is amended by revising paragraph (9) of section 1222 and the historical note to read as follows:

§ 1.1222 Statutory provisions; other terms relating to capital gains and losses.

Sec. 1222. *Other terms relating to capital gains and losses.*

* * * * *

(9) *Net capital gain.* The term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.

* * * * *

[Sec. 1222 as amended by sec. 230(b), Rev. Act 1964 (78 Stat. 100) [Pub. L. 98-272, 1964-1 (Part 2) C.B. 6]; sec. 513(c), Tax Reform Act 1969 (83 Stat. 643) [Pub. L. 91-172, 1969-3 C.B. 10, 100]]

Par. 14. Section 1.1222-1 is amended by revising paragraphs (d) and (e) to read as follows:

§ 1.1222-1 Other terms relating to capital gains and losses.

* * * * *

(d)(1) The term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from sales or exchanges of capital assets, which losses include any amounts carried to the taxable year pursuant to section 1212(a) or section 1212(b).

(2) Notwithstanding subparagraph (1) of this paragraph, in the case of a taxpayer other than a corporation for taxable years beginning before January 1, 1964, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus the taxable income (computed without regard to gains and losses from sales or exchanges of capital assets and without regard to the deductions provided by section 151, relating to personal exemptions, or any deductions in lieu thereof) of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from sales or exchanges of capital assets, which losses include amounts carried to the taxable year by such taxpayer under paragraph (a)(1) of § 1.1212-1. Thus, in the case of estates and trusts for taxable years beginning before January 1, 1964, taxable income for the purposes of this paragraph shall be computed without regard to gains and losses from sales or exchanges of capital assets and without regard to the deductions allowed by section 642(b) to estates and trusts in lieu of personal exemptions. The term "net capital gain" is not applicable in the case of a taxpayer other than a corporation for taxable years beginning after December 31, 1963, and before January 1, 1970. In the case of a taxpayer whose tax liability is computed under section 3 for taxable years beginning before January 1, 1964, the term "taxable income", for purposes of this paragraph, shall be read as "adjusted gross income".

(e) The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the sum allowed under section 1211. However, in the case of a corporation, amounts which are short-term capital losses under § 1.1212-1 (a) are excluded in determining such "net capital loss".

* * * * *

Par. 15. Section 1.1314(a) is amended by revising so much of section 1314 (a) as follows paragraph (2) of such section and adding a historical note to read as follows:

§ 1.1314(a) Statutory provisions, amount and method of adjustment; ascertainment of amount of adjustment.

Sec. 1314. *Amount and method of adjustment*—(a) *Ascertainment of amount of adjustment.*

* * * * *

There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle). A similar computation shall be made for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172, or by a capital loss carryback or carryover (as defined in section 1212), determined with reference to the taxable year with respect to which the error was made. The amount so ascertained (together with any amounts wrongfully collected as additions to the tax or interest, as a result of such error) for each taxable year shall be the amount of the adjustment for that taxable year.

[Sec. 1314(a) as amended by sec. 512(f)(7), Tax Reform Act 1969 (83 Stat. 641)]

Par. 16. Section 1.1314(a)-2 is

amended by revising paragraphs (a) (1) and (2), (b), and (c) to read as follows:

§ 1.1314(a)-2 Adjustment to other barred taxable years.

(a) * * *

(1) The tax liability for such other year or years must be affected, or must have been treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryback or carryover (as defined in section 1212).

(2) The net operating loss deduction or capital loss carryback or carryover must be determined with reference to the taxable year with respect to which the error was made.

* * * * *

(b) The amount of the adjustment for such other year or years shall be computed in a manner similar to that provided in § 1.1314(a)-1. The tax previously determined for such other year or years shall be ascertained. A recomputation must then be made to ascertain the increase or decrease in tax, if any, resulting solely from the correction of the net operating loss deduction or capital loss carryback or carryover. The difference between the tax previously determined and the tax as recomputed is the amount of the adjustment. In the recomputation, no consideration shall be given to items other than the following: (1) the items upon which the tax previously determined for such other year or years was based, and (2) the net operating loss deduction or capital loss carryback or carryover as corrected. In determining the correct net operating loss deduction or capital loss carryback or carryover, no changes shall be made in taxable income (net income in the case of taxable years subject to the provisions of the Internal Revenue Code of 1939 or prior revenue laws), net operating loss or capital loss, for any barred taxable year, except as provided in section 1314. Section 172 and the corresponding provisions of prior revenue laws, and the regulations promulgated thereunder, prescribe the methods of computing the net operating loss deduction. Section 1212 and the corresponding provisions of prior revenue laws, and the regulations promulgated thereunder, prescribe the methods for computing the capital loss carryback and carryover.

(c) A net operating loss deduction or a capital loss carryback or carryover determined with reference to the year of the error may affect, or may have been treated as affecting, a taxable year with respect to which an adjustment is not prevented by the operation of any law or rule of law. In such case, the appropriate adjustment shall be made with respect to such open taxable year. However, the redetermination of the tax for such open taxable year is not made pursuant to part II (section 1311 and following), subchapter Q, chapter 1 of the Code, and the adjustment for such open year and the method of computation are not limited by the provisions of said sections.

* * * * *

Par. 17. Section 1.1314(b) is amended by revising section 1314(b) and adding a historical note to read as follows:

§ 1.1314(b) Statutory provisions; amount and method of adjustment; method of adjustment.

Sec. 1314. *Amount and method of adjustment.* * * *

(b) *Method of adjustment.* The adjustment authorized in section 1311(a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assessment or filing claim for refund for such taxable year or years. If, as a result of a determination described in section 1313(a)(4), an adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be redetermined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such redetermination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss or net capital loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss or net capital loss arises.

[Sec. 1341(b) as amended by sec. 512(f)(8), Tax Reform Act 1969 (183 Stat. 642)]

Par. 18. Section 1.1314(b)-1 is amended by revising paragraph (c) to read as follows:

§ 1.1314(b)-1 Method of adjustment.

* * * * *

(c) The amount of an adjustment treated as if it were a deficiency or an overpayment, as the case may be, will bear interest and be subject to additions to the tax to the extent provided by the internal revenue laws applicable to deficiencies and overpayments for the taxable year with respect to which the adjustment is made. In the case of an adjustment resulting from an increase or decrease in a net operating loss or net capital

loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss or net capital loss arises.

* * * * *

Par. 19. Section 1.6411 is amended by revising so much of subsection (a) as precedes paragraph (1) of such subsection, subsections (a)(1) and (5), (b), and (c) of section 6411, and by adding a historical note. The amended and added provisions read as follows:

§ 1.6411 Statutory provisions; tentative carryback adjustments.

Sec. 6411. *Tentative carryback adjustments*—(a) *Application for adjustment.* A taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback provided in section 172(b), by an investment credit carryback provided in section 46(b), by a work incentive program carryback provided in section 50A(b), or by a capital loss carryback provided in section 1212(a)(1), from any taxable year. The application shall be verified in the manner prescribed by section 6065 in the case of a return of such taxpayer, and shall be filed, on or after the date of filing of the return for the taxable year of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit from which the carryback results and within a period of 12 months from the end of such taxable year (or, with respect to any portion of an investment credit carryback or a work incentive program carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, within a period of 12 months from the end of such subsequent taxable year), in the manner and form required by regulations prescribed by the Secretary or his delegate. The application shall set forth in such detail and with such supporting data and explanation as such regulations shall require—

(1) The amount of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit;

* * * * *

(5) The amount, with respect to the tax for the taxable year immediately preceding the taxable year from which the carryback is made, as to which an extension of time for payment under section 6164 is in effect; and

* * * * *

(b) *Allowance of adjustments.* Within a period of 90 days from the date on which an application for a tentative carryback adjustment is filed under subsection (a), or from the last day of the month in which falls the last date prescribed by law (including extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit from which such carryback results, whichever is the later, the Secretary or his delegate shall make, to the extent he deems practicable in such period, a limited examination of the application, to discover omissions and errors of computation therein, and shall determine the amount of the decrease in the tax attributable to such carryback upon the basis of the application and the examination, except that the Secretary or his delegate may disallow, without further action, any application which he finds contains errors of computation which he deems cannot be corrected by him within such 90-day period or material omissions. Such decrease shall be applied against any unpaid amount of the tax decreased (including any amount of such tax as to which an extension of time under section 6164 is in effect) and any remainder shall be credited against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit the time for payment of which tax is extended under section 6164. Any remainder shall, within such 90-day period, be either credited against any tax or installment thereof then due from the taxpayer, or refunded to the taxpayer.

(c) *Consolidated returns.* If the corporation seeking a tentative carryback adjustment under this section, made or was required to make a consolidated return, either for the taxable year within which the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit arises, or for the preceding taxable year affected by such loss or credit, the provisions of this section shall apply only to such extent and subject to such conditions, limitations, and exceptions as the Secretary or his delegate may by regulations prescribe.

[Sec. 6411 as amended by sec. 2(a), (b), (c), (d), and (e), Act of Nov. 2, 1966 (Pub. L. 89-721, 80 Stat. 1150) [1966-2 C.B. 643]; sec. 2(b), Act of Dec. 27, 1967 (Pub. L. 90-225, 81 Stat. 731) [1968-1 C.B. 640]; sec. 512(d), Tax Reform Act 1969 (83 Stat. 639) [Pub. L. 91-172, 1969-3 C.B. 10, 98]]

Par. 20. Section 1.6411-1 is amended by revising paragraphs (a) and (c) to read as follows:

§ 1.6411-1 Tentative carryback adjustments.

(a) *In general.* Any taxpayer who has a net operating loss under section 172. a net capital loss under section 1211(a) which is a carryback under section 1212, an unused investment credit under section 46, or an unused work incentive program (WIN) credit under section 50A may file an application under section 6411 for a tentative carryback adjustment of the taxes for taxable years prior to the taxable

year of the net operating or capital loss or the unused credit, whichever is applicable, which are affected by the net operating loss carryback, the capital loss carryback, the unused investment credit carryback, or the unused WIN credit carryback resulting from such loss or unused credit. The regulations under section 6411 shall apply with respect to investment credit carrybacks for taxable years ending after December 31, 1961, but only with respect to applications for tentative carryback adjustments for investment credit carrybacks filed after November 2, 1966. The regulations under section 6411 shall apply with respect to WIN credit carrybacks for taxable years beginning after December 31, 1971. The right to file an application for a tentative carryback adjustment is not limited to corporations, but is available to any taxpayer otherwise entitled to carry back a loss or unused credit. A corporation may file an application for a tentative carryback adjustment even though it has not extended the time for payment of tax under section 6164.

* * * * *

(c) *Time and place for filing application.* Except as otherwise provided in this paragraph the application for a tentative carryback adjustment shall be filed on or after the date of the filing of the return for the taxable year of the net operating loss, net capital loss, unused investment credit, or unused WIN credit and shall be filed within a period of twelve months from the end of such taxable year. With respect to any portion of an investment credit carryback or a WIN credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the twelve-month period shall be measured from the end of such subsequent taxable year. In the case of an application for a tentative carryback adjustment attributable to the carryback of an unused investment credit, the twelve-month period for filing shall not expire before the close of December 31, 1966. Any application filed prior to the date on which the return for the taxable year of the loss or unused credit is filed shall be considered to have been filed on the date such return is filed. In the case of an application filed before April 15, 1968, the application shall be filed with the internal revenue officer to whom the tax was paid or by whom the assessment was made. Except as provided in paragraph (b) of § 301.6091-1 (relating to hand-carried documents), in the case of an application filed after April 14, 1968, if the tax was paid to the Director of International Operations, the application shall be filed with him; otherwise the application shall be filed with the internal revenue office with which the return was filed.

* * * * *

Par. 21. Section 1.6411-2 is amended by revising paragraph (a) to read as follows:

§ 1.6411-2 Computation of tentative carryback adjustment.

(a) *Tax previously determined.* The taxpayer is to determine the amount of decrease, attributable to the carryback, in tax previously determined for each taxable year before the taxable year of the net operating loss, net capital loss, unused investment credit, or unused WIN credit. The tax previously determined is to be ascertained in accordance with the method prescribed in section 1314(a). Thus, the tax previously determined will be the tax shown on the return as filed, increased by any amounts assessed (or collected without assessment) as deficiencies before the date of the filing of the application for a tentative carryback adjustment, and decreased by any amounts abated, credited, refunded, or otherwise repaid prior to such date. Any items as to which the Internal Revenue Service and the taxpayer are in disagreement at the time of the filing of the application shall be taken into account in ascertaining the tax previously determined only if, and to the extent that, they were reported in the return, or were reflected in any amounts assessed (or collected without assessment) as deficiencies, or in any amounts abated, credited, refunded, or otherwise repaid, before the date of filing the application. The tax previously determined, therefore, will reflect the foreign tax credit and the credit for tax withheld at source provided in section 32.

* * * * *

Par. 22. Section 1.6411-3 is amended by revising paragraphs (a)(2) and (b) and d(2) to read as follows:

§ 1.6411-3 Allowance of adjustments.

(a) *Time prescribed.* * * *

(2) The last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss, net capital loss, unused investment credit, or unused WIN credit from which the carryback results.

(b) *Examination.* Within the 90-day period described in paragraph (a) of this section, the district director or director of a service center shall make, to the extent he deems practicable in such period, an examination of the application to discover omissions and errors of computation. He shall determine within such period the decrease in tax previously determined, affected by the carryback or any related adjustments, upon the basis of the application and such examination. Such decrease shall be determined in the same manner as that provided in section 1314(a) for the determination by the taxpayer of the decrease in taxes previously determined which must be set forth in the application for a tentative carryback adjustment. Such internal revenue officer, however, may

correct any errors of computation or omissions he may discover upon examination of the application. In determining the decrease in tax previously determined which is affected by the carryback or any related adjustment, he accordingly may correct any mathematical error appearing on the application and he may likewise correct any modification required by the law and incorrectly made by the taxpayer in computing the net operating loss, net capital loss, unused investment credit, or unused WIN credit, the resulting carrybacks, or the net operating loss deduction, capital loss deduction, investment credit or WIN credit allowable. If the required modification has not been made by the taxpayer and such internal revenue officer has available the necessary information to make such modification within the 90-day period, he may, in his discretion, make such modification. In determining such decrease, however, such internal revenue officer will not, for example, change the amount claimed on the return as a deduction for depreciation because he believes that the taxpayer has claimed an excessive amount; likewise, he will not include in gross income any amount not so included by the taxpayer, even though such officer believes that such amount is subject to tax and properly should be included in gross income.

* * * * *

(d) *Application of decrease.* * * *

(2) In case the unpaid amount of tax includes more than one of such amounts, the district director, or director of a service center in his discretion, shall determine against which amount or amounts, and in what proportion the decrease is to be applied. In general, however, the decrease will be applied against any amounts described in subparagraph (1)(i), (ii), and (iii) of this paragraph in the order named. If there are several amounts of the type described in subparagraph (1)(iii) of this paragraph, any amount of the decrease which is to be applied against such amount will be applied by assuming that the tax previously determined minus the amount of the decrease to be so applied is "the tax" and that the taxpayer had elected to pay such tax in installments. The unpaid amount of tax against which a decrease may be applied under subparagraph (1) of this paragraph may not include any amount of tax for any taxable year other than the year of the decrease. After making such application, such internal revenue officer will credit any remainder of the decrease against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss, capital loss, unused investment credit, or unused WIN credit, the time for payment of which has been extended under section 6164.

* * * * *

REGULATIONS ON PROCEDURE AND ADMINISTRATION (26 CFR Part 301)

Par. 23. Section 301.6411 is amended by revising so much of subsection (a) as precedes paragraph (1) of such subsection, subsections (a)(1) and (5), (b), and (c), of section 6411, and by adding a historical note. The amended and added provisions read as follows:

§ 301.6411 Statutory provisions; tentative carryback adjustments.

Sec. 6411. *Tentative carryback adjustments*—(a) *Application for adjustment.* A taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback provided in section 172(b), by an investment credit carryback provided in section 46(b), by a work incentive program carryback provided in section 50A(b), or by a capital loss carryback provided in section 1212(a)(1), from any taxable year. The application shall be verified in the manner prescribed by section 6065 in the case of a return of such taxpayer, and shall be filed, on or after the date of filing of the return for the taxable year of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit from which the carryback results and within a period of 12 months from the end of such taxable year (or, with respect to any portion of an investment credit carryback or a work incentive program carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, within a period of 12 months from the end of such subsequent taxable year), in the manner and form required by regulations prescribed by the Secretary or his delegate. The application shall set forth in such detail and with such supporting data and explanation as such regulations shall require—

(1) The amount of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit;

* * * * *

(5) The amount, with respect to the tax for the taxable year immediately preceding the taxable year from which the carryback is made, as to which an extension of time for payment under section 6164 is in effect; and

* * * * *

(b) *Allowance of adjustments.* Within a period of 90 days from the date on which an application for a tentative carryback adjustment is filed under subsection (a), or from the last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit from which

such carryback results, whichever is the later, the Secretary or his delegate shall make, to the extent he deems practicable in such period, a limited examination of the application, to discover omissions and errors of computation therein, and shall determine the amount of the decrease in the tax attributable to such carryback upon the basis of the application and the examination, except that the Secretary or his delegate may disallow, without further action, any application which he finds contains errors of computation which he deems cannot be corrected by him within such 90-day period or material omissions. Such decrease shall be applied against any unpaid amount of the tax decreased (including any amount of such tax as to which an extension of time under section 6164 is in effect) and any remainder shall be credited against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit the time for payment of which tax is extended under section 6164. Any remainder shall, within such 90-day period, be either credited against any tax or installment thereof then due from the taxpayer, or refunded to the taxpayer.

(c) *Consolidated returns.* If the corporation seeking a tentative carryback adjustment under this section, made or was required to make a consolidated return, either for the taxable year within which the net operating loss, net capital loss, unused investment credit, or unused work incentive program credit arises, or for the preceding taxable year affected by such loss or credit, the provisions of this section shall apply only to such extent and subject to such conditions, limitations, and exceptions as the Secretary or his delegate may by regulations prescribe.

[Sec. 6411 as amended by sec. 2(a), (b), (c), (d) and (e), Act of Nov. 2, 1966 (Pub. L. 89-721, 80 Stat. 1150) [1966-2 C.B. 643]; sec. 2(b), Act of Dec. 27, 1967 (Pub. L. 90-225, 81 Stat. 731 [1968-1 C.B. 640]; sec. 512(d), Tax Reform Act 1969 (83 Stat. 639) [Pub. L. 91-172, 1969-3 C.B. 10, 98]; sec. 601(e)(1), Rev. Act 1971 (85 Stat. 560) [Pub. L. 92-178, 1972-1 C.B. 443, 477]]

Par. 24. Section 301.6501(h) is amended by revising the heading of such section, the heading and subsection(h) of section 6501, and the historical note to read as follows:

§ 301.6501(h) Statutory provisions; limitations on assessment and collection; net operating loss or capital loss carrybacks.

Sec. 6501. *Limitations on assessment and collection.* * * *

(h) *Net operating loss or capital loss carrybacks.* In the case of a deficiency attributable to the application to the taxpayer of a net operating loss carryback or a capital loss carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss or net capital loss which results in such carryback may be assessed. In the case of a deficiency attributable to the application of a net operating loss carryback, such deficiency may be assessed within 18 months after the date on which the taxpayer files in accordance with section 172(b)(3) a copy of the certification (with respect to the taxable year of the net operating loss) issued under section 317 of the Trade Expansion Act of 1962, if later than the date prescribed by the preceding sentence.

[Sec. 6501(h) as added by sec. 81(b), Technical Amendments Act 1958 (72 Stat. 1663) [Pub. L. 85-866, 1958-3 C.B. 254]; and as amended by sec. 317(c), Trade Expansion Act 1962 (76 Stat. 890) [Pub. L. 87-794, 1962-3 C.B. 107]; sec. 512(e)(1)(A), (B), (C), and (D), Tax Reform Act 1969 (83 Stat. 640) [Pub. L. 91-172, 1969-3 C.B. 10, 98]]

Par. 25. Section 301.6501(h)-1 is amended by revising such section and its heading to read as follows:

§ 301.6501(h)-1 Net operating loss or capital loss carrybacks.

In the case of a deficiency attributable to the application to the taxpayer of a net operating loss or capital loss carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss or net capital loss which results in such carryback may be assessed. In the case of a deficiency attributable to the application of a net operating loss carryback, such deficiency may be assessed within 18 months after the date on which the taxpayer files in accordance with section 172(b)(3) a copy of the certification (with respect to such taxable year) issued under section 317 of the Trade Expansion Act of 1962, if later than the date prescribed by the preceding sentence.

Par. 26. Section 301.6501(j) is amended by revising section 6501(j) and the historical note to read as follows:

§ 301.6501(j) Statutory provisions; limitations on assessment and collection; investment credit carrybacks.

Sec. 6501. *Limitations on assessment and collection.* * * *

(j) *Investment credit carrybacks.* In the case of a deficiency attributable to the application to the taxpayer of an investment credit carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the unused investment credit which results in such carryback may be assessed, or, with respect to any portion of an investment credit carry-

back from a taxable year attributable to a net operating loss carryback or capital loss carryback from a subsequent taxable year, at any time before the expiration of the period within which a deficiency for such subsequent taxable year may be assessed.

[Sec. 6501(j) as added by sec. 2(e)(1), Rev. Act 1962 (76 Stat. 971) [Pub. L. 87-834, 1962-3 C.B. 111]; and as amended by sec. 2(f), Act of Nov. 2, 1966 (Pub. L. 89-721, 80 Stat. 1150) [1966-2 C.B. 643]; sec. 2(c), Act of Dec. 27, 1967 (Pub. L. 90-225, 81 Stat. 731) [1968-1 C.B. 640]; sec. 512(e)(1)(E), Tax Reform Act 1969 (83 Stat. 640) [Pub. L. 91-172, 1969-3 C.B. 10, 98]]

Par. 27. Section 301.6501(j)-1 is amended to read as follows:

§ 301.6501(j)-1 Investment credit carryback; taxable years ending after December 31, 1961.

With respect to taxable years ending after December 31, 1961, a deficiency attributable to the application to the taxpayer of an investment credit carryback may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the unused investment credit which results in such carryback may be assessed, or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss or capital loss carryback from a subsequent taxable year, at any time before the expiration of the period within which a deficiency for such subsequent taxable year may be assessed. For purposes of this section a deficiency shall include a deficiency which may be assessed pursuant to the provisions of section 6213(b)(2), but only those arising with respect to applications for tentative carryback adjustments filed after November 2, 1966.

Par. 28. Section 301.6501(k) is redesignated as section 301.6501(l) and the historical note is revised. Such redesignated section and revised historical note read as follows:

§ 301.6501(l) Statutory provisions; limitations on assessment and collection; joint income return after separate return.

Sec. 6501. *Limitations on assessment and collection.* * * *

(l) *Joint income return after separate return.* For period of limitations for assessment and collection in the case of a joint income return filed after separate returns have been filed, see section 6013(b)(3) and (4).

[Sec. 6501(h) as redesignated by sec. 81(b), Technical Amendments Act 1958 (72 Stat. 1663) [Pub. L. 85-866, 1958-3 C.B. 254]; sec. 3(c), Act of Sept. 14, 1960 (Pub. L. 86-780, 74 Stat. 1013) [1960-2 C.B. 720]; sec. 2(e)(1), Rev. Act 1962 (76 Stat. 971) [Pub. L. 87-834, 1962-3 C.B. 111]; sec. 6501(k) as redesignated by sec. 3(b), Act of Sept. 2, 1964 (Pub. L. 88-571, 78 Stat. 857) [1964-2 C.B. 649]]

Par. 29. There is inserted immediately after section 301.6501(j)-1 the following new section:

§ 301.6501(k) Statutory provisions; limitations on assessment and collection; reductions of policyholders surplus account of life insurance companies.

Sec. 6501. *Limitations on assessment and collection.* * * *

(k) *Reductions of policyholders surplus account of life insurance companies.* In the case of a deficiency attributable to the application to the taxpayer of section 815(d)(5) (relating to reductions of policyholders surplus account of life insurance companies for certain unused deductions), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2) may be assessed.

[Sec. 6501(k) as added by sec. 3(b), Act of Sept. 2, 1964 (Pub. L. 88-571, 78 Stat. 858)]

Par. 30. There is inserted immediately after redesignated section 301.6501(l) the following new sections:

§ 301.6501(m) Statutory provisions; limitations on assessment and collection; tentative carryback adjustment assessment period.

Sec. 6501. *Limitation on assessment and collection.* * * *

(m) *Tentative carryback adjustment assessment period.* In a case where an amount has been applied, credited, or refunded under section 6411 (relating to tentative carryback adjustments) by reason of a net operating loss carryback, a capital loss carryback, an investment credit carryback, or a work incentive program carryback to a prior taxable year, the period described in subsection (a) of this section for assessing a deficiency for such prior taxable year shall be extended to include the period described in subsection (h), (j), or (o), whichever is applicable; except that the amount which may be assessed solely by reason of this subsection shall not exceed the amount so applied, credited, or refunded under section 6411, reduced by any amount which may be assessed solely by reason of subsection (h), (j), or (o), as the case may be.

[Sec. 6501(m) as added by sec. 3(a), Act of Nov. 2, 1966 (Pub. L. 89-721, 80 Stat. 115) [1966-2 C.B. 643]; and as amended by sec. 512(e)(1)(F), Tax Reform Act 1969 (83 Stat. 640) [Pub. L. 91-172, 1969-3 C.B. 10, 98]; sec. 601(e)(2), Rev. Act 1971 (85 Stat. 560) [Pub. L. 92-178, 1972-1 C.B. 443, 477]]

§ 301.6501(m)-1 Tentative carryback adjustment assessment period.

(a) *Period of limitation after tentative carryback adjustment.* (1) Under section 6501(m), in a case where an amount has been applied, credited, or refunded under section 6411, by reason of a net operating loss carryback, a capital loss carryback, an investment credit carryback or a work incentive program credit carryback to a prior taxable year, the period described in section 6501(a) of the Code for assessing a deficiency for such prior taxable year is extended to include the period described in section 6501(h),

(j), or (o), whichever is applicable; except that the amount which may be assessed solely by reason of section 6501(m) may not exceed the amount so applied, credited, or refunded under section 6411, reduced by any amount which may be assessed solely by reason of section 6501(h), (j), or (o), as the case may be.

(2) The application of this paragraph may be illustrated by the following example:

Example. Assume that M Corporation, which claims an unused investment credit of $50,000 for the calendar year 1968, files an application under section 6411 of the Code for an adjustment of its tax for 1965, and receives a refund of $50,000 in 1969. In 1971, it is determined that the amount of the unused investment credit for 1968 is $30,000 rather than $50,000. Moreover, it is determined that M Corporation would have owed $40,000 of additional tax for 1965 if it had properly reported certain income which it failed to include in its 1965 return. Assuming that M Corporation filed its 1968 return on March 15, 1969, and that the 3-year period described in section 6501(a) has not been extended, the period prescribed in section 6501(j) for assessing the excessive amount refunded, $20,000 (*i.e.*, $50,000, original amount refunded, less $30,000, correct amount of unused investment credit), does not expire until March 15, 1972, and $20,000 may be assessed on or before such date under section 6501(j). Under section 6501(m), M Corporation may be assessed on or before March 15, 1972, an amount not in excess of $30,000 ($50,000, the amount refunded under section 6411, minus $20,000, the amount which may be assessed solely by reason of section 6501(j)).

(b) *Effective date.* The provisions of paragraph (a) of this section apply only with respect to applications under section 6411 filed after November 2, 1966.

§ 301.6501(o) Statutory provisions; limitation on assessment and collection; work incentive program credit carrybacks.

Sec. 6501. *Limitation on assessment and collection.* * * *

(o) *Work incentive program credit carrybacks.* In the case of a deficiency attributable to the application to the taxpayer of a work incentive program credit carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the unused work incentive program credit which results in such carryback may be assessed, or, with respect to any portion of a work incentive program credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, at any time before the expiration of the period within which a deficiency for such subsequent taxable year may be assessed.

[Sec. 6501(o) as added by sec. 601(d)(1), Rev. Act 1971 (85 Stat. 558) [Pub. L. 92-178, 1972-1 C.B. 443, 477]]

§ 301.6501(o)-1 Work incentive program credit carrybacks, taxable years beginning after December 31, 1971.

With respect to taxable years beginning after December 31, 1971, a deficiency attributable to the application to the taxpayer of a work incentive program credit carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)) may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the unused work incentive program credit which results in such carryback may be assessed, or, with respect to any portion of a work incentive program credit carryback from a taxable year attributable to a net operating loss or capital loss carryback from a subsequent taxable year, at any time before the expiration of the period within which a deficiency for such subsequent taxable year may be assessed.

Par. 31. Section 6511(d) of section 301.6511(d) is amended by revising the heading of paragraph (2), by revising so much of subparagraph (A) as precedes clause (i) of such subparagraph and subparagraph (B) of paragraph (2), by revising paragraph (4)(A) of section 6511(d), by adding paragraphs (5), (6), and (7), and by revising the historical note. The amended and added provisions read as follows:

§ 301.6511(d) Statutory provisions; limitations on credit or refund; special rules applicable to income taxes.

Sec. 6511. *Limitations on credit or refund.* * * *

(d) *Special rules applicable to income taxes.* * * *

(2) *Special period of limitation with respect to net operating loss or capital loss carrybacks*—

(A) *Period of limitation.* If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or the 39th month, in the case of a corporation) following the end of the taxable year of the net operating loss or net capital loss which results in such carryback, or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later; except that—

* * * * *

(B) *Applicable rules.* (i) If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback or a capital loss carryback is otherwise prevented by the operation of any law

or rule of law other than section 7122, relating to compromises, such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. If the allowance of an application, credit, or refund of a decrease in tax determined under section 6411(b) is otherwise prevented by the operation of any law or rule of law other than section 7122, such application, credit, or refund may be allowed or made if application for a tentative carryback adjustment is made within the period provided in section 6411(a). In the case of any such claim for credit or refund or any such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction, and the effect of such deduction, or with respect to the determination of a short-term capital loss, and the effect of such short-term capital loss, to the extent that such deduction or short-term capital loss is affected by a carryback which was not an issue in such proceeding.

(ii) A claim for credit or refund for a computation year (as defined in section 1302(c)(1)) shall be determined to relate to an overpayment attributable to a net operating loss carryback or a capital loss carryback, as the case may be, when such carryback relates to any base period year (as defined in section 1302(c)(3)).

* * * * *

(4) *Special period of limitation with respect to investment credit carrybacks*—(A) *Period of limitation.* If the claim for credit or refund relates to an overpayment attributable to an investment credit carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or 39th month, in the case of a corporation) following the end of the taxable year of the unused investment credit which results in such carryback (or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the period shall be that period which ends with the expiration of the 15th day of the 40th month, or 39th month, in the case of a corporation, following the end of such subsequent taxable year) or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to such carryback.

* * * * *

(5) *Special period of limitation with respect to self-employment tax in certain cases.* If the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 (relating to the tax on self-employment income) attributable to an agreement, or modification of an agreement, made pursuant to section 218 of the Social Security Act (relating to coverage of State and local employees), and if the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule of law other than section 7122 (relating to compromises), such credit or refund may be allowed or made if claim therefor is filed on or before the later of the following dates: (A) the last day of the second year after the calendar year in which such agreement (or modification) is agreed to by the State and the Secretary of Health, Education, and Welfare, or (B) December 31, 1965.

(6) *Special period of limitation with respect to reduction of policyholders surplus account of life insurance companies*—(A) *Period of limitation.* If the claim for credit or refund relates to an overpayment arising by operation of section 815(d)(5) (relating to reduction of policyholders surplus account of life insurance companies for certain unused deductions), in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 39th month following the end of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2), or the period prescribed in subsection (c), in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of overpayment arising by operation of section 815(d)(5).

(B) *Applicable rules.* If the allowance of a credit or refund of an overpayment arising by operation of section 815(d)(5) is otherwise prevented by operation of any law or rule of law, other than section 7122 (relating to compromises), such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. In the case of any such claim for credit or refund, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the effect of the operation of section 815(d)(5), to the extent such effect of the operation of section 815(d)(5) was not in issue in such proceeding.

(7) *Special period of limitation with respect to work incentive program credit carrybacks*—(A) *Period of limitation.* If the claim for credit or refund relates to an overpayment at-

tributable to a work incentive program credit carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or 39th month, in the case of a corporation) following the end of the taxable year of the unused work incentive program credit which results in such carryback (or, with respect to any portion of a work incentive program credit carryback from a taxpayer year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the period shall be that period which ends with the expiration of the 15th day of the 40th month, or 39th month, in the case of a corporation, following the year of such taxable year) or the period prescribed in subsection (o) in respect of such taxable year, whichever expires later. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to such carryback.

(B) *Applicable rules.* If the allowance of a credit or refund of an overpayment of tax attributable to a work incentive program credit carryback is otherwise prevented by the operation of any law or rule of law other than section 7122, relating to compromises, such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. In the case of any such claim for credit or refund, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall not be conclusive with respect to the work incentive program credit, and the effect of such credit, to the extent that such credit is affected by a carryback which was not in issue in such proceeding.

[Sec. 6511(d) as amended by sec. 82(d), Technical Amendments Act 1958 (72 Stat. 1663) [Pub. L. 85-866, 1958-3 C.B. 254]; sec. 1(a), Act of Sept. 16, 1959 (Pub. L. 86-280, 73 Stat. 563) [1959-2 C.B. 689]; sec. 317(d), Trade Expansion Act 1962 (76 Stat. 891) [Pub. L. 87-794, 1962-3 C.B. 107]; sec. 2(e)(2), Rev. Act 1962 (76 Stat. 971) [Pub. L. 87-834, 1962-3 C.B. 111]; sec. 232(d) and sec. 239, Rev. Act 1964 (78 Stat. 111, 128) [Pub. L. 88-272, 1964-1 (Part 2) C.B. 6]; sec. 3(c), Act of Sept. 2, 1964 (Pub. L. 88-571, 78 Stat. 858) [1964-2 C.B. 649]; sec. 2(d), Act of Dec. 27, 1967 (Pub. L. 90-225, 81 Stat. 731) [1968-1 C.B. 640]; sec. 311(d)(3) and sec. 512(e)(2), Tax Reform Act 1969 (83 Stat. 588, 640) [Pub. L. 91-172, 1969-3 C.B. 10. 98]; sec. 601(d)(2), Rev. Act 1971 (85 Stat. 558) [Pub. L. 92-178, 1972-1 C.B. 443, 477]]

Par. 32. Section 301.6511(d)-2 is amended by revising the heading and paragraphs (a) and (b)(1) thereof to read as follows:

§ 301.6511(d)-2 Overpayment of income tax on account of net operating loss or capital loss carrybacks.

(a) *Special period of limitation.* (1) If the claim for credit or refund relates to an overpayment of income tax attributable to a net operating loss carryback (provided in section 172 (b)), or a capital loss carryback (provided in section 1212(a)), then in lieu of the 3-year period from the time the return was filed in which the claim may be filed or credit or refund allowed, as prescribed in section 6511(a) or (b), the period shall be whichever of the following 2 periods expires later:

(i) The period which ends with the expiration of the fifteenth day of the fortieth month (or thirty-ninth month, in the case of a corporation) following the end of the taxable year of the net operating loss or net capital loss which resulted in the carryback; or

(ii) The period which ends with the expiration of the period prescribed in section 6511(c) within which a claim for credit or refund may be filed with respect to the taxable year of the net operating loss or net capital loss which resulted in the carryback except that—

(*a*) With respect to an overpayment attributable to a net operating loss carryback to any year on account of a certification issued to the taxpayer under section 317 of the Trade Expansion Act of 1962, the period shall not expire before the expiration of the sixth month following the month in which such certification is issued to the taxpayer, and

(*b*) With respect to an overpayment attributable to the creation of, or an increase in, a net operating loss as a result of the elimination of excessive profits by a renegotiation (as defined in section 1481(a)(1)(A)), the period shall not expire before September 1, 1959, or the expiration of the twelfth month following the month in which the agreement or order for the elimination of such excessive profits becomes final, whichever is the later.

(2) In the case of a claim for credit or refund involving a net operating loss or capital loss carryback described in subparagraph (1) of this paragraph, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in section 6511(b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to the carryback. If the claim involves an overpayment based not only on a net operating loss or capital loss carryback described in subparagraph (1) of this paragraph but based also on other items, the credit or refund cannot exceed the sum of the following:

(i) The amount of the overpayment which is attributable to the net operating loss or capital loss carryback, and

(ii) The balance of such overpayment up to a limit of the portion, if any, of the tax paid within the period provided in section 6511(b)(2) or (c), or within the period provided in any other applicable provision of law.

(3) If the claim involves an over-

payment based not only on a net operating loss or capital loss carryback described in subparagraph (1) of this paragraph but based also on other items, and if the claim with respect to any items is barred by the expiration of any applicable period of limitation, the portion of the overpayment attributable to the items not so barred shall be determined by treating the allowance of such items as the first adjustment to be made in computing such overpayment. If a claim for credit or refund is not filed, and if credit or refund is not allowed, within the period prescribed in this paragraph, then credit or refund may be allowed or made only if claim therefor is filed, or if such credit or refund is allowed, within the period prescribed in section 6511(a), (b), or (c), whichever is applicable, subject to the provisions thereof limiting the amount of credit or refund in the case of a claim filed, or if no claim was filed, in case of credit or refund allowed, within such applicable period. For the limitations on the allowance of interest for an overpayment where credit or refund is subject to the provisions of this section, see section 6611(f).

(b) *Barred overpayments.* (1) If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback or capital loss carryback is otherwise prevented by the operation of any law or rule of law (other than section 7122, relating to compromises), such credti or refund may be allowed or made under the provisions of section 6511(d)(2)(B) if a claim therefor is filed within the period provided by section 6511(d)(2)(A) and paragraph (a) of this section for filing a claim for credit or refund of an overpayment attributable to a carryback. Similarly, if the allowance of an application, credit, or refund of a decrease in the tax determined under section 6411(b) is otherwise prevented by the operation of any law or rule of law (other than section 7122), such application, credit, or refund may be allowed or made if an application for a tentative carryback adjustment is filed within the period provided in section 6411(a). Thus, for example, even though the tax liability (not including the net operating loss deduction or capital loss carryback (or the effect of such deduction or carryback)) for a given taxable year has previously been litigated before the Tax Court, credit or refund of an overpayment may be allowed or made despite the provisions of section 6512(a), if claim for such credit or refund is filed within the period provided in section 6511(d)(2)(A) and paragraph (a) of this section. In the case of a claim for credit or refund of an overpayment attributable to a carryback, or in the case of an application for a tentative carryback adjustment, the determination of any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction, and the effect of such deduction, or with respect to the determination of a short-term capital loss, and the effect of such short-term capital loss, to the extent that such deduction or short-term capital loss is affected by a carryback which was not in issue in such proceeding.

* * * * *

Par. 33. Section 301.6511(d)-4 is amended by revising subdivision (i) of paragraph (a)(1) to read as follows:

§ 301.6511(a)-4 Overpayment of income tax on account of investment credit carryback.

(a) *Special period of limitation.* (1) * * *

(i) The period which ends with the expiration of the fifteenth day of the fortieth month (or thirty-ninth month, in the case of a corporation) following the end of the taxable year of the unused investment credit which resulted in the carryback (or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the period which ends with the expiration of the fifteenth day of the fortieth month (or thirty-ninth month, in the case of a corporation) following the end of such subsequent taxable year); or

* * * * *

Par. 34. There is inserted immediately after § 301.6511(a)-6 the following new section:

§ 301.6511(d)-7 Overpayment of income tax on account of work incentive program credit carryback.

(a) *Special period of limitation.* (1) If the claim for credit or refund related to an overpayment of income tax attributable to a work incentive program (WIN) credit carryback, provided in section 50A, then in lieu of the 3-year period from the time the return was filed in which the claim may be filed or credit or refund allowed, as prescribed in section 6511(a) or (b), the period shall be whichever of the following two periods expires later:

(i) The period which ends with the expiration of the 15th day of the 40th month (or 39th month, in the case of a corporation) following the end of the taxable year of the unused WIN credit which resulted in the carryback (or, with respect to any portion of a WIN credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, the period which ends with the expiration of the 15th day of the 40th month (or 39th month in the case of a corporation) following the end of such subsequent taxable year); or

(ii) The period which ends with the expiration of the period prescribed in section 6511(c) within which a claim for credit or refund may be filed with respect to the taxable year of the unused WIN credit which resulted in the carryback.

(2) In the case of a claim for credit or refund involving a WIN credit carryback described in subparagraph (1) of this paragraph, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in section 6511(b)(2) or (c), whichever is applicable, to the extent of the amount of the overpayment attributable to the carryback. If the claim involves an overpayment based not only on a WIN credit carryback described in subparagraph (1) of this paragraph but based also on other items, the credit or refund cannot exceed the sum of the following:

(i) The amount of the overpayment which is attributable to the WIN credit carryback, and

(ii) The balance of such overpayment up to a limit of the portion, if any, of the tax paid within the period provided in section 6511(b)(2) or (c), or within the period provided in any other applicable provision of law.

(3) If the claim involves an overpayment based not only on a WIN credit carryback described in subparagraph (1) of this paragraph but based also on other items, and if the claim with respect to any items is barred by the expiration of any applicable period of limitation, the portion of the overpayment attributable to the items not so barred shall be determined by treating the allowance of such items as the first adjustment to be made in computing such overpayment. If a claim for credit or refund is not filed, and if credit or refund is not allowed, within the period prescribed in this paragraph, then credit or refund may be allowed or made only if claim therefor is filed, or if such credit or refund is allowed, within the period prescribed in section 6511(a), (b), or (c), whichever is applicable, subject to the provisions thereof limiting the amount of credit or refund in the case of a claim filed, or if no claim was filed, in case of credit or refund allowed, within such applicable period. For the limitations on the allowance of interest for an overpayment where credit or refund is subject to the provisions of this section, see section 6611(f).

(b) *Barred overpayments.* If the allowance of a credit or refund of an overpayment of tax attributable to a WIN credit carryback is otherwise prevented by the operation of any law or rule of law (other than section 7122, relating to compromises), such credit or refund may be allowed or made under the provisions of section 6511(d)(7)(B) if a claim therefor is filed within the period provided by section 6511(d)(7)(A) and paragraph (a) of this section for filing a claim for credit or refund of an overpayment attributable to a carryback. In the case of a claim for credit or refund of an overpayment attributable to a carryback, the determination of any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall not be conclusive with respect to the WIN credit, and the effect of such credit, to the extent that such credit is affected by a carryback which was not in issue in such proceeding.

Par. 35. Section 301.6601 is amended by revising subsection (e) of section 6601 and the historical note to read as follows:

§ 301.6601 Statutory provisions; interest on underpayment, nonpayment, or extensions of time for payment, of tax.

Sec. 6601. *Interest on underpayment, nonpayment, or extensions of time for payment, of tax.*

* * * * *

(e) *Income tax reduced by carryback or adjustment for certain unused deductions*—(1) *Net operating loss or capital loss carryback.* If the amount of any tax imposed by subtitle A is reduced by reason of a carryback of a net operating loss or net capital loss, such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the net operating loss or net capital loss arises.

(2) *Investment credit carryback.* If the credit allowed by section 38 for any taxable year is increased by reason of an investment credit carryback, such increase shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the investment credit carryback arises, or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such increase shall not affect the computation of interest under this section for the period ending with the last day of such subsequent taxable year.

(3) *Adjustment for certain unused deductions of life insurance companies.* If the amount of any tax imposed by subtitle A is reduced by operation of section 815(d)(5) (relating to reduction of policyholders surplus account of life insurance companies for certain unused deductions), such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2).

(4) *Work incentive program credit carryback.* If the credit allowed by section 40 for any taxable year is increased by reason of a work incentive program credit carryback, such increase shall not affect the computation or interest under this section for the period ending with the last day of the taxable year in which the work incentive program credit carryback arises, or, with respect to any portion of a work incentive program carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such increase shall not affect the computation of interest under this section for the period ending

with the last day of such subsequent taxable year.

[Sec. 6601 as amended by secs. 66(c), 83 (a)(1), 84(a), Technical Amendments Act 1958 (72 Stat. 1658, 1663, 1664) [Pub. L. 85-866, 1958-3 C.B. 254]; sec. 206(e), Small Business Tax Revision Act 1968 (72 Stat. 1685); sec. 203(c)(2), Federal-Aid Highway Act 1961 (75 Stat. 126) [Pub. L. 87-61, 1961-2 C.B. 309]; sec. 2(e)(3), Rev. Act 1962 (76 Stat. 972) [Pub. L. 87-834, 1962-3 C.B. 111]; sec. 3(d), Act of Sept. 2, 1964 (Pub. L. 88-571, 78 Stat. 857) [1964-2 C.B. 649]; sec. 1(f), Act of Apr. 8, 1966 (Pub. L. 89-384, 80 Stat. 104) [1966-1 C.B. 414]; sec. 2(e), Act of Dec. 27, 1967 (Pub. L. 90-225, 81 Stat. 731) [1968-1 C.B. 640]; sec. 2(e), Act of Aug. 7, 1969 (Pub. L. 91-53, 83 Stat. 92) [1969-3 C.B. 1]; sec. 512(e)(3), Tax Reform Act 1969 (83 Stat. 641) [Pub. L. 91-172, 1969-3 C.B. 10, 98]; sec. 601(d)(3), Rev. Act 1971 (85 Stat. 558) [Pub. L. 92-178, 1972-1 C.B. 443, 477]]

Par. 36. Section 301.6601-1 is amended by revising paragraph (e) to read as follows:

§ 301.6601-1 Interest on underpayments.

* * * * *

(e) *Income tax reduced by carryback.* (1) The carryback of a net operating loss, net capital loss, investment credit, or work incentive program (WIN) credit shall not affect the computation of interest on any income tax for the period commencing with the last day prescribed for the payment of such tax and ending with the last day of the taxable year in which the loss or credit arises. For example, if the carryback of a net operating loss, a net capital loss, an investment credit, or a WIN credit to a prior taxable period eliminates or reduces a deficiency in income tax for that period, the full amount of the deficiency will nevertheless bear interest at the rate of 6 percent per annum from the last date prescribed for payment of such tax until the last day of the taxable year in which the loss or credit arose. Interest will continue to run beyond such last day or any portion of the deficiency which is not eliminated by the carryback. With respect to any portion of an investment credit carryback, or a WIN credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such investment credit carryback or WIN credit carryback shall not affect the computation of interest on any income tax for the period commencing with the last day prescribed for the payment of such tax and ending with the last day of such subsequent taxable year.

(2) Where an extension of time for payment of income tax has been granted under section 6164 to a corporation expecting a net operating loss carryback or a net capital loss carryback, interest is payable at the rate of 6 percent per annum on the amount of such unpaid tax from the last date prescribed for payment thereof without regard to such extension.

(3) Where there has been an allowance of an overpayment attributable to a net operating loss carryback, a capital loss carryback, an investment credit carryback, or a WIN credit carryback and all or part of such allowance is later determined to be excessive, interest shall be computed in the excessive amount from the last day of the year in which the net operating loss, net capital loss, investment credit, or WIN credit arose until the date on which the repayment of such excessive amount is received. Where there has been an allowance of an overpayment with respect to any portion of an investment credit carryback, or a WIN credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year and all or part of such allowance is later determined to be excessive, interest shall be computed on the excessive amount from the last day of such subsequent taxable year until the date on which the repayment of such excessive amount is received.

* * * * *

Par. 37. Section 301.6611 is amended by revising subsections (e) and (f) of section 6611 and the historical note to read as follows:

§ 301.6611 Statutory provisions, interest on overpayments.

Sec. 6611. *Interest on overpayments.*
* * *

(e) *Income tax refund within 45 days after return is filed.* If any overpayment of tax imposed by subtitle A is refunded within 45 days after the last date prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or, in case the return is filed after such last date, is refunded within 45 days after the date the return is filed, no interest shall be allowed under subsection (a) on such overpayment.

(f) *Refund of income tax caused by carryback or adjustment for certain unused deductions*—(1) *Net operating loss or capital loss carryback.* For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a carryback of a net operating loss or net capital loss, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such net operating loss or net capital loss arises.

(2) *Investment credit carryback.* For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from an investment credit carryback, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such investment credit carryback arises, or, with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made prior to the close of such subsequent taxable year.

(3) *Adjustment for certain unused deductions of life insurance companies.* For purposes of subsection (a), if any overpayment of tax imposed by subtitle A arises by operation of section 815(d)(5) (relating to reduction of policyholders surplus account of life insurance companies for certain unused deductions, such overpayment shall be deemed not to have been made prior to the close of the last taxable year to which the loss described in section 815(d)(5)(A) is carried under section 812(b)(2).

(4) *Work incentive program credit carryback.* For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a work incentive program credit carryback, such overpayment shall be deemed not to have been made prior to the close of the taxable year in which such work incentive program credit carryback arises, or, with respect to any portion of a work incentive program credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made prior to the close of such subsequent taxable year.

* * * * *

[Sec. 6611 as amended by secs. 42(b) and 83(b) and (c), Technical Amendments Act 1958 (72 Stat. 1640, 1664) [Pub. L. 85-866, 1958-3 C.B. 254]; sec. 2(e)(4), Rev. Act 1962 (76 Stat. 972) [Pub. L. 87-834, 1962-3 C.B. 111]; sec. 3(e), Act of Sept. 2, 1964 (Pub. L. 88-571, 78 Stat. 858) [1964-2 C.B. 649]; sec. 1(a), Act of Nov. 2, 1966 (Pub. L. 89-721, 80 Stat. 1150) [1966-2 C.B. 643]; sec. 2(f), Act of Dec. 27, 1967 (Pub. L. 90-225, 81 Stat. 732) [1968-1 C.B. 640]; sec. 512(e)(4), Tax Reform Act 1969 (83 Stat. 641) [Pub. L. 91-172, 1969-3 C.B. 10, 98]; sec. 601(d)(4), Rev. Act 1971 (85 Stat. 559) [Pub. L. 92-178, 1972-1 C.B. 443, 477]]

Par. 38. Section 301.6611-1 is amended by revising paragraphs (e) and (j) to read as follows:

§ 301.6611-1 Interest on overpayments.

* * * * *

(e) *Refund of income tax caused by carryback.* If any overpayment of tax imposed by subtitle A of the Code results from the carryback of a net operating loss, a net capital loss, an investment credit, or a work incentive (WIN) credit, such overpayment, for purposes of this section, shall be deemed not to have been made prior to the end of the taxable year in which the loss or credit arises, or, with respect to any portion of an investment credit carryback or a WIN credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made prior to the close of such subsequent taxable year.

* * * * *

(j) *Refund within 45 days.* No interest shall be allowed on any overpayment of tax imposed by subtitle A of the Code if such overpayment is refunded—

(1) In the case of a return filed on or before the last date prescribed for filing the return of such tax (determined without regard to any extension of time for filing such return), within 45 days after such last date, or

(2) After December 17, 1966, in the case of a return filed after the last day prescribed for filing the return, within 45 days after the date on which the return is filed.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 27, 1973.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 3, 1974, 8:45 a.m., and published in the issue of the Federal Register for January 4, 1974, 39 F.R. 962)

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26 CFR 1.1211-1: Limitation on capital losses.

Whether gain realized by a United States citizen from the sale of stock in a foreign corporation, which is income treated as a dividend covered by the provisions of section 1248 of the Code, may be offset by net capital losses (section 1211) incurred from the sale of other domestic securities. See Rev. Rul. 74-60, page 236.

Section 1212.—Capital Loss Carrybacks and Carryovers

Whether a net capital loss carryback from 1972 to 1969 will affect the computation by a mutual savings bank of the deduction for the addition to the bad debt reserve under section 593 of the Code for 1969. See Rev. Rul. 74-188, page 147.

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26 CFR 1.1212: Statutory provisions; capital loss carrybacks and carryovers.

Capital loss carrybacks with respect to corporations. See T.D. 7301, page 203.

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26 CFR 1.1212-1: Capital loss carryovers.

Whether gain realized by a United States citizen from the sale of stock in a foreign corporation, which is income treated as a dividend covered by the provisions of section 1248 of the Code, may be offset by net capital losses (section 1211) incurred from the sale of other domestic securities. See Rev. Rul. 74-60, page 236.

Part III.—General Rules for Determining Capital Gains and Losses

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Section 1221.—Capital Asset Defined

26 CFR 1.1221-1: Meaning of terms.

Real estate acquired by bank through foreclosure. Real estate acquired by a bank, mortgage finance company, or an insurance company in foreclosure, or by deed in lieu of foreclosure, that was not held for the production of rental income but was advertised and sold as soon as possible, was held primarily for sale in the ordinary course of their trade or business

within the meaning of section 1221 of the Code and gain or loss from the sales is ordinary gain or loss even though improvements were made to unimproved properties; Rev. Rul. 57-468 superseded.

Rev. Rul. 74-159

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Rev. Rul. 57-468, 1957-2 C.B. 543.

The question presented is whether parcels of real estate acquired and held by a bank (other than an organization described in section 593(a) of the Internal Revenue Code of 1954, to which section 595 applies) under the circumstances described below are capital assets or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

For many years the taxpayer, a bank, has foreclosed on a number of mortgages on real estate and acquired a number of parcels of real estate on foreclosure and by deeds in lieu of foreclosure. The taxpayer does not hold any of the properties for the production of rental income and has consistently made every effort to dispose of the properties. To this end, the taxpayer advertises in magazines and newspapers, prepares brochures and other publications, and makes a practice of circulating information about such properties among brokers. In order to sell such properties as soon as possible, improvements were made to many of the unimproved properties. The taxpayer financed the construction of dwellings as well as the construction of commercial buildings on vacant land and also made improvements to buildings situated on land owned by it. In the case of certain parcels of unimproved real estate, the taxpayer developed the property by installing sewers and water pipes, paving streets, grading the land, and installing curbing. It also platted and subdivided certain properties into lots and financed the construction of dwelling houses on many of such lots. At all times the properties were held for sale as soon as possible at a fair price. The taxpayer made continuous, substantial, and frequent sales of such properties.

During the taxable year with respect to which advice is requested, the taxpayer sustained a net loss upon the sale of certain of those properties. The specific question presented is whether such loss is a capital loss to which the statutory limitation upon capital losses provided by section 1211 (a) of the Code is applicable, or whether such loss constitutes an ordinary loss, deductible in full under section 165(a).

Section 1221 of the Code, as far as is pertinent, defines the term "capital asset" as meaning property held by the taxpayer (whether or not connected with his trade or business), but does not include 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 end of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

In *Mauldin v. Commissioner,* 195 F.2d 714 (10th Cir. 1952), where the taxpayer purchased real estate for purposes other than for sale in the ordinary course of his business but abandoned his original purpose, platted the property and sold it as lots from which he derived a substantial part of his income, the court held that the type and scope of activity of the taxpayer in connection with the property disclosed that the property was held primarily for sale to customers in the ordinary course of business, and that the gain realized on sales thereof was taxable as ordinary income. In its opinion, the court stated that, while the purpose for which the property was acquired is of some weight, the purpose for which it was held is the controlling factor, citing *Rollingwood Corp. v. Commissioner,* 190 F.2d 263 (9th Cir. 1951).

In *Brown v. Commissioner,* 143 F.2d 468 (5th Cir. 1944), where unimproved land acquired by taxpayer and used for grazing cattle was subsequently subdivided, developed, and sold as lots through a real estate agent, the court held that since the property was subdivided, developed, and held for sale to anyone who wished to buy, and the sales were continuing rather than isolated or casual transactions, the property was held primarily for sale to customers in the ordinary course of trade or business and that any gain realized on the sale thereof constituted ordinary income.

In the instant case, none of the properties sold was a rental or income producing property in the hands of the bank. As in the *Mauldin* and *Brown* cases, the type and scope of the taxpayer's activities indicate that the taxpayer is in the business of selling such properties to customers in the ordinary course of such business.

Accordingly, in this case it is held that the real estate acquired by the bank in foreclosure or by deeds in lieu of foreclosures was held primarily for sale to customers in the ordinary course of its trade or business within the meaning of section 1221 of the Code, and any gain or loss on the sale thereof was an ordinary gain or loss, rather than a capital gain or loss. See *Girard Trust Corn Exchange Bank,* 22 T.C. 1343 (1954), acq., 1955-2 C.B. 6. This conclusion is equally applicable to a mortgage finance company or an insurance company which acquires and thereafter disposes of real estate under similar circumstances.

Rev. Rul. 57-468 is superseded, since the position set forth therein is restated under the current law in this Revenue Ruling.

26 CFR 1.1221-1: Meaning of terms.

Whether foreign currency is a capital asset and any gain or loss realized on reconversion is a capital gain or loss. See Rev. Rul. 74-7, page 198.

Section 1222.—Other Terms Relating to Capital Gains and Losses

26 CFR 1.1222-1: Other terms relating to capital gains and losses.
(Also Section 61; 1.61-1.)

Regulated investment company; settlement of litigation. An amount received by a regulated investment company in settlement of litigation involving the value of the right of the company to select its investment advisor is ordinary income, not an amount received on the sale or exchange of a capital asset.

Rev. Rul. 74-251

Advice has been requested whether, under the circumstances described below, an amount received in settlement of ligitation constitutes a long-term capital gain within the meaning of section 1222(3) of the Internal Revenue Code of 1954.

For many years *X* corporation had been the investment advisor and principal underwriter for *Y* corporation, a regulated investment company. In 1968 *X* negotiated and entered into an exclusive new and profitable investment advisory contract with *Y*. Shortly thereafter, the majority shareholders of *X*, certain of whom were directors of *Y*, sold their stock in *X* at a substantial profit.

In 1970 a law suit was filed on behalf of *Y* by certain of its shareholders against the former shareholders of *X*. In that suit *Y* made the following allegation:

> The right to select *Y*'s investment advisor and principal underwriter is an asset of *Y* and not of *X*. *Y* could have negotiated with *X* and with other investment advisors and principal underwriters and auctioned or sold the right to act as investment advisor and principal underwriter at a price corresponding to the price reflecting the value which the old shareholders received for their shares of *X*. Thus, the consideration received by the old shareholders for the sale of stock in *X* rightfully belonged to *Y*, and the retention thereof by the old shareholders constitutes an appropriation of the assets of *Y*.

Subsequent to the trial of the case, but prior to decision by the court, a stipulation of settlement was entered into by the respective parties to the action. Pursuant to the settlement, certain of the former shareholders of *X* paid *Y* a specified amount in total settlement of the allegation.

Section 1222(3) of the Code provides that the term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

In the instant case, *Y* contends that the amount received from the former shareholders of *X* represents compensation for their taking and profiting from a portion of *Y*'s capital fabric, *Y*'s intangible right to select its investment advisor. *Y* further contends that such taking of its right by *X*'s shareholders, and their subsequent payment for it in form of a settlement, is tantamount to a sale of such right. *Y* concludes that since its intangible right is a capital asset held for more than 6 months, it is entitled to treat the proceeds as a long-term capital gain.

An analysis of *Y*'s contentions show that there was no sale or exchange of its assets. *X*'s shareholders, in causing *X* to obtain a profitable contract with *Y* as an investment advisor, profited from the value of that contract in selling their stock in *X*. While it may be true that *X*'s shareholders *used* *Y*'s right to select an investment advisor to produce a profit for themselves, they clearly did not purchase such right upon the settlement of the litigation. In effect, *Y* merely recovered from *X*'s shareholders amounts they received from the purchasers of *X*'s stock representing anticipated profits from an advisory contract held by *X*.

Unless it can be clearly established that there has been a sale or exchange of property, money received in settlement of litigation is ordinary income. The mere settlement of a law suit does not in itself constitute a sale or exchange. See *Paul E. Kempter*, 22 CCH Tax Ct. Mem. 274 (1963).

Section 1.61-1 of the Income Tax Regulations provides, in part, that gross income means all income from whatever source derived, unless excluded by law.

Accordingly, in the instant case, it is held that the amount received by *Y* in settlement of litigation is ordinary income includible in its gross income under section 61 of the Code, and is not an amount received on the sale or exchange of a capital asset and, thus, does not constitute a long-term capital gain within the meaning of section 1222(3).

Part IV.—Special Rules for Determining Capital Gains and Losses

Section 1232.—Bonds and Other Evidences of Indebtedness

26 CFR 1.1232-1: Bonds and other evidences of indebtedness; scope of section.
(Also Section 6049; 1.6049-1.)

T.D. 7311[1]

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

Bonds and other evidences of indebtedness

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

[1] The publication of this Treasury Decision in 39 F.R. 11880, dated April 1, 1974, contains (1) instructions for modifying the notice of proposed rulemaking published in 38 F.R. 27840, dated October 9, 1973, and (2) the full context of the regulations with such modifications. As here published, the Treasury Decision reflects the full context of such regulations, with modifications. The individual instructions have been omitted.

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

Preamble

By a notice of proposed rule making appearing in the Federal Register for Tuesday, October 9, 1973 (38 F.R. 27840), amendments to the Income Tax Regulations (26 CFR Part 1) were proposed in order to require holders of face-amount certificates to include original issue discount in income ratably over the term of the certificates in accordance with section 1232(a)(3) of the Internal Revenue Code of 1954. The ratable inclusion rule applies to holders of such certificates in a manner similar to which such rules are applicable to depositors in financial institutions. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the proposed amendments are adopted by this document, subject to the change that these amendments shall apply only to face-amount certificates issued after December 31, 1974.

Adoption of amendments to the regulations

Based on the foregoing, the following amendments of the regulations are hereby adopted:

Paragraph 1. A new paragraph (c)(4) is added to § 1.72-6 to read as follows:

§ 1.72-6 Investment in the contract.

* * * * *

(c) *Special rules.* * * *

(4) In the case of "face-amount certificates" described in section 72(l), the amount of consideration paid for purposes of computing the investment in the contract shall include any amount added to the holder's basis by reason of section 1232(a)(3)(E) (relating to basis adjustment for amount of original issue discount ratably included in gross income as interest under section 1232(a)(3)).

Par. 2. Paragraph (c) of § 1.1232-1 is amended to read as follows:

§ 1.1232-1 Bonds and other evidences of indebtedness; scope of section.

* * * * *

(c) *Face-amount certificates*—(1) *In general.* For purposes of section 1232, this section and §§ 1.1232-2 through 1.1232-4, the term "other evidence of indebtedness" includes "face-amount certificates" as defined in section 2(a)(15) and 4 of the Investment Company Act of 1940 (15 U.S.C. 80a-2 and 80a-4).

(2) *Amounts received in taxable years beginning prior to January 1, 1964.* Amounts received in taxable years beginning prior to January 1, 1964 under face-amount certificates which were issued after December 31, 1954, are subject to the limitation on tax under section 72(e)(3). See paragraph (g) of § 1.72-11 (relating to limit on tax attributable to receipt of a lump sum received as an annuity payment). However, section 72(e)(3) does not apply to any such amounts received in taxable years beginning after December 31, 1963.

(3) *Certificates issued after December 31, 1974.* In the case of a face-amount certificate issued after December 31, 1974 (other than such a certificate issued pursuant to a written commitment which was binding on such date and at all times thereafter), the provisions of section 1232(a)(3) (relating to the ratable inclusion of original issue discount in gross income) shall apply. See § 1.1232-3A(f). For treatment of any increase in basis under section 1232(a)(3)(E) as consideration paid for purposes of computing the investment in the contract under section 72, see § 1.72-6(c)(4).

* * * * *

Par. 3. A new paragraph (f) is added to § 1.1232-3A to read as follows:

§ 1.1232-3A Inclusion as interest of original issue discount on certain obligations issued after May 27, 1969.

* * * * *

(f) *Application of section 1232(a)(3) to face-amount certificates*—(1) *In general.* Under paragraph (c)(3) of § 1.1232-1, the provisions of section 1232(a)(3) and this section apply in the case of a face-amount certificate issued after December 31, 1974 (other than such certificate issued pursuant to a written commitment which was binding on such date and at all times thereafter).

(2) *Relationship with paragraph (e) of this section.* Determinations with regard to the inclusion as interest of original issue discount on, and certain adjustments with respect to, face-amount certificates to which this section applies shall be made in a manner consistent with the rules of paragraph (e) of this section (relating to the application of section 1232 to certain deposits in financial institutions and similar arrangements). Thus, for example, if a face-amount certificate is redeemed before maturity, the holder shall be allowed a deduction in computing adjusted gross income computed in a manner consistent with the rules of paragraph (e)(2) of this section. For a further example, if under the terms of a face-amount certificate, the issuer may grant additional credits to be paid at a fixed maturity date, computations with respect to such additional credits shall be made in a manner consistent with the rules of paragraph (e)(6) and (7) of this section (as applicable) relating to contingent interest arrangements.

Par. 4. Paragraph (a)(1) of § 1.6049-1 is changed by revising subdivision (ii) (*a*)(*3*), (*4*) and (*5*), so much of subdivision (ii) (*b*) as precedes (*1*) thereof, of redesignating existing subdivision (ii)(*d*) as (ii)(*e*), and adding a new subdivision

(ii)(*d*), and by revising subdivision (iv). These revised and redesignated provisions read as follows:

§ 1.6049-1 Returns of information as to interest paid in calendar years after 1962 and original issue discount includible in gross income for calendar years after 1970.

(a) *Requirement of reporting*—(1) *In general.* * * *

(ii) * * *

(*a*) * * *

(*3*) The issue price of the obligation (as defined in paragraph (b)(2) of § 1.1232-3).

(*4*) The stated redemption price of the obligation at maturity (as defined in paragraph (b)(1)(iii) of § 1.1232-3).

(*5*) The ratable monthly portion of original issue discount with respect to the obligation as defined in section 1232(a)(3)(A) (determined without regard to a reduction for a purchase allowance or whether the holder purchased at a premium).

* * * * *

(*b*) With respect to any obligation (other than an obligation to which paragraph (e) or (f) of § 1.1232-3A applies (relating respectively to deposits in banks and similar financial institutions and to face-amount certificates), the issuing corporation (or an agent acting on its behalf)—* * *

* * * * *

(*d*) The requirements of (*a*)(*3*), (*a*)(*4*), and (*a*)(*5*) of this subdivision shall not apply to a time deposit open account arrangement to which paragraph (e)(5) of § 1.1232-3A applies, or to a face-amount certificate to which paragraph (f) of § 1.1232-3A applies.

(*e*) * * *

* * * * *

(iv) Except with respect to an obligation to which paragraph (e) or (f) of § 1.1232-3A applies (relating respectively to deposits in banks and similar financial institutions and to face-amount certificates), every person who is a nominee on behalf of the actual owner of an obligation as to which there is original issue discount aggregating $10 or more includible in the gross income of such owner during a calendar year after 1970, regardless of whether he receives a Form 1099-OID with respect to such discount, shall make an information return on Forms 1096 and 1087-OID for such calendar year showing in the manner prescribed on such forms the same information for the actual owner as is required or permitted in subdivision (ii) of this subparagraph for the record holder.

* * * * *

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved March 28, 1974.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 29, 1974, 8:45 a.m., and published in the issue of the Federal Register for April 1, 1974, 39 F.R. 11880)

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26 CFR 1.1232-1: Bonds and other evidences of indebtedness; scope of section.

Whether amounts attributable to original issue discount and premium payable by reason of redemption prior to maturity, paid by a domestic corporation on its debentures, constitutes interest for purposes of Article VIII(1) of the United States-Netherlands Income Tax Convention. See Rev. Rul. 74-172, page 178.

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26 CFR 1.1232-1: Bonds and other evidences of indebtedness; scope of section.

Extent to which mortgage participation certificates in mortgage "pool" guaranteed by Federal Home Loan Mortgage Corporation may be subject to section 1232 of the Code. See Rev. Rul. 74-221, page 365.

Section 1236.—Dealers in Securities

26 CFR 1.1236-1: Dealers in securities.

Whether foreign currencies are securities within the meaning of section 1091 of the Code. See Rev. Rul. 74-218, page 202.

Section 1245.—Gain from Dispositions of Certain Depreciable Property

26 CFR 1.1245-1: General rule for treatment of gain from dispositions of certain depreciable property.

Whether a portion of the gain from the sale of depreciable assets by a nonexempt cooperative, within the meaning of section 1381(a) of the Code, treated as ordinary income will be considered patronage sourced income. See Rev. Rul. 74-84, page 244.

Section 1248.—Gain from Certain Sales or Exchanges of Stock in Certain Foreign Corporations

26 CFR 1.1248-1: Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.
(Also Sections 316, 1211, 1212; 1.316-1, 1.1211-1, 1.1212-1.)

Section 1248 stock; gain treated as dividend; offset against capital loss. The portion of gain realized by a U.S. citizen on the sale of stock in a controlled foreign corporation treated as a dividend under section 1248 of the Code is not taken into account as gain from the sale of a capital asset in determining the extent to which his loss from the sale of domestic securities is allowable under section 1211.

Rev. Rul. 74-60

Advice has been requested whether an amount included in gross income as a dividend under section 1248 of the Internal Revenue Code of 1954 is taken into account as gain from the sale or exchange of a capital asset for purposes of determining the extent to

which losses from sales or exchanges of capital assets are allowable under section 1211.

The taxpayer, a United States citizen, owned stock representing 30 percent of the total combined voting power of *X*, a controlled foreign corporation within the meaning of section 957 of the Code and the Income Tax Regulations thereunder. The taxpayer's stock in *X* was a capital asset held for more than 6 months.

In 1972 the taxpayer realized a gain from the sale of his entire stock interest in *X* to an unrelated party. A portion of such gain was treated as a dividend under the provisions of section 1248(a) of the Code. In addition, the taxpayer had long-term capital losses in 1972 from the sale of various publicly held United States securities to which section 1248 does not apply.

Section 1211(b)(1) of the Code provides, in part, that an individual shall be allowed losses from the sales or exchanges of capital assets only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the smaller of (A) the taxable income for the taxable year computed without regard to capital gains and losses or the personal deduction, (B) $1,000, or (C) the sum of (i) the excess of the net short-term capital loss over the net long-term capital gain, and (ii) one-half of the excess of net long-term capital loss over the net short-term capital gain.

Section 1248(a) of the Code provides, in part, that if a United States person sells stock in a foreign corporation and such person owns 10 percent or more of the total combined voting power of the stock of such foreign corporation at any time during the 5-year period ending on the date of the sale when such foreign corporation was a controlled foreign corporation (as defined in section 957), then the gain recognized on the sale of the stock in the foreign corporation must be included in the gross income of the United States shareholder as a dividend, to the extent of the earnings and profits of the foreign corporation attributable to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold was held by such person while such corporation was a controlled foreign corporation.

In the instant case, but for the application of section 1248(a) of the Code, the taxpayer's entire gain from the sale of *X*'s stock would be a long-term capital gain under section 1222(3) which could be offset by the taxpayer's long-term capital losses under section 1222(4). Any resulting net long-term capital loss under section 1222(8) would be subject to the provisions of section 1211(b)(1).

However, since section 1248(a) of the Code treats a portion of the taxpayer's gain as a dividend, such amount is subtracted from the taxpayer's long-term capital gain realized on the sale of the stock of *X* and is included in his gross income as a dividend.

Accordingly, in the instant case, the amount includible in the gross income of the taxpayer as a dividend under section 1248 of the Code is not taken into account as gain from the sale or exchange of a capital asset for purposes of determining the extent to which losses from sales or exchanges of capital assets are allowable under section 1211.

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26 CFR 1.1248-1: Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.
(Also Section 367; 1.367-1.)

Sale or exchange of controlled foreign corporation's stock. Section 1248 of the Code does not apply to a distribution arising from the sale for cash by a domestic corporation's wholly-owned foreign subsidiary of the stock in its second tier foreign subsidiary to an unrelated party. However, section 1248 does apply when wholly-owned first tier and second tier foreign subsidiaries amalgamate without obtaining an advance ruling under section 367 and the domestic parent exchanges its stock in the first tier corporation for stock of the resulting new corporation. Rev. Rul. 73-373 superseded.

Rev. Rul. 74-106

The Internal Revenue Service has reconsidered Rev. Rul. 73-373, 1973-2 C.B. 310, concerning the application of section 1248 of the Internal Revenue Code of 1954 where an advance ruling under section 367 was obtained by a domestic corporation when its wholly-owned foreign subsidiary exchanged all of its stock in a second tier wholly-owned foreign corporation for all of the stock of a corporation that emerged from the amalgamation of the second tier corporation and a third tier wholly-owned foreign corporation.

The above-cited Revenue Ruling holds that, since no United States person was involved in the sale or exchange of the stock of the foreign corporations, section 1248(a) of the Code does not apply.

Upon reconsideration it has been determined that due to certain inaccuracies in the factual pattern presented in Rev. Rul. 73-373, it failed to illustrate the point that it was intended to illustrate. In view of this the following situations are presented to illustrate the application of section 1248 of the Code with respect to a domestic corporation.

Situation 1: *M*, a domestic corporation and a United States person within the meaning of section 7701(a)(30) of the Code, owns all of the outstanding capital stock of *S*, a foreign corporation. *S* owns all of the outstanding capital stock of *T*, a foreign corporation. During the taxable

year *S* sold all of the capital stock owned by it in corporation *T* to an unrelated party for cash.

Situation 2: *M*, a domestic corporation and United States person within the meaning of section 7701(a)(30) of the Code, owns all of the outstanding capital stock of *S*, a foreign corporation. *S* owns all of the outstanding capital stock of *T*, a foreign corporation. During the current taxable year *T* and *S* amalgamated under the corporation laws of the foreign country to become the *ST* corporation. The assets and liabilities of *S* and *T* immediately before the amalgamation became the assets and liabilities of *ST*. *S*'s capital stock held by *M* was exchanged for the same number of shares of stock of *ST*. The amalgamation of *S* with *T* occurred without an advance ruling under section 367 being obtained.

The specific question is whether *M*, in each of the above situations, is subject to the provisions of section 1248 of the Code.

Section 1248 of the Code provides, in pertinent part, that if a United States person, as defined in section 7701(a)(30), sells or exchanges stock in a foreign corporation the gain recognized on the sale or exchange of such stock shall be included in the income of such person as a dividend subject to certain rules and limitations.

Section 367(a) of the Code provides that in determining the extent to which gain shall be recognized in the case of any of the exchanges described in sections 332, 351, 354, 355, 356, or 361, a foreign corporation shall not be considered as a corporation unless—(1) before such exchange, or (2) in the case of an exchange described in section 367(b), which pertains to a mere change in form, either before or after such exchange, it has been established to the satisfaction of the Secretary of the Treasury or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

Section 354 of the Code provides, in general, that no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

In *Situation 1*, no United States person was involved in the sale or exchange of stock. Accordingly, section 1248 of the Code does not apply since no United States person sold or exchanged the stock of a controlled foreign corporation including distributions treated as an exchange under section 302 or 331.

In *Situation 2*, *S* amalgamated with *T* without obtaining an advance ruling under section 367 of the Code. Thus, since section 354 is not applicable, *M* is taxable on any realized gain. Accordingly, *M* is subject to section 1248 of the Code since *M* surrendered its stock in foreign corporation *S* to *S* in exchange for *ST* stock.

Revenue Ruling 73-373 is hereby superseded.

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26 CFR 1.1248-1: Treatment of gain from certain sales or exchanges of stocks in certain foreign corporations.

Whether an election made on behalf of a controlled foreign corporation to elect certain alternative accounting methods and practices was timely filed under section 1.964-1(c)(6) of the regulations where there is a subsequent sale or exchange of stock under section 1248 of the Code. See Rev. Rul. 74-272, page 192.

Section 1253.—Transfers of Franchises, Trademarks, and Trade Names

26 CFR 13.0(b): Manner of making election or serving notice.

Cost of trademark; business expense. A corporation that acquired a trademark in 1968 under an agreement requiring payments to the transferor to be computed as a percentage of sales of the product covered by the trademark may elect, under section 1253(d) of the Code, to deduct such payments for years ending after 1969 and beginning before 1980 as trade or business expenses, even though the transferor reports the payments as being from the sale or exchange of a capital asset.

Rev. Rul. 74-302

During its taxable year ending in 1970, *X* corporation made a payment to *Y* corporation on account of *X*'s acquisition of a trademark from *Y* during 1968. Pursuant to the provisions of the contract of sale of the trademark, the amount of the payment was computed as a percentage of sales of the product covered by the trademark. In its Federal income tax return for 1970 *X* elected, under the provisions of Treasury Decision 7032, 1970-1 C.B. 511, to treat the payment contingent upon sales, within the meaning of section 1253(d)(1) of the Internal Revenue Code of 1954, as a trade or business expense. *Y* reported the payment received from *X* as being from the sale or exchange of a capital asset.

Section 1253(d)(1) of the Code provides that amounts paid or accrued during the taxable year on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name which are contingent on the productivity, use, or other disposition of the franchise, trademark, or trade name transferred shall be allowed as a deduction under section 162(a) (relating to trade or business expenses).

Section 516(d)(3) of the Tax Reform Act of 1969 (83 Stat. 648) [Pub. L. 91-172, 1969-3 C.B. 104], provides that section 1253 of the Code shall apply to transfers after December 31, 1969, except that section 1253(d)(1) shall, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate

may by regulations prescribe), apply to transfers before January 1, 1970, but only with respect to payments made in taxable years ending after December 31, 1969, and beginning before January 1, 1980.

Held, *X* properly claimed the trademark payment as a deduction on its Federal income tax return for 1970, pursuant to section 1253(d)(1) of the Code and section 516(d)(3) of the Tax Reform Act of 1969.

Subchapter Q. Readjustment of Tax Between Years and Special Limitations

Part I.—Income Averaging

Section 1302.—Definition of Averageable Income; Related Definitions

26 CFR 1.1302-2: Average base period income.
(Also Section 6501; 301.6501(a)-1.)

Income averaging; barred base period year. In determining average base period income for income averaging purposes, taxable income for a base period year barred by the statute of limitations must be adjusted, where necessary, to arrive at the correct taxable income for such year.

Rev. Rul. 74-61

Advice has been requested whether, for purposes of determining average base period income in connection with income averaging, taxable income for a base period year, that is barred by the statute of limitations for assessment and refund of tax, must be adjusted (where necessary) to arrive at the correct taxable income for such year.

Sections 1301 through 1305 of the Internal Revenue Code of 1954 provide general income averaging provisions for individuals whose income fluctuates widely from year to year or increases rapidly over a short period. These provisions permit a part of the unusually large amount of taxable income received in a taxable year to be taxed at lower rates of Federal income tax.

Section 1301 of the Code provides that if an eligible individual has averageable income for the computation year, and if the amount of such income exceeds $3,000, then the tax imposed by section 1 for the computation year which is attributable to averageable income shall be five times the increase in tax under section 1 which would result from adding 20 percent of such income to 120 percent of average base period income.

Section 1302(a) of the Code provides that "averageable income" means the amount by which taxable income for the computation year (reduced as provided therein) exceeds 120 percent of average base period income.

Section 1302(b) of the Code provides, in part, that the term "average base period income" means one-fourth of the sum of the base period incomes for the base period, and that "base period income" for any taxable year is the taxable income for such year adjusted as provided therein.

Section 1302(c) of the Code defines the term "computation year" to mean the taxable year for which the taxpayer chooses the benefits of income averaging and the term "base period" to mean the four taxable years immediately preceding the computation year.

Sections 1301 through 1305 of the Code and the regulations promulgated thereunder do not preclude adjustments in taxable income reported in a base period year in applying those provisions of law even though the assessment of a deficiency in, or allowance of a credit or refund of, Federal income tax is barred by the statute of limitations for the base period year.

In a recent decision involving the computation of averageable income under the income averaging provisions, the United States Tax Court held that a taxpayer is required to use the correct taxable income for each base period year "whether or not the assessment of a deficiency or the refund of an overpayment for such base period year is barred by the statute of limitations." *Robert W. Unser*, 59 T.C. 528, 530-531 (1973).

The court in the *Unser* case relied on *ABKCO Industries, Inc.*, 56 T.C. 1083 (1971), which followed a series of court decisions and Revenue Rulings in holding that it was proper to recompute taxable income for a year barred by the statute of limitations to arrive at the correct amount thereof for purposes of determining, under section 172 of the Code, the amount of the net operating loss carryback or carryover to another taxable year. *See Phoenix Coal Company v. Commissioner*, 231 F. 2d 420 (2nd Cir. 1956); *State Farming Company*, 40 T.C. 774 (1963); and Rev. Rul. 56-285, 1956-1 C.B. 134.

Compare *Commissioner v. Disston*, 325 U.S. 442 (1945), 1945 C.B. 426, in which the Supreme Court of the United States held that the statute of limitations does not purport to preclude an examination into events of prior years for the purpose of correctly determining gift tax liability for years which are still open.

Since taxable income has no special definition under the income averaging provisions of the Code, the definition under section 63 of the Code must apply. Section 63 provides, in general, that taxable income is gross income minus all allowable deductions. The fact that a base period year is barred by the statute of limitations does not change the definition of taxable income for such year. Therefore, regardless of whether a base period year is barred, the proper determination of taxable income must be made. This is not in contravention of the statute of limitations since it is not the tax for the year which is barred by the statute of limitations that is being determined, but merely the establishment of a correct taxable income for that base year for the determination of the

tax for the computation year.

Accordingly, in the instant case, the taxable income for any base period year, that is barred by the statute of limitations for assessment or refund, must be adjusted (where necessary) to arrive at the correct taxable income for such year in determining the average base period income for income averaging purposes.

Part VI.—Other Limitations

Section 1348.—Fifty-Percent Maximum Rate on Earned Income

(Also Section 702; 1.702-1.)

Maximum tax on earned income; partnership. Consulting fees received by a partnership, in which capital is not a material income-producing factor, constitute "earned income" within the meaning of section 1348(b)(1) of the Code and each partner must take into account separately his distributive share of this income and the deductions specified in section 62 properly chargeable against it in order to arrive at "earned net income" for purposes of computing his maximum income tax liability.

Rev. Rul. 74-231

Advice has been requested concerning the character of income earned by a partnership for services rendered and how each partner takes his distributive share of partnership items into account for the purposes of computing his maximum tax on earned income under section 1348 of the Internal Revenue Code of 1954.

The partnership's income is derived solely from professional fees for its consulting services performed by engineers, draftsmen, architects, and administrative personnel under the supervision of two partners, both of whom are licensed engineers. The partnership does not engage in construction activities except in an advisory capacity.

No substantial portion of the gross income of the partnership is attributable to the employment of capital in its business.

Section 1348 of the Code provides for a 50 percent maximum tax rate on earned income. Subject to certain exceptions not pertinent to this case, section 1348(b)(1) provides, in part, that the term "earned income" means any income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b).

Under section 1348(b)(2) of the Code, for purposes of computing the fifty percent maximum tax rate, the term "earned net income" means "earned income" reduced by any deductions allowable under section 62 which are properly allocable to or chargeable against "earned income." Under section 62, the definition of "adjusted gross income," in the case of an individual, is gross income minus certain deductions. These deductions include trade and business deductions of self-employed individuals.

Section 911(b) of the Code provides, in pertinent part, that the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

Section 702(a)(8) of the Code provides, in pertinent part, that in determining his income tax, each partner shall take into account separately his distributive share of partnership items of income, gain, loss, deduction, or credit to the extent provided by regulations prescribed by the Secretary or his delegate. Section 702(b) provides, in part, that the character of the above items shall be determined as if they were realized directly from the sources from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Section 1.702-1(a)(8) of the regulations provides, in pertinent part, that each partner shall take into account separately, any items of income, gain, loss, deduction, or credit subject to a special allocation under the partnership agreement which differs from the allocation of partnership taxable income or loss generally and any partnership item which if separately taken into account by any partner would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

Accordingly, in the instant case, since the sole business of the partnership is the performance of personal services and since capital is not a material income-producing factor in the business of the partnership, the consulting fees received by the partnership for such personal services have the character of earned income within the meaning of section 1348(b)(1) of the Code.

Furthermore, under section 702 of the Code, in determining his income tax liability, each partner must take into account separately his distributive share of partnership "earned income" and of those deductions specified in section 62 which are properly chargeable against the earned income in order to arrive at "earned net income" for the purposes of computing his maximum income tax liability under section 1348.

Subchapter S. Election of Certain Small Business Corporations as to Taxable Status

Section 1371.—Definitions

26 CFR 1.1371-1: Definition of small business corporation.

Whether an electing small business corporation may avoid employment taxes on

services performed by its shareholders. See Rev. Rul. 74-44, page 287.

Section 1372.—Election by Small Business Corporation

26 CFR 1.1372-1: Election by small business corporation.

Small business corporation; change of facts shown on Form 2553. A timely filed valid election to be treated as a small business corporation under section 1372 of the Code is not invalidated by the corporation's issuing a lesser number of shares of stock than shown on its Form 2553.

Rev. Rul. 74-150

A new corporation with three equal shareholders elected during the month preceding the first month of its taxable year to be treated as a "small business corporation" in accordance with the provisions of section 1372 of the Internal Revenue Code of 1954. The corporation was incorporated with 9,000 shares of stock authorized to be issued. The issuance of the stock was to be based upon the appraisal value of certain assets. The election on Form 2553, Election by Small Business Corporation, including the shareholders' statement of consent, was filed prior to the actual issuance of the stock. The corporation subsequently decided to issue its stock on the basis of cost rather than appraisal value and, therefore, issued a lesser number of shares than was listed on Form 2553.

Held, the provisions of the timely filed valid election to be treated as a small business corporation under section 1372 of the Code and the applicable regulations thereunder are not invalidated by the corporation subsequently issuing a lesser number of shares of stocks than was set forth in the election on Form 2553. The purpose of Form 2553 is to provide a means by which a timely election may be made by a corporation under section 1372, and to record the required consent of the shareholders to that election. If facts contained in Form 2553 that are not relevant to the corporation's qualifications to make such an election, or to the validity of its shareholders' consent, are changed, such changes will not invalidate an otherwise valid election.

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26 CFR 1.1372-4: Termination of election.

Small business corporation; bankruptcy of shareholder. The filing of a voluntary petition in bankruptcy by a shareholder of an electing small business corporation terminates the corporation's election as of the beginning of the taxable year in which the petition is filed.

Rev. Rul. 74-9

Advice has been requested whether, under the circumstances described below, a small business corporation's election was terminated under section 1372(e) of the Internal Revenue Code of 1954.

A corporation filed an election to be treated as a small business corporation in January 1970. In December 1971, one of the shareholders of the corporation filed an individual voluntary petition in bankruptcy pursuant to the provisions of Chapter 12 of the Bankruptcy Act, 11 U.S.C. 801 through 926. The bankruptcy court did not appoint a trustee of the property of the shareholder and therefore he continued in possession of his property, which included his stock in the small business corporation. The shareholder was later adjudged bankrupt.

Section 1372(e) of the Code provides, in part, that an election by a small business corporation shall terminate if at any time the corporation ceases to be a small business corporation as defined in section 1371(a).

Section 1371(a) of the Code provides, in part, that the term "small business corporation" means a corporation which does not have as a shareholder a person (other than an estate) who is not an individual.

Section 444 of the Bankruptcy Act, 11 U.S.C. 844, provides that where no trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under Chapter 12 subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe.

Section 477 of the Bankruptcy Act, 11 U.S.C. 877, provides that upon the consummation of a proceeding under Chapter 12, after confirmation of an arrangement, the court shall enter a final decree discharging the trustee, if any, closing the estate, and making such provisions, by way of injunction or otherwise, as may be equitable.

Where a debtor in proceeding for an extension of time to pay debts under the Bankruptcy Act remained in possession of the property, the amount of rental collected by the debtor belonged to the bankrupt estate and was required to be accounted for to the estate by whomsoever received, except such sums as were necessarily expended for the benefit of the estate, and was required to be distributed to the trustee for creditors or to the general creditors as their rights might appear. See *In re Bowman*, 24 F. Supp. 381 (1938).

Rev. Rul. 68-48, 1968-1 C.B. 301, discusses the procedural and substantive responsibilities that fall upon the trustee in bankruptcy of a bankrupt partnership. One question discussed concerns the nature of the entity created by bankruptcy and the kind of return the trustee should file. The Revenue Ruling states, in part, that the intervention of the status of bankruptcy into the affairs of both an individual and a partnership creates an entity separate and apart from the bankrupt individual or partnership. The Revenue Ruling further states that the trustee in bankruptcy is taxed as an estate rather than as a trust.

Rev. Rul. 66-266, 1966-2 C.B. 356, holds that an "estate" within the meaning of section 1371 of the Code, includes only the estate of a decedent. Therefore, the term "estate" does not include the estate of an individual in bankruptcy, or an estate of an infant, incompetent, or other person under a disability for purposes of section 1371. However, a corporation, otherwise qualified, may qualify as a small business corporation under section 1371 of the Code even though it has as a shareholder an individual, other than an individual in bankruptcy, who is under a disability. The individual infant, incompetent, or other person under a disability rather than the estate is considered to be the shareholder.

In the instant case, the filing by a shareholder of a voluntary petition in bankruptcy pursuant to the provisions of Chapter 12 created an estate in bankruptcy. Accordingly, since the stock of the small business corporation was neither owned by an "estate" within the meaning of section 1371, or an infant, incompetent, or other person under a disability who is treated as a shareholder under section 1371, the election to be treated as a small business corporation was terminated as of the beginning of the taxable year in which the petition in bankruptcy was filed.

Subchapter T.—Cooperatives and Their Patrons
Part I.—Tax Treatment of Cooperatives

Section 1381. — Organizations to Which Part Applies

26 CFR 1.1381-1: Organizations to which part applies.

Proper method for determining the taxable income of a cooperative to be used in computing qualified investment for purposes of the investment credit. See Rev. Rul. 74-288, page 6.

Section 1382.—Taxable Income of Cooperatives

26 CFR 1.1382-1: Taxable income of cooperatives; gross income.

Proper method for determining the taxable income of a cooperative to be used in computing qualified investment for purposes of the investment credit. See Rev. Rul. 74-288, page 6.

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26 CFR 1.1382-2: Taxable income of cooperatives; treatment of patronage dividends.

Nonexempt cooperative; patronage dividends. Patronage dividends of a nonexempt cooperative, whose work force is composed of both member and nonmember workers, based on the total hours worked by the nonmember workers plus the total hours worked by member workers increased by a specified percentage to determine the applicable percentage of net income available for patronage distributions, do not qualify as patronage dividends to the extent that such distributions are from income attributable to nonmember workers and to the extent the cooperative is not entitled to a deduction for such distributions under section 1382 (b)(1) of the Code. The quantity method to determine patronage dividends may be elected and an example of the calculations under this method is set forth.

Rev. Rul. 74-20

Advice has been requested whether, under the circumstances described below, the taxpayer is using a proper method of computing amounts available for patronage distributions under section 1382 of the Internal Revenue Code of 1954.

The taxpayer, a nonexempt cooperative within the meaning of section 1381(a) of the Code, is engaged in the manufacture and sale of wood products. The taxpayer's work force is composed of 100 member workers and 15 nonmember workers.

Under the provisions of the taxpayer's by-laws, when computing the net income available for distribution as a patronage dividend, the taxpayer used a percentage equal to the adjusted hours worked by member workers during the fiscal year divided by the sum of actual hours worked by nonmember workers plus the adjusted hours worked by member workers. The adjusted hours of the member workers is the sum of their actual hours worked increased by 40 percent. Thus, for example, if the actual hours worked by member workers equaled 60 hours and actual hours worked by nonmember workers equaled 40 hours the equation before the adjustment would be 60/100 times net income. By adjusting the actual hours worked by the member workers by 40 percent the equation would be changed to 84/124 times net income since the total actual hours worked by members workers would be increased by 24 hours (60 times 40 percent) and the total hours worked by all workers would be correspondingly increased by 24 hours.

Section 1382(b)(1) of the Code provides that in determining the taxable income of an organization to which subchapter T, Part I of the Code applies, there shall not be taken into account amounts paid during the payment period for the taxable year as patronage dividends, to the extent paid in money, qualified written notices of allocation, or other property with respect to patronage occurring during such taxable year.

Section 1388(a) of the Code defines the term patronage dividend to mean an amount paid to a patron by an organization to which Part 1 of Subchapter T of the Code applies (1) on the basis of quantity or value of business done with or for such patron; (2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid; and (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

In the instant case, the increasing of the hours worked by the member workers by 40 percent is not a de-

termination on the basis of either quantity or value but is solely an arbitrary determination. The result is to distribute to the member workers income of the taxpayer that is attributable in part to net earnings from the efforts of the nonmember workers. See Rev. Rul. 74-24, page 244.

Accordingly, in the instant case, patronage dividends computed by increasing the hours worked by member workers in determining the applicable percentage of net earnings available for patronage distributions do not qualify as patronage dividends to the extent that such distributions are from income attributable to nonmember workers and to that extent the taxpayer is not entitled to a deduction for such distributions under section 1382 (b) (1) of the Code.

However, the taxpayer may elect to use the quantity method in calculating net earnings available for patronage dividends. This method is based on the number of hours worked and is illustrated as follows:

Assume members worked 3,000 hours and nonmembers worked 1,000 hours to produce net earnings of $8{,}000x$ dollars. To calculate the amount of net earnings attributable to member workers the calculation should read:

$$\frac{\text{3,000 hours worked by members}}{\text{4,000 total hours worked}} \text{ times } \$8{,}000x = \$6{,}000x$$

$\$6{,}000x$ is the amount attributable to member efforts on the basis of quantity of work done.

The formula for determining the patronage dividend for an individual member when the quantity method is used is as follows:

$$\frac{\text{number of hours worked by member}}{\text{total number of member hours worked}} \text{ times net earnings available for patronage distribution}$$

Thus, if member *A* worked 500 hours of the 3,000 hours worked by all members, *A*'s patronage dividend would be calculated as follows:

$$\frac{500}{3{,}000} \text{ times } \$6{,}000x = \$1{,}000x \text{ amount of patronage dividend payable to } A.$$

The applicable percentage as calculated under the above method must be applied to all aspects of the taxpayer's operation so as to clearly reflect the income attributable to the member workers and nonmember workers. See Rev. Rul. 74-24, page 244, this Bulletin.

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26 CFR 1.1382-2: Taxable income of cooperatives; treatment of patronage dividends. (Also Section 167; 1.167(b)-0.)

Subchapter T cooperative; method of depreciation. A subchapter T cooperative may use any method of depreciation provided under section 167(b) of the Code, subject to limitations of sections 167(c) and 167(j), in computing its depreciation deduction under section 167 (a), but the method used must also be used for determining the amount of its net earnings for computing patronage dividends under section 1382(b).

Rev. Rul. 74-303

Advice has been requested whether a cooperative organization, as described in subchapter T of the Internal Revenue Code of 1954 (relating to cooperatives and their patrons), may use any method of depreciation authorized in section 167(b) in computing its depreciation deduction.

Section 1382(a) of the Code provides, in pertinent part, that the gross income of any cooperative organization described in section 1381 shall be determined without any adjustment (as a reduction in gross receipts, an increase in cost of goods sold, or otherwise) by reason of any allocation or distribution to a patron out of net earnings of such organization or by reason of any amount paid to a patron as a per-unit retain allocation.

Section 1.1382-2(a) of the Income Tax Regulations provides, in general, that in determining the taxable income of any cooperative organization as described in section 1381 of the Code, there shall be allowed as deductions from gross income, in addition to other deductions allowable under chapter 1 of the Code (relating to normal taxes and surtaxes) the deductions with respect to patronage dividends provided in section 1382(b) and section 1.1382-2(b) and (c). One of the deductions allowable under chapter 1 is depreciation under section 167.

Section 167(a) of the Code provides the general rule that there shall be allowed as a depreciation deduction a reasonable allowance for exhaustion, wear and tear of property used in the trade or business, or of property held for the production of income. Except as limited by sections 167(c) and 167 (j), section 167(b) provides for the use of certain methods and rates such as, for example, (1) the straight-line method, (2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the straight-line method, and (3) the sum-of-the-years-digits method. See also section 1.167 (b)-0 of the regulations.

Neither subchapter T of the Code nor section 167 preclude a cooperative organization from using any method of depreciation provided by section 167(b) in computing its deduction for depreciation under section 167(a).

Accordingly, it is held that a cooperative organization, as described in subchapter T of the Code, in computing its deduction for depreciation under section 167(a) is entitled to

use any method of depreciation provided in section 167(b) subject to the limitation of sections 167(c) and 167 (j). However, such cooperative organization must use the same method of depreciation in computing its depreciation deduction under section 167(a) for taxable income purposes and for purposes of determining the "net earnings" of the organization in computing the amount allowable as a deduction for patronage dividends under section 1382(b). See Rev. Rul. 74-274, page 247.

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26 CFR 1.1382-2: Taxable income of cooperatives; treatment of patronage dividends.

Whether a nonexempt farmers' cooperative must reduce the combined net income from its member and nonmember business by the amount of State income tax. See Rev. Rul. 74-161, page 247.

Part III—Definitions; Special Rules

Section 1388.—Definitions; Special Rules

26 CFR 1.1388-1: Definitions and special rules.
(Also Section 631; 1.631-1.)

Nonexempt cooperative; patronage income. Gain recognized by a nonexempt cooperative engaged in the manufacture of wood products under an election to treat the cutting of timber as a sale or exchange is patronage income in the year recognized to the extent attributable to member workers and will qualify for distribution as a patronage dividend. That portion of the gain attributable to nonmember workers is not patronage income and will not qualify. Rev. Rul. 71-439 amplified.

Rev. Rul. 74-24

Advice has been requested whether the gain recognized from the cutting of timber under the circumstances described below is to be reported as taxable income in the year recognized.

The taxpayer, a nonexempt cooperative within the meaning of section 1381(a) of the Internal Revenue Code of 1954, is engaged in the manufacture and sale of wood products. It owns standing timber that serves as a source of raw materials, and has properly elected the provisions of section 631(a) of the Code to treat the cutting of such timber as a sale or exchange of the timber. The taxpayer is a coopertive of the type described in Revenue Ruling 71-439, 1971-2 C.B. 321. The cooperative described in Revenue Ruling 71-439, however, was composed solely of member workers. The taxpayer is composed of 100 member workers and 15 nonmember workers.

Revenue Ruling 71-439 holds that the gain from the cutting of timber, which the taxpayer recognizes pursuant to the "section 631(a) election," represents the unrealized appreciation in value of timber cut during the year which, in the absence of an election under section 631(a) of the Code, would have been reflected in the taxpayer's ordinary income from the sale of its products and would have been included in amounts available for distribution as a patronage dividend. The "section 631(a) election" permits an early recognition at capital gains rates of an amount that ultimately may or may not be realized by the taxpayer when the finished products are sold.

Under the facts of Rev. Rul. 71-439, the actual realization of the appreciation in the value of the standing timber (when the finished products are sold) is brought about through the cooperative efforts of the members of the cooperative. The Revenue Ruling concludes that the gain recognized by a nonexempt cooperative association pursuant to an election under section 631(a) of the Code is income from a patronage source.

Similarly, in the instant case, the gain recognized by the taxpayer, pursuant to the election under section 631(a) of the Code, is income from a patronage source, in the year the gain is so recognized, to the extent it is attributable to the efforts of member workers and will qualify as a patronage dividend within the meaning of section 1388 of the Code. That portion of the gain attributable to the efforts of the nonmember workers, however, is not patronage sourced and cannot be distributed as part of a qualified patronage dividend within the meaning of section 1388 of the Code. Thus, since the taxpayer employs workers who are not members of the cooperative the recognized gain must be allocated between member workers and nonmember workers to determine the amount of patronage sourced income allocable to the "section 631(a) election."

Rev. Rul. 71-439 is hereby amplified.

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26 CFR 1.1388-1: Definitions and special rules.
(Also Section 1245; 1.1245-1.)

Nonexempt cooperative; patronage income. The ordinary income portion of gain realized from the sale of section 1245 property by a nonexempt cooperative is patronage sourced income to be allocated between member and nonmember workers in accordance with the applicable method of allocation utilized in those prior years in which depreciation deductions were taken on the property sold and to the extent allocated to member workers qualifies as a patronage dividend. However, the portion of such gain attributable to depreciation deducted in years the cooperative did not qualify under section 1381(a) of the Code and the portion of the gain treated under section 1231 as gain from the sale of a capital asset are not patronage income.

Rev. Rul. 74-84

Advice has been requested whether the gain from the sale of a depreciable asset under the circumstances de-

scribed below is patronage or nonpatronage sourced income and whether the distribution of such qualifies as a patronage dividend under section 1388(a) of the Internal Revenue Code of 1954.

During the current taxable year the taxpayer, a nonexempt cooperative within the meaning of section 1381(a) of the Code, employing both members and nonmembers, sold, at a gain, machinery it used in the manufacture of wood products. The taxpayer had charged depreciation on this machinery to operations thus reducing the amount available for distribution as patronage dividends in prior taxable years. The sale of the machinery was the only transaction that qualified under section 1231 during the year.

Section 1231 of the Code provides, in part, that if the gain from sales or exchanges of property used in a trade or business exceeds the losses from such sales or exchanges, the gains and losses shall be considered as gains and losses from the sales and exchanges of capital assets held for more than six months. However, the section 1231 gain is reduced by the amount of ordinary income recognized under section 1245.

Section 1245(a) of the Code provides, that if "section 1245 property" is disposed of during the taxable year the amount by which the lower of (1) the recomputed basis of the property or (2) in the case of a sale, exchange, or involuntary conversion, the amount realized or (3) in the case of any other disposition, the fair market value of such property, exceeds the adjusted basis of such property shall be treated as a gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any of the provisions of subtitle A of the Code.

Section 1245(b) of the Code defines "section 1245 property" to mean any property which is or has been property of a character subject to allowance for depreciation provided in section 167.

Section 1.1382-3(c)(2) of the Income Tax Regulations defines the term "income derived from sources other than patronage" to mean incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment and securities, or from the sale or exchange of capital assets, is income derived from sources other than patronage.

Section 1388(a) of the Code provides that for the purpose of subchapter T of the Code, the term "patronage dividend" means an amount paid to a patron by an organization to which part 1 of subchapter T of the Code applies (1) On the basis of quantity or value of business done with or for such patron, (2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid and, (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons. The term patronage dividend does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid with respect to substantially identical transactions.

Accordingly, in the instant case, that portion of the gain from the sale of machinery treated as ordinary income under section 1245 of the Code is considered patronage sourced income because, in effect, the taxpayer is merely recapturing income that otherwise would have been available for distribution as a patronage dividend. That portion of the gain treated under section 1231 as gain from the sale of a capital asset held for more than six months is considered income derived from sources other than patronage and, thus, does not give rise to a deduction to the cooperative when distributed to its patrons.

Furthermore, under the provisions of section 1382(f) of the Code the portion of the above gain treated as patronage sourced income should be allocated between working members of the cooperative and the employees of the cooperative who are not members in accordance with the applicable method, either quantity or value, utilized in those prior years in which the depreciation deductions were taken. See Rev. Rul. 74-20, page 242, this Bulletin. The distribution of that part of the income allocable to the working members in those respective years will, to that extent, qualify as a patronage dividend. Section 1382(f) provides that if any portion of the earnings from business done with or for patrons is includible in the taxpayer's gross income for a taxable year after the taxable year during which the patronage occurred, then, for the purposes of applying section 1382(b) to such portion, patronage shall be considered to have occurred during the organization's taxable year during which such earnings are includible in its gross income. If the years in which the depreciation deduction was taken were not years in which the taxpayer qualified as a cooperative the income resulting from the application of section 1245 will be considered nonpatronage sourced income.

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26 CFR 1.1388-1: Definitions and special rules.

Nonexempt cooperative; patronage income. Interest income received by a nonexempt cooperative from loans made to its chief supplier to assure supplies, and an operating loss sustained in its op-

eration of a veneer plant operated as a part of its business, are patronage sourced to the extent allocable to member workers. However, a payment it received as lessee from the cancellation of its lease on the veneer plant is nonpatronage sourced income.

Rev. Rul. 74-160

Advice has been requested whether, under the circumstances described below, (1) certain income received and losses sustained are patronage or nonpatronage sourced income or losses, and (2) whether a distribution of such income qualifies as a patronage dividend under section 1388(a) of the Internal Revenue Code of 1954.

The taxpayer, a nonexempt cooperative within the meaning of section 1381(a) of the Code, is engaged in the manufacture and sale of plywood. It is composed of both member and nonmember workers. Only member workers are entitled to receive patronage dividends. These patronage dividends are computed by the method set forth in Rev. Rul. 74-20, page 242.

During the taxable year the taxpayer made loans to its chief supplier in order to permit the supplier to finance equipment necessary to carry out its business operation. Without the loans the supplier would have been unable to supply the cooperative. The taxpayer realized interest income on these loans.

As a part of its business the taxpayer was the lessee and operator of a veneer plant for a number of years. During the taxable year the lease on the veneer plant was cancelled and the taxpayer received a payment as a result of cancellation of the lease. The veneer plant had an operating loss for the year.

Section 1.1382-3(c)(2) of the Income Tax Regulations defines the term "income derived from sources other than patronage" to mean incidental income from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example income derived from the leases of premises, from investment and securities, or from the sale or exchange of capital assets, constitutes income derived from sources other than patronage.

Section 1388(a) of the Code provides that for the purpose of subchapter T of the Code, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of subchapter T applies: (1) on the basis of quantity or value of business done with or for such patron, (2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons. The term patronage dividend does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for its patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions.

Rev. Rul. 69-576, 1969-2 C.B. 166, holds that the classification of an item of income as from either patronage or nonpatronage sources is dependent on the relationship of the activity generating the income to the cooperative. Therefore, if the income is produced by a transaction that actually facilitates the accomplishment of the cooperative's marketing, purchasing or service activities, the income is from patronage sources. However, if the income producing activity does not actually facilitate the accomplishment of the cooperative's marketing, purchasing or service activities but merely enhances the overall profitability of the cooperative, the income is from nonpatronage sources.

The loans to its chief supplier to purchase equipment actually facilitated the accomplishment of taxpayer's cooperative activities, in that it enabled the taxpayer to obtain necessary supplies for its operations. Without making the loans, the taxpayer would have been unable to obtain necessary supplies. As the taxpayer could deduct any loss suffered as a result of these loans, so also any income generated as a result of these loans should be treated as directly related to the taxpayer's activities. See Rev. Rul. 58-40, 1958-1 C.B. 275, compare *Gulftex Drug Co., Inc.*, 29 T.C. 118 (1958), and the cases cited therein.

Accordingly, to the extent such income is allocable to the member patrons on the basis of business done with or for those patrons, the income is patronage sourced income that may be distributed as patronage dividends. However, to the extent the interest income is allocable to nonmember business it constitutes nonpatronage sourced income that must be taken into account in computing the Federal income tax of taxpayer. For an analogous calculation, see the method set forth in Rev. Rul. 74-20.

Section 1241 of the Code provides that amounts received for cancellation of a lease shall be considered as amounts received in exchange for such lease. In the instant case the taxpayer, as tenant, received payment as a result of a cancellation of a lease. The lease was property used in the trade or business within the meaning of section 1.1231-1 of the regulations. See Rev. Rul. 72-85, 1972-1 C.B. 234.

Accordingly, the payment received for cancellation of the lease is considered as an amount received for the sale of a capital asset which under section 1.1382-3(c)(2) of the regulations, is considered income derived from sources other than patronage.

The operating loss resulting from the operation of the veneer plant by the taxpayer is a loss from patronage sources to the extent it is allocable to the business done with or for worker members. The manufacture of veneer is an integral part of the taxpayer's cooperative function and thus any profit or loss resulting from the operation of such a plant results in patronage and nonpatronage sourced income or loss to be allocated in the same manner as the interest income considered above.

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26 CFR 1.1388.1: Definitions and special rules.
(Also Section 1382; 1.1382-2.)

Nonexempt farmers' cooperative; patronage dividend. The State income taxes paid by a nonexempt farmers' cooperative on earnings from business done with nonmembers does not reduce the earnings from business done with members in computing the amount available for distribution as a patronage dividend.

Rev. Rul. 74-161

Advice has been requested whether a nonexempt farmers' cooperative must reduce the combined net income from its member and nonmember business by the amount of State income tax imposed on the nonmember income before computing the amount available for distribution as a patronage dividend under section 1388 of the Internal Revenue Code of 1954.

Taxpayer is a nonexempt farmers' cooperative that pays patronage dividends only to its members. The State in which it operates imposes an income tax on the cooperative's net profit derived from its nonmember business.

Section 1388 provides:

(a) PATRONAGE DIVIDEND—For purposes of subchapter T, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of subchapter T applies—

(1) on the basis of quantity or value of business done with or for such patron,

(2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and

(3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

Under section 1.1388-1(a)(1)(iii) of the Income Tax Regulations a patronage dividend is defined, in part, as an amount paid to a patron by a cooperative organization which is determined by reference to the net earnings of the cooperative from business done with or for its patrons. Net earnings include the excess of amounts retained (or assessed) by the organization to cover expenses or other items over the amount of such expenses or other items. Net earnings does not include earnings attributable to nonmembers to whom the cooperative has no obligation to pay patronage dividends.

In the instant case, the State imposes an income tax on the earnings of the cooperative from business with nonmembers. The earnings from business done with its members must, therefore, be segregated from the earnings from business done with the nonmembers with the income tax imposed only on the earnings from the nonmembers.

Accordingly, the earnings from business done with members are available for distribution as patronage dividends unreduced by the State income tax imposed on the nonmember earnings.

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26 CFR 1.1388-1: Definitions and special rules.

Nonexempt cooperative; patronage dividends. A distribution by a nonexempt cooperative that used different methods of depreciation for net book earnings and net earnings from business done with or for patrons reported for Federal income tax purposes will qualify as a patronage dividend only to the extent of the net earnings reported for Federal income tax purposes.

Rev. Rul. 74-274

Advice has been requested whether a distribution of a cooperative's "net book earnings" would qualify as patronage dividends under the circumstances described below.

The taxpayer, a nonexempt cooperative within the meaning of section 1381(a)(2) of the Internal Revenue Code of 1954, had income from both patronage and nonpatronage sources during the taxable year. In computing the amount available for patronage dividends as a result of the patronage activity for the current taxable year the taxpayer used as the net earnings amount the net book earnings for the taxable year. The net book earnings was greater than the amount of net earnings from business done with or for its patrons as reported by the taxpayer on its Federal income tax return. The difference in income is attributable to the taxpayer's method of computing depreciation for book purposes which is different than that used for Federal income tax purposes (i.e., the straight line method of depreciation was used for book purposes while an accelerated method of depreciation described in section 167 (b) was used for Federal income tax purposes).

The question is whether the taxpayer may distribute the net book earnings as patronage dividends and deduct such patronage dividend distributions on its Federal income tax return.

Section 1388(a) of the Code provides that for the purpose of subchapter T, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of subchapter T applies. Such amount paid to a patron is an amount which, among other things not pertinent here, is determined by reference to the net earnings of the organiza-

tion from business done with or for its patrons.

Section 1.1388-1(a)(1)(iii) of the Income Tax Regulations provides that the term "net earnings" for the purpose of section 1.1388-1(a)(1)(iii), includes the excess of amounts retained (or assessed) by the organization to cover expenses or other items over the amount of such expenses or other items.

Section 1382(b) of the Code provides, in pertinent part, that in determining the taxable income of an organization to which part I, subchapter T applies, there shall not be taken into account amounts paid during the payment period for the taxable year as patronage dividends as defined in section 1388(a).

The phrase "net earnings of the organization from business done with or for its patrons" in section 1388(a) of the Code has reference only to the net earnings of the organization derived from patronage business reported for Federal income tax purposes.

Accordingly, a distribution by the taxpayer of an amount greater than the net earnings of the organization from business done with or for its patrons will not qualify as a patronage dividend to the extent that such distribution exceeds the net earnings.

Chapter 2.—Tax on Self-Employment Income

Section 1402.—Definitions

26 CFR 1.1402(c)-1: Trade or business.

Status of a gravedigger performing services for the operator of a funeral establishment. See Rev. Rul. 74-219, page 295.

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26 CFR 1.1402(c)-1: Trade or business.

Status of a distributor performing services for a delivery-service corporation. See Rev. Rul. 74-220, page 296.

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26 CFR 1.1402(c)-1: Trade or business.

Income of a self-employed public official compensated solely on a fee basis. See Rev. Rul. 74-225, page 101.

Chapter 3.—Withholding of Tax on Nonresident Aliens and Foreign Corporations and Tax-Free Covenant Bonds

Subchapter A. Nonresident Aliens and Foreign Corporations

Section 1441.—Withholding of Tax on Nonresident Aliens

26 CFR 1.1441-1: Requirement for withholding of tax on nonresident aliens, foreign partnerships, and foreign corporations.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1441-2: Income subject to withholding.
(Also Section 863; 1.863-1, 1.863-2.)

Nonresident alien; sign on fee; withholding. A sign on fee paid by a domestic team of an international professional soccer league to a nonresident alien player as an inducement not to negotiate a player contract with any other team may be allocated under section 863(b) of the Code as income from sources within and without the U.S.; the U.S. source income is subject to withholding under section 1441(a).

Rev. Rul. 74-108

Advice has been requested whether a sign on fee, paid to a nonresident alien individual by a domestic corporation pursuant to a "sign on agreement" (agreement), is income from sources within the United States subject to income tax withholding under section 1441(a) of the Internal Revenue Code of 1954.

The taxpayer, a domestic corporation, operates a professional soccer club in the United States. The club is a member of a professional league affiliated with the governing body of world-wide professional soccer. The taxpayer entered into an agreement with a nonresident alien individual during the current taxable year. In order to induce the nonresident alien individual to sign the agreement, the taxpayer paid him a sign on fee. The agreement was executed by the taxpayer and the nonresident alien individual outside the United States.

The sign on fee is paid to induce the player to sign and become bound by the provisions of the agreement. The agreement does not require the player actually to play for the club; it is merely a preliminary agreement that is separate and distinct from a "uniform player" contract which binds a player to play soccer for a salary. When a player enters into an agreement, the taxpayer places him on its reserve list thereby protecting such player from recruiting efforts of any other club and preventing him from negotiating to play or playing for any other professional soccer club. No part of the sign on fee is attributable to future services, but the team anticipates the agreement and fee will induce the player to sign and become bound by the uniform player contract if the club wishes to use his services and a separate employment contract is negotiated for this purpose.

The professional soccer league with which the taxpayer's team is affiliated includes eleven members. Seven of the member teams, including the taxpayer, are located within the United States and the remaining four are located without the United States. The taxpayer's team schedule provides for some of its soccer games to be played in the United States and the remainder to be played in foreign countries.

Section 1441(a) of the Code provides, in part, that except as otherwise provided in section 1441(c), all persons in whatever capacity acting, having control or payment of any of the items of income specified in section 1441(b), to the extent that any of such items constitutes gross income from sources within the United States, of any nonresident alien individual shall deduct and withhold from such items a tax equal to 30 percent thereof.

The items of income described in section 1441(b) of the Code include wages, compensation, and other fixed or determinable annual or periodical income. Section 1.1441-3(a) of the Income Tax Regulations provides that the sources of income shall be determined in accordance with sections 861 to 864 and regulations thereunder.

Rev. Rul. 58-145, 1958-1 C.B. 360, provides that bonuses, which are not predicated on continuing employment, made to new baseball players solely for signing their first contracts, do not represent remuneration for services performed. Such bonuses are taxable to the baseball player as ordinary income in the taxable year received. Accordingly, in the instant case the sign on fee, which is similar to a bonus, paid to the nonresident alien individual is not compensation for labor or personal services for purposes of the source of income rules in section 861(a)(3) or section 862(a)(3) of the Code.

The sign on fee, or bonus, was paid to insure that if the nonresident alien individual did play professional soccer, he would provide his services for the taxpayer only and to no other professional soccer club. See *Richard A. Allen*, 50 T.C. 466 (1968). The bonus was paid as compensation for the promises made by the nonresident alien individual in the sign on agreement which in essence amounted to a covenant not to compete.

Compensation received for a promise not to compete is taxable as ordinary income and does not constitute income from the sale of property either real or personal. See *John D. Beals, Jr.*, 31 B.T.A. 966, *aff'd*, 82 F. 2d 268 (2d Cir.), XV-2 C.B. 227 (1936). Such compensation is fixed or determinable annual or periodical income and its source is the place where the promisor forfeited his right to act. *Korfund Co.*, 1 T.C. 1180 (1943). Therefore, amounts paid to a nonresident alien for his promise not to compete in the United States are subject to withholding under section 1441(a) of the Code.

In the instant case the sign on fee is paid for the nonresident alien individual's promise not to compete both within and without the United States. Therefore, the sign on fee is attributable to sources both within and without the United States and the income must be apportioned appropriately. See section 863(b) of the Code pertaining to the reporting of income partly from within and partly from without the United States.

Accordingly, a portion of the sign on fee in the instant case is income from sources within the United States and is subject to withholding under the provisions of section 1441(a) of the Code. The basis upon which the sign on fee is allocated as income from sources within and sources without the United States must be reasonable and based on the facts and circumstances in each case. For example, in some cases it may be reasonable to make the allocation on the basis of the relative value of the taxpayer's services within and without the United States, or on the basis of the portion of the year during which soccer is played within and without the United States. Where a reasonable basis for allocation does not exist, the entire sign on fee is income from sources within the United States and is subject to section 1441(a).

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26 CFR 1.1441-2: Income subject to withholding.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1441-3: Exceptions and rules of special application.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1441-4: Exemptions from withholding.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1441-5: Claiming to be a person not subject to withholding.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1441-6: Withholding pursuant to the application of a tax treaty which confers a reduced rate of, or an exemption from, United States income tax.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Section 1442.—Withholding of Tax on Foreign Corporations

26 CFR 1.1442-2: Exemption from withholding of tax on foreign corporations.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Section 1443.—Foreign Tax-Exempt Organizations

26 CFR 1.1443-1: Foreign tax-exempt organizations.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Subchapter C. Application of Withholding Provisions

Section 1461.—Liability for Withheld Tax

26 CFR 1.1461-1: Ownership certificates for bond interest.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1461-2: Return of tax withheld.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

26 CFR 1.1461-3: Payment of withheld tax.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

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26 CFR 1.1461-4: Adjustments for over-withholding of tax.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Section 1463.—Tax Paid By Recipient of Income

26 CFR 1.1463-1: Tax paid by recipient of income.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Section 1464.—Refunds and Credits with Respect to Withheld Tax

26 CFR 1.1464-1: Refunds or credits.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Section 1465.—Definition of Withholding Agent

26 CFR 1.1465-1: General provisions relating to withholding agents.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Chapter 4.—Rules Applicable to Recovery of Excessive Profits on Government Contracts

Subchapter B. Mitigation of Effect of Renegotiation of Government Contracts

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Section 1481.—Mitigation of Effect on Renegotiation of Government Contracts

Renegotiation; credits against excessive profits; State income taxes paid. In determining the credit under section 1481(b) of the Code resulting from the renegotiation of a government contract to eliminate "excessive profits," neither the Renegotiation Board's reduction of excessive profits by State income taxes attributable to non-excessive profits, nor the taxpayer's possible claim for refund for State income taxes paid affects the deduction for State income taxes already paid or accrued in recomputing taxable income for the prior year.

Rev. Rul. 74-259

Advice has been requested whether, under the circumstances set forth below, in computing the credit allowed under section 1481 of the Internal Revenue Code of 1954 the taxpayer's deduction for State income taxes should be adjusted for the taxable year in which excessive profits are deemed to have been made.

The taxpayer is a corporation organized under the laws of State *N*. It is engaged in the manufacture of military equipment under contracts with the United States Government which are subject to "renegotiation" to eliminate "excessive profits" within the meaning assigned to those terms in section 1481(a) of the Code. The taxpayer uses the accrual method of accounting.

For its taxable year 1965, the taxpayer's total profit from its business was 1,000*x* dollars, 500*x* dollars of which arose from government contracts subject to renegotiation. On March 15, 1966, the taxpayer filed its Federal income tax return for 1965 on which it reported total profits of 1,000*x* dollars and took a deduction for income taxes imposed by State *N* on those profits. In 1965 State *N* taxed income at the flat rate of three percent of total profits. Accordingly, the taxpayer deducted 30*x* dollars for State taxes, leaving taxable income of 970*x* dollars reported on its Federal income tax return for 1965.

On June 1, 1972, the Renegotiation Board determined that the taxpayer realized excessive profits of 100*x* dollars from its government contracts for the taxable year 1965. Pursuant to 32 C.F.R. 1459.9 (1973) of the Renegotiation Board Regulations, the Board ruled that 88*x* dollars was the amount of excessive profits to be eliminated and repaid to the United States. This amount was computed as follows:

Total profits realized by the taxpayer from renegotiable government contracts	500*x* dollars
Less: Amount determined by Renegotiation Board to be excessive profits	100*x*
Non-excessive profits	400*x* dollars
Excessive profits	100*x* dollars
Less: State *N* income tax attributable to non-excessive profits (3 percent times 400*x* dollars)	12*x*
Amount of excessive profits to be eliminated and repaid to the United States, before computation of credit under section 1481(b) of the Code	88*x* dollars

Section 1481(a) of the Code provides that if a renegotiation takes place and an amount of excessive profits received or accrued under a contract for a taxable year (referred to as "prior taxable year") is eliminated and the taxpayer is required to repay the United States the amount of excessive profits eliminated, or the amount of excessive profits eliminated is applied as an offset against other amounts due the taxpayer, the part which was received or was accrued for the prior taxable year shall be reduced by the amount of excessive profits eliminated.

Under section 1481(b) of the Code, excess Federal taxes already paid for the prior taxable year can be credited against the amount the taxpayer has to repay the government pursuant to the Renegotiation Board determination. Section 1481(b) provides that there shall be credited against the amount of excessive profits eliminated (88*x* dollars in the instant case) the amount by which the tax for the prior taxable year is decreased by reason of the application of section 1481(a). The credit is equal to the difference between the amount of Federal income tax assessed on the contractor's income for the period (including the excessive profits) and the amount of Federal income tax which would have been assessed if the excessive profits had been excluded from the returns.

Rev. Rul. 71-415, 1971-2 C.B. 322, provides that under section 1481(b) of the Code the taxpayer's taxable income for Federal income tax purposes is required to be, in effect, determined upon the basis of, and by giving effect to, the renegotiation. The Internal Revenue Service does not function in the determination or collection of excessive profits for renegotiation purposes. However, in giving effect to the renegotiation, the Service will reduce the taxpayer's gross income for the prior taxable year by the amount of excessive profits to be eliminated.

Accordingly, in the instant case, the fact that the excessive profits are reduced by the amount of State income taxes attributable to the non-excessive profits or that the taxpayer might have a claim for refund for State income taxes paid has no bearing on the amount of the deduction for State *N* taxes already paid or accrued for purposes of determining the credit provided in section 1481(b) of the Code. In determining the credit, the total amount of State *N* income taxes paid or accrued is a proper deduction under the taxpayer's accounting method. See *Security Flour Mills v. Commissioner,* 321 U.S. 281 (1944), 1944 C.B. 526 and *Taylor Instrument Co.,* 14 T.C. 388 (1950).

The credit under section 1481(b) of the Code in this case is computed by determining the Federal income tax on taxable income for taxable year 1965 of 970*x* dollars and subtracting the Federal income tax liability on taxable income of 882*x* dollars after renegotiation (970*x* dollars less 88*x* dollars excessive profits eliminated). The amount of State *N* tax refund, if any, is includible in the taxpayer's income in the year in which all the events have occurred that are necessary to fix the taxpayer's right to such refund.

Chapter 6.—Consolidated Returns
Subchapter A. Returns and Payment of Tax

Section 1502.—Regulations

26 CFR 1.1502-13: Intercompany transactions.
(Also Sections 611, 631; 1.611-1, 1.631-3.)

Transactions between members of an affiliated group. An arms-length coal lease agreement in 1972 between members of an affiliated group filing consolidated returns, in which the owner-lessor retained an economic interest and the lessee obtained the right to mine and dispose of the coal, does not constitute a deferred intercompany transaction within the meaning of regulations section 1.1502-13(a)(2)(i) or (iii). Section 631(c) of the Code applies to the royalty payments received by the owner-lessor.

Rev. Rul. 74-10

Advice has been requested (1) whether, under the circumstances described below, for taxable years beginning after December 31, 1965, section 631(c) of the Internal Revenue Code of 1954, can apply to transactions between members of an affiliated group filing consolidated returns and, if so, (2) whether such transactions are deferred intercompany transactions in computing the consolidated taxable income.

Corporations *X* and *Y* are members of an affiliated group of corporations filing consolidated returns on the basis of a calendar year. *X* is the owner of coal properties and *Y* is engaged in the mining of coal. In February 1972 they entered into an arm's length coal lease agreement whereby *X* disposed of coal in place to *Y*. The agreement is of the type described in section 631(c) of the Code, relating to the disposal of coal with a retained economic interest. Under the agreement *X* retained an economic interest in the coal and *Y* obtained the right to mine and dispose of the coal. The amount of royalty paid by *Y* to *X* under the agreement was a specified amount per ton as the coal was mined. The coal royalties paid by *Y* have been properly excluded by *Y* from the gross income from mining for the purpose of determining its percentage depletion allowable under section 613. That is, such royalties are not a deduction for Federal income tax purposes, but rather are a reduction of *Y*'s gross income from mining. See section 1.613-2(c)(4) of the Income Tax Regulations.

Section 631(c) of the Code provides, in part, that in the case of the disposal of coal held for more than 6 months by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272, shall be considered as though it were a gain or loss on the sale of such coal. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal.

In effect, section 631(c) of the Code provides, in certain instances, for capital gains treatment of coal roy-

alties. See also section 1231(b)(2).

As a general rule, in determining the consolidated taxable income for taxable years beginning after December 31, 1965, recognized gains or losses on intercompany transactions (other than deferred intercompany transactions) shall not be deferred or eliminated. Section 1.1502-13(b) of the Income Tax Regulations.

Section 1.1502-13(a)(1) of the regulations, applicable to taxable years beginning after December 31, 1965, provides, in pertinent part, that an intercompany transaction is a transaction during a consolidated return year between corporations that are members of the same group immediately after such transaction. Section 1.1502-13(a)(2) provides that a deferred intercompany transaction is an "intercompany transaction" involving (1) a sale or exchange of property, (2) the performance of services where the amount of the expenditure is capitalized, or (3) any other expenditure where the amount of the expenditure is capitalized.

Section 1.1502-80 of the regulations provides, in part, that the Internal Revenue Code, or other law, shall be applicable to the group to the extent the regulations do not exclude its application.

There is nothing in the regulations under section 1502 applicable to taxable years beginning after December 31, 1965, which precludes the application of section 631(c) of the Code to amounts received by a member of the affiliated group from another member of the group. The question then is whether the transaction between *X* and *Y*, as described above, is an "intercompany transaction" within the meaning of section 1.1502-13(a)(1) of the regulations or a "deferred intercompany transaction" within the meaning of section 1.1502-13(a)(2) of the regulations.

Since the royalties paid by *Y* are a reduction of *Y*'s gross income from mining and are not capitalized, the transaction between *X* and *Y* is not a deferred intercompany transaction within the meaning of section 1.1502-13(a)(2)(iii) of the regulations. The transaction is not a sale or exchange which is a deferred intercompany transaction within the meaning of section 1.1502-13(a)(2)(i) since that section contemplates that the amount paid by the purchasing member will be reflected in its basis and that deferred gain or loss will be then restored to income when an event to which other provisions of section 1.1502-13 of the regulations apply. In this case the purchaser has no basis for the amounts paid as royalties. Thus, the transaction between *X* and *Y* is an intercompany transaction within the meaning of section 1.1502-13(a)(1) of the regulations.

Accordingly, in the instant case, the provisions of section 631(c) of the Code are applicable to the transaction between *X* and *Y*. Furthermore, the gain realized by *X* upon the disposal of the coal in place to *Y* may not be eliminated in computing the consolidated taxable income of the affiliated group for 1972. For 1972 *X*, the owner-lessor, is not entitled to the deduction for depletion provided under sections 611 and 613. Moreover, *Y*'s deduction for percentage depletion shall be determined under section 613 without regard to the fact that section 631(c) applies to the royalties received by *X*.

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26 CFR 1.1502-75: Filing of consolidated returns.

Consolidated returns; permission to discontinue filing. A request for permission to discontinue filing consolidated returns will be denied where filing separate returns would enable a domestic subsidiary to utilize a foreign tax credit which would otherwise be lost and enable the parent to maximize the use of net operating loss carrybacks and carryovers since shifting to separate returns to achieve tax advantages does not constitute "good cause" within the meaning of section 1.1502-75(c)(1) of the regulations.

Rev. Rul. 74-91

Advice has been requested whether the circumstances described below, constitute good cause for granting to an affiliated group permission to discontinue filing consolidated returns beginning with the calendar year ending December 31, 1973.

X corporation is the parent corporation of an affiliated group. *Y* is the wholly-owned domestic subsidiary of *X*. *Z* was the wholly-owned foreign subsidiary of *Y* until *Y* sold the stock of *Z* on June 30, 1973. As a result of the sale of the stock of *Z*, part of *Y*'s gain was required to be treated by it as a dividend under section 1248 of the Internal Revenue Code of 1954.

As provided by section 1.1248-1(d)(1)(i) of the Income Tax Regulations, *Y* was entitled to claim a foreign tax credit with respect to the dividend received from *Z*.

Since 1971 the affiliated group has incurred net operating losses which were reflected in the consolidated returns. The affiliated group incurred a net operating loss for 1973 and it anticipates a net operating loss for 1974. In such event the affiliated group would have no Federal income tax liability to absorb the foreign tax credit, and this would result in a carryover of foreign tax credit. Since the affiliated group does not anticipate any future foreign source income, the foreign tax credit would not be utilized. If separate returns are filed for 1973, the tax liability for *Y* would be approximately 2,000x dollars in comparison to its zero tax liability on a consolidated return basis. As a result of separate returns being filed, *Y* would be able to utilize the foreign tax credit and *X* would be able to maximize the use of the net operating loss carrybacks and carryovers.

Section 1.1502-75(a)(2) of the

regulations provides that a group which filed a consolidated return for the immediately preceding taxable year is required to file a consolidated return for the taxable year unless it has been granted permission by the Commissioner of Internal Revenue to discontinue filing consolidated returns. Subparagraph (c)(1) of that section provides, in part, that for good cause shown, the Commissioner of Internal Revenue may grant permission to a group to discontinue filing consolidated returns. Subdivisions (ii) and (iii) of that subparagraph provides for certain factors to be considered by the Commissioner in determining whether good cause exist for granting permission to discontinue filing consolidated returns.

In considering the meaning of good cause (used in similar fashion in a predecessor to section 1.1502-75(c)(1)(i)) Rev. Rul. 57-3, 1957-1 C.B. 290, 291, provides that events, activities, and economic conditions affecting individual members of an affiliated group are not considered material insofar as the inter-relationships of the members of the group are concerned. Such circumstances, including the shifting from a consolidated return basis to a separate return basis in order to achieve temporary tax reductions or advantages, are not good cause.

Accordingly, in the instant case, it is held that since the request to discontinue filing consolidated returns is being made to utilize certain tax advantages available, such reasons do not constitute good cause within the meaning of section 1.1502-75(c)(1) of the regulations and, therefore, permission to file separate returns beginning with the taxable year ending December 31, 1973, is denied.

Section 1503.—Computation and Payment of Tax

26 CFR 1.1503-1: Computation and payment of tax.
(Also Section 904; 1.904-2.)

Foreign tax credit; affiliated group including Western Hemisphere trade corporations; carrybacks and carryovers. The amount of the foreign tax reduction required by reason of the inclusion of Western Hemisphere trade corporations in an affiliated group filing consolidated returns and using the overall limitation in determining the foreign tax credit does not qualify for the foreign tax credit carryback and carryover provisions of section 904(d) of the Code.

Rev. Rul. 74-72

Advice has been requested whether the amount of the foreign tax reduction determined under section 1503(b)(1) of the Internal Revenue Code of 1954 qualifies for the carryback and carryover provisions of section 904(d).

The taxpayer is the common parent of an affiliated group of corporations, some of which qualify as Western Hemisphere trade corporations within the meaning of section 921 of the Code. The affiliated group files consolidated Federal income tax returns and uses the overall limitation under section 904(a)(2) in determining the foreign tax credit under section 901. As required by section 1503(b)(1), the amount of foreign taxes paid by the Western Hemisphere trade corporations which could be taken into account for purposes of section 901 was reduced.

Section 1503(b)(1) of the Code provides, in part, that if the affiliated group includes one or more Western Hemisphere trade corporations, and if for the taxable year an election under section 904(b)(1) (relating to election of overall limitation on foreign tax credit) is in effect, then the amount of taxes paid or accrued to foreign countries and possessions of the United States by such Western Hemisphere trade corporations which may be taken into account for purposes of section 901 shall be reduced by the amount by which the amount of such taxes exceeds the amount of the tax computed under section 1503(a) with respect to the portion of the consolidated taxable income attributable to such corporations.

Section 901 of the Code provides, in part, that the foreign tax credit allowed by that section is subject to the applicable limitation of section 904. Section 904(a)(2) provides, in part, that under the overall limitation, the amount of the credit in respect of the taxes paid to all foreign countries shall not exceed the same proportion of the tax against which such tax is taken which the taxpayer's taxable income from sources without the United States bears to his entire taxable income for the same taxable year.

Section 904(d) of the Code and section 1.904-2 of the Income Tax Regulations provide, in effect and in part, that where taxes paid to any foreign country for any taxable year beginning after December 31, 1957, exceed the amount allowable as a credit under the overall limitation the excess may be carried back to the two preceding years and then carried forward to the five succeeding years as a credit provided the carryback and carryover years are also years for which the overall limitation was in effect.

The specific issue in the instant case is whether the amount of the foreign tax reduction qualifies for the carryback and carryover provisions of section 904(d) of the Code.

In general, section 901 of the Code allows a credit for those foreign taxes determined to be eligible for allowance as credits. The credits so allowed are then subject to the limitation of section 904(a). Section 904(a) operates only upon those foreign taxes otherwise eligible for allowance as credits under section 901. Section 904(d), in turn, operates upon those taxes disallowed as credits under section 904(a).

In the instant case, the foreign taxes were disallowed because of the limita-

tion of section 1503(b)(1) of the Code.

Accordingly, it is held that the amount of the foreign tax reduction required by section 1503(b)(1) of the Code does not qualify for the foreign tax credit carryback and carryover provisions of section 904(d).

Subchapter B. Related Rules
Part II.—Certain Controlled Corporations

Section 1563.—Definitions and Special Rules

26 CFR 1.1563-1: Definition of controlled group of corporations and component members.

Surtax exemptions; parent-subsidiary member of a combined group. A parent-subsidiary group as defined under section 1563(a)(1) of the Code which had elected, for the taxable year ending December 31, 1965, to claim multiple surtax exemptions, terminated its election in 1968 and, as the result of the Tax Reform Act of 1969, became by definition a member of a combined group including additional corporations that were brother-sister corporations under section 1563(a)(3). The combined group is not a continuation of or a successor to the parent-subsidiary controlled group and is not precluded by sections 1562 and 1564 from making a multiple surtax election for the year 1970.

Rev. Rul. 74-73

Advice has been requested whether, under the circumstances described below, a combined group of corporations is a continuation of, or the successor to, a parent-subsidiary controlled group.

A parent-subsidiary group, as defined under section 1563(a)(1) of the Internal Revenue Code of 1954, elected for the taxable year ended December 31, 1965, to claim multiple surtax exemptions pursuant to section 1562. This election was terminated in 1968 by the consent of the group in accordance with the provisions of section 1562(c)(1).

As a result of section 401(c) of the Tax Reform Act of 1969, which changed the definition of a "brother-sister controlled group" of corporations under section 1563(a)(2) of the Code, the parent-subsidiary group, by definition, was expanded in relevant part to include certain other corporations.

The definition as expanded includes these additional corporations that had been in existence in the instant case since 1965, owned and controlled by the same persons having stock ownership in the parent corporation. The additional three corporations had not been considered "brother-sister" corporations with the parent prior to the Tax Reform Act of 1969 as the stock of all four corporations was owned by more than one person within the meaning of section 1563(a).

Because of the expansion of the definition of "brother-sister controlled group," the parent-subsidiary group became part of a combined group under section 1563(a)(3).

The specific questions raised are (1) whether the combined group is a continuation of, or a successor to, the parent-subsidiary group, and (2) whether the combined group is precluded by reason of section 1562(d) of the Code from making a multiple surtax election pursuant to sections 1562 and 1564 for the taxable year ended December 31, 1970, since the parent-subsidiary group had terminated its multiple surtax election effective December 31, 1968.

Section 1561 of the Code permits, in effect, only one surtax exemption for a controlled group.

Section 1562 of the Code provides, in part, an elective exception to section 1561 and permits additional surtax exemptions for members of a controlled group.

Section 1562(d) of the Code and section 1.1562-4 of the Income Tax Regulations provide that if an election under section 1562(a)(1) by a controlled group of corporations is terminated for any reason described in section 1562(c), such group (and any successor group as defined under section 1.1562-5(c) of the regulations) shall not be eligible to make an election under section 1562(a) with respect to any December 31 before the sixth December 31 after the December 31 with respect to which such termination was effective.

Section 1.1562-5(a) of the regulations provides the rules for determining when a parent-subsidiary controlled group shall be considered as remaining in existence. There is no provision for the situation where the component members of a parent-subsidiary group become members of a combined group as a result of an amendment to section 1563(a)(2) of the Code. Section 1563(b)(4) of the Code however provides that a corporation may be the component member of only one group. Since the component members of the parent-subsidiary group have become members of a combined group, the parent-subsidiary group which they had formed has ceased to exist. The combined group is the new controlled group.

Under section 1.1562-5(c) of the regulations, the combined group is not a successor to the parent-subsidiary group since there had been no transfer of stock (either by sale, exchange, distribution, contribution to capital or otherwise) involved in the formation of the new combined group.

Accordingly, it is held that the combined group is not a continuation of or a successor to the parent-subsidiary group and, therefore, is not precluded by reason of section 1562(d) of the Code from making an election under sections 1562 and 1564 with respect to the taxable year ended December 31, 1970.

Subtitle B.—Estate and Gift Taxes
Chapter 11.—Estate Tax
Subchapter A.—Estates of Citizens or Residents
Part II.—Credits Against Tax

Section 2014.—Credit for Foreign Death Taxes

26 CFR 20.2014: Statutory provisions; credit for foreign death taxes.
(Also Sections 2101, 2102, 2104, 2105, 2106, 2107, 2108, 2501, 2511, 6018, 6325; 20.2101, 20.2102, 20.2104, 20.2105, 20.2106-1, 20.2107, 20.2108, 20.6018, 20.6325-1, 25.2501-1, 25.2511.)

T.D. 7296 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 20.—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954; PART 25.—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Estate tax credit for foreign death taxes; estate and gift tax treatment of transfers of nonresidents not citizens of the United States

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

By a notice of proposed rule making appearing in the Federal Register for December 30, 1972 (37 F.R. 28901), amendments to the Estate Tax Regulations (26 CFR Part 20) and the Gift Tax Regulations (26 CFR Part 25) were proposed in order to conform such regulations to the amendments of the Internal Revenue Code of 1954 made by sections 106 (b)(3), 108, and 109 of the Foreign Investors Tax Act of 1966 (80 Stat. 1570, 1571, and 1574) [Pub. L. 89-809, 1966-2 C.B. 656] and by section 435(b) of the Tax Reform Act of 1969 (83 Stat. 625) [Pub. L. 91-172, 1969-3 C.B. 10].

Section 106(b)(3) of the 1966 Act limits the applicability of the "similar credit" requirement of section 2014 of the Code to estates of decedents who were citizens of a foreign country with respect to which a special Presidential proclamation has been made. The "similar credit" requirement conditions the allowance under section 2014 of a Federal estate tax credit for foreign death taxes upon the allowance by the foreign country imposing the death taxes of a similar credit to the estates of U. S. citizens who were residents of that foreign country. The amendment applies to estates of decedents dying after November 13, 1966.

Section 108 of the 1966 Act relates to the Federal estate tax treatment of estates of decedents who were nonresidents not citizens of the United States and who died after November 13, 1966. It increases the exemption from $2,000 to $30,000, substantially reduces the tax rates, provides a special limitation on the amount of the credit allowable for State death taxes, provides new situs rules with respect to debt obligations and similar property, and adds new sections 2107 and 2108 to the Code. New section 2107 provides for special estate tax treatment in cases of certain decedents who made tax-motivated expatriations from the United States. New section 2108 provides for the application of certain estate tax provisions as they existed prior to amendment by the 1966 Act, in cases of estates of decedents who were residents of a foreign country with respect to which the President has made a special proclamation resulting from the President's finding, among other things, that the foreign country imposes a more burdensome tax on estates of citizens of the United States who were not residents of that foreign country than the United States imposes on the estates of decedents who were residents of that foreign country and not citizens of the United States.

Section 109 of the 1966 Act relates to the Federal gift tax treatment of gifts made after December 31, 1966, by nonresidents not citizens of the United States. It provides that gifts of intangible personal property by such donors are not subject to the gift tax except in cases of certain donors who made tax-motivated expatriations from the United States. It also provides special situs rules for stock in a corporation and for debt obligations and similar property.

Section 435(b) of the 1969 Act changed the date from "December 31, 1972" to "December 31, 1969" in the rule under section 2104(c) of the Code relating to deposits with a domestic banking branch of a foreign corporation. This rule provides generally that, in the case of decedents dying after December 31, 1969, deposits with a branch in the United States of a foreign corporation have a situs in the United States if the branch is engaged in the commercial banking business.

No objection to the rules proposed having been received during the 30-day period prescribed in the notice, the amendments of the regulations as so proposed are hereby adopted.

ESTATE TAX REGULATIONS
(26 CFR Part 20)

Paragraph 1. Section 20.0-1 is amended by striking out the last sentence of paragraph (a)(1) and by revising paragraph (b)(1), (2), and (4) to read as follows:

§ 20.0-1 Introduction.

* * * * *

(b) *Scope of regulations*—(1) *Estates of citizens or residents.* Subchapter A of chapter 11 of the Code pertains to the taxation of the estate of a person who was a citizen or a resident of the United States at the time of his death. A "resident" de-

[1] The publication of this Treasury Decision in 38 F.R. 34190, dated December 12, 1973, contains the proposed rulemaking published in 37 F.R. 28901, dated December 30, 1972, with modifications thereto.

cedent is a decedent who, at the time of his death, had his domicile in the United States. The term "United States," as used in the Estate Tax Regulations, includes only the States and the District of Columbia. The term also includes the Territories of Alaska and Hawaii prior to their admission as States. See section 7701 (a) (9). A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal. For the meaning of the term "citizen of the United States" as applied in a case where the decedent was a resident of a possession of the United States, see § 20.2208-1. The regulations pursuant to subchapter A are set forth in §§ 20.2001 to 20.2056(e)-3.

(2) *Estates of nonresidents not citizens.* Subchapter B of chapter 11 of the Code pertains to the taxation of the estate of a person who was a nonresident not a citizen of the United States at the time of his death. A "nonresident" decedent is a decedent who, at the time of his death, had his domicile outside the United States under the principles set forth in subparagraph (1) of this paragraph. (See, however, section 2202 with respect to missionaries in foreign service.) The regulations pursuant to subchapter B are set forth in §§ 20.2101 to 20.2108.

* * * * *

(4) *Procedure and administration provisions.* Subtitle F of the Internal Revenue Code contains some sections which are applicable to the Federal estate tax. The regulations pursuant to those sections are set forth in §§ 20.6001 to 20.7404. Such regulations do not purport to be all the regulations on procedure and administration which are pertinent to estate tax matters. For the remainder of the regulations on procedure and administration which are pertinent to estate tax matters, see Part 301 (Procedure and Administration Regulations) of this chapter.

* * * * *

Par. 2. Section 20.0-2 is amended by revising paragraph (c) to read as follows:

§ 20.0-2 General description of tax.

* * * * *

(c) *Method of determining tax; estate of nonresident not a citizen.* In general, the method to be used in determining the Federal estate tax imposed upon the transfer of an estate of a decedent who was a nonresident not a citizen of the United States is similar to that described in paragraph (b) of this section with respect to the estate of a citizen or resident. Briefly stated, the steps are as follows: First, ascertain the sum of the value of that part of the decedent's "entire gross estate" which at the time of his death was situated in the United States (see §§ 20.2103-1 and 20.2104-1) and, in the case of an estate of an expatriate to which section 2107 applies, any amounts includible in his gross estate under section 2107(b) (see paragraph (b) of § 20.2107-1); second, determine the value of the taxable estate by subtracting from the amount determined under the first step the amount of the allowable deductions (see § 20.2106-1); third, compute the gross estate tax on the taxable estate (see § 20.2101-1); and fourth, subtract from the gross estate tax the total amount of any allowable credits in order to arrive at the net estate tax payable (see § 20.2102-1 and paragraph (c) of § 20.2107-1).

Par. 3. Section 20.2013-2 is amended by revising paragraph (c) to read as follows:

§ 20.2013-2 "First limitation."

* * * * *

(c) (1) For purposes of the ratio stated in paragraph (a) of this section, the "transferor's adjusted taxable estate" referred to as factor "D" is the amount of the transferor's taxable estate (or net estate) decreased by the amount of any "death taxes" paid with respect to his gross estate and increased by the amount of the exemption allowed in computing his taxable estate (or net estate). The amount of the transferor's taxable estate (or net estate) is determined in accordance with the provisions of § 20.2051-1 in the case of a citizen or resident of the United States or of § 20.2106-1 in the case of a nonresident not a citizen of the United States (or the corresponding provisions of prior regulations). The term "death taxes" means the Federal estate tax plus all other estate, inheritance, legacy, succession, or similar death taxes imposed by, and paid to, any taxing authority, whether within or without the United States. However, only the net amount of such taxes paid is taken into consideration.

(2) The amount of the exemption depends upon the citizenship and residence of the transferor at the time of his death. Except in the case of a decedent described in section 2209 (relating to certain residents of possessions of the United States who are considered nonresidents not citizens), if the decedent was a citizen or resident of the United States, the exemption is the $60,000 authorized by section 2052 (or the corresponding provisions of prior law). If the decedent was a nonresident not a citizen of the United States, or is considered under section 2209 to have been such a nonresident, the exemption is the $30,000 or $2,000, as the case may be, authorized by section 2106(a) (3) (or the corresponding provisions of prior law), or such larger amount as is authorized by section 2106(a) (3) (B) or may have been allowed as an exemption pursuant to the prorated exemption provisions of an applicable death tax convention. See § 20.2052-1

and paragraph (a)(3) of § 20.2106-1.

* * * * *

Par. 4. Section 20.2013-3 is amended by revising paragraph (a)(1) to read as follows:

§ 20.2013-3 "Second limitation."

(a) The amount of the Federal estate tax attributable to the transferred property in the present decedent's estate is the "second limitation." Thus, the credit is limited to the difference between—

(1) The net estate tax payable (see paragraph (b)(5) or (c), as the case may be, of § 20.0-2) with respect to the present decedent's estate, determined without regard to any credit for tax on prior transfers under section 2013 or any credit for foreign death taxes claimed under the provisions of a death tax convention, and

* * * * *

Par. 5. Section 20.2013-4 is amended by revising that part of paragraph (a) which precedes example (1) therein to read as follows:

§ 20.2013-4 Valuation of property transferred.

(a) For purposes of section 2013 and §§ 20.2013 to 20.2013-6, the value of the property transferred to the decedent is the value at which the property was included in the transferor's gross estate for the purpose of the Federal estate tax (see sections 2031, 2032, 2103, and 2107, and the regulations thereunder) reduced as indicated in paragraph (b) of this section. If the decedent received a life estate or remainder or other limited interest in property included in the transferor's gross estate, the value of the interest is determined as of the date of the transferor's death on the basis of recognized valuation principles (see especially §§ 20.2031-7 and 20.2031-10). The application of this paragraph may be illustrated by the following examples:

* * * * *

Par. 6. Section 20.2014 is amended by revising section 2014 (a), by adding a new section 2014 (h), and by revising the historical note. These amended and added provisions read as follows:

§ 20.2014 Statutory provisions; credit for foreign death taxes.

Sec. 2014. *Credit for foreign death taxes*—(a) *In general.* The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any foreign country in respect of any property situated within such foreign country and included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent). The determination of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States.

* * * * *

(h) *Similar credit required for certain alien residents.* Whenever the President finds that—

(1) A foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

(2) Such foreign country, when requested by the United States to do so has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

(3) It is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death,

the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death.

[Sec. 2014 as amended by sec. 102(c)(2), Technical Amendments Act 1958 (72 Stat. 1674) [Pub. L. 85-866, 1958-3 C.B. 254]; sec. 2, Act of Aug. 21, 1959 (Pub. L. 86-175, 1959-2 C.B. 686, 73 Stat. 397); sec. 106(b)(3), Foreign Investors Tax Act 1966 (80 Stat. 1570) [Pub. L. 89-809, 1966-2 C.B. 656]]

Par. 7. Section 20.2014-1 is amended by revising paragraph (a)(1) and (3) and by adding a new paragraph (c). These amended and added provisions read as follows:

§ 20.2014-1 Credit for foreign death taxes.

(a) *In general.* (1) A credit is allowed under section 2014 against the Federal estate tax for any estate, inheritance, legacy, or succession taxes actually paid to any foreign country (hereinafter referred to as "foreign death taxes"). The credit is allowed only for foreign death taxes paid (i) with respect to property situated within the country to which the tax is paid, (ii) with respect to property included in the decedent's gross estate, and (iii) with respect to the decedent's estate. The credit is allowable to the estate of a decedent who was a citizen of the United States at the time of his death. The credit is also allowable, as provided in paragraph (c) of this section, to the estate of a decedent who was a resident but not a citizen of the United States at the time of his death. The credit is not allowable to the estate of a decedent who was neither a citizen nor a resident of the United States at the time of his death. See paragraph (b)(1) of § 20.0-1 for the meaning of the term "resident" as applied to a decedent. The credit is allowable not

only for death taxes paid to foreign countries which are states in the international sense, but also for death taxes paid to possessions or political subdivisions of foreign states. With respect to the estate of a decedent dying after September 2, 1958, the term "foreign country," as used in this section and §§ 20.2014-2 to 20.2014-6, includes a possession of the United States. See §§ 20.2011-1 and 20.2011-2 for the allowance of a credit for death taxes paid to a possession of the United States in the case of a decedent dying before September 3, 1958. No credit is allowable for interest or penalties paid in connection with foreign death taxes.

* * * * *

(3) No credit is allowable under section 2014 in connection with property situated outside of the foreign country imposing the tax for which credit is claimed. However, such a credit may be allowable under certain death tax conventions. In the case of a tax imposed by a political subdivision of a foreign country, credit for the tax shall be allowed with respect to property having a situs in that foreign country, even though, under the principles described in this subparagraph, the property has a situs in a political subdivision different from the one imposing the tax. Whether or not particular property of a decedent is situated in the foreign country imposing the tax is determined in accordance with the same principles that would be applied in determining whether or not similar property of a nonresident decedent not a citizen of the United States is situated within the United States for Federal estate tax purposes. See §§ 20.2104-1 and 20.2105-1. For example, under § 20.2104-1 shares of stock are deemed to be situated in the United States only if issued by a domestic corporation. Thus, a share of corporate stock is regarded as situated in the foreign country imposing the tax only if the issuing corporation is incorporated in that country. Further, under § 20.2105-1 amounts receivable as insurance on the life of a nonresident not a citizen of the United States at the time of his death are not deemed situated in the United States. Therefore, in determining the credit under section 2014 in the case of a decedent who was a citizen or resident of the United States, amounts receivable as insurance on the life of the decedent and payable under a policy issued by a corporation incorporated in a foreign country are not deemed situated in such foreign country. In addition, under § 20.2105-1 in the case of an estate of a nonresident not a citizen of the United States who died on or after November 14, 1966, a debt obligation of a domestic corporation is not considered to be situated in the United States if any interest thereon would be treated under section 862 (a)(1) as income from sources without the United States by reason of section 861(a)(1)(B) (relating to interest received from a domestic corporation less than 20 percent of whose gross income for a 3-year period was derived from sources within the United States). Accordingly, a debt obligation the primary obligor on which is a corporation incorporated in the foreign country imposing the tax is not considered to be situated in that country if, under circumstances corresponding to those described in § 20.2105-1 less than 20 percent of the gross income of the corporation for the 3-year period was derived from sources within that country. Further, under § 20.2104-1 in the case of an estate of a nonresident not a citizen of the United States who died before November 14, 1966, a bond for the payment of money is not situated within the United States unless it is physically located in the United States. Accordingly, in the case of the estate of a decedent dying before November 14, 1966, a bond is deemed situated in the foreign country imposing the tax only if it is physically located in that country. Finally, under § 20.2105-1 moneys deposited in the United States with any person carrying on the banking business by or for a nonresident not a citizen of the United States who died before November 14, 1966, and who was not engaged in business in the United States at the time of death are not deemed situated in the United States. Therefore, an account with a foreign bank in the foreign country imposing the tax is not considered to be situated in that country under corresponding circumstances.

* * * * *

(c) *Credit allowable to estate of resident not a citizen.* (1) In the case of an estate of a decedent dying before November 14, 1966, who was a resident but not a citizen of the United States, a credit is allowed to the estate under section 2014 only if the foreign country of which the decedent was a citizen or subject, in imposing foreign death taxes, allows a similar credit to the estates of citizens of the United States who were resident in that foreign country at the time of death.

(2) In the case of an estate of a decedent dying on or after November 14, 1966, who was a resident but not a citizen of the United States, a credit is allowed to the estate under section 2014 without regard to the similar credit requirement of subparagraph (1) of this paragraph unless the decedent was a citizen or subject of a foreign country with respect to which there is in effect at the time of the decedent's death a Presidential proclamation, as authorized by section 2014 (h), reinstating the similar credit requirement. In the case of an estate of a decedent who was a resident of the United States and a citizen or subject of a foreign country with respect to which such a proclamation has been made, and who dies while the proclamation is in effect, a credit is allowed under section 2014 only if that foreign

country, in imposing foreign death taxes, allows a similar credit to the estates of citizens of the United States who were resident in that foreign country at the time of death. The proclamation authorized by section 2014(h) for the reinstatement of the similar credit requirement with respect to the estates of citizens or subjects of a specific foreign country may be made by the President whenever he finds that—

(i) The foreign country, in imposing foreign death taxes, does not allow a similar credit to the estates of citizens of the United States who were resident in the foreign country at the time of death,

(ii) The foreign country, after having been requested to do so, has not acted to provide a similar credit to the estates of such citizens, and

(iii) It is in the public interest to allow the credit under section 2014 to the estates of citizens or subjects of the foreign country only if the foreign country allows a similar credit to the estates of citizens of the United States who were resident in the foreign country at the time of death.

The proclamation for the reinstatement of the similar credit requirement with respect to the estates of citizens or subjects of a specific foreign country may be revoked by the President. In that case, a credit is allowed under section 2014, to the estate of a decedent who was a citizen or subject of that foreign country and a resident of the United States at the time of death, without regard to the similar credit requirement if the decedent dies after the proclamation reinstating the similar credit requirement has been revoked.

Par. 8. Section 20.2014-2 is amended by revising the example in paragraph (a) to read as follows:

§ 20.2014-2 "First limitation."

(a) * * *

Example. At the time of his death on June 1, 1966, the decedent, a citizen of the United States, owned stock in X Corporation (a corporation organized under the laws of Country Y) valued at $80,000. In addition, he owned bonds issued by Country Y valued at $80,000. The stock and bond certificates were in the United States. Decedent left by will $20,000 of the stock and $50,000 of the Country Y bonds to his surviving spouse. He left the rest of the stock and bonds to his son. Under the situs rules referred to in paragraph (a)(3) of § 20.2014-1 the stock is deemed situated in Country Y while the bonds are deemed to have their situs in the United States. (The bonds would be deemed to have their situs in Country Y if the decedent had died on or after November 14, 1966.) There is no death tax convention in existence between the United States and Country Y. The laws of Country Y provide for inheritance taxes computed as follows:

Inheritance tax of surviving spouse:	
Value of stock	$20,000
Value of bonds	50,000
Total value	70,000
Tax (16 percent rate)	11,200
Inheritance tax of son:	
Value of stock	60,000
Value of bonds	30,000
Total value	90,000
Tax (16 percent rate)	14,400

The "first limitation" on the credit for foreign death taxes is:

$$\frac{\$20{,}000 + \$60{,}000 \text{ (factor C of the ratio stated at § 20.2014-2(a))}}{\$70{,}000 + \$90{,}000 \text{ (factor D of the ratio stated at § 20.2014-2(a))}} \times (\$11{,}200 + \$14{,}400) \text{ (factor B of the ratio stated at § 20.2014-2(a))} = 12{,}800$$

* * * * *

Par. 9. Section 20.2014-3 is amended by revising subdivision (i) in Example (1) in paragraph (c) to read as follows:

§ 20.2014-3 "Second limitation."

* * * * *

(c) * * *

Example (1). (i) Decedent, a citizen and resident of the United States at the time of his death on February 1, 1967, left a gross estate of $1,000,000 which includes the following: shares of stock issued by a domestic corporation, valued at $750,000; bonds issued in 1960 by the United States and physically located in foreign Country X, valued at $50,000; and shares of stock issued by a Country X corporation, valued at $200,000, with respect to which death taxes were paid to Country X. Expenses, indebtedness, etc., amounted to $60,000. Decedent specifically bequeathed $40,000 of the stock issued by the Country X corporation to a U.S. charity and left the residue of his estate, in equal shares, to his son and daughter. The gross Federal estate tax is $266,500, and the credit for State death taxes is $27,600. Under the situs rules referred to in paragraph (a)(3) of § 20.2014-1, the shares of stock issued by the Country X corporation comprise the only property deemed to be situated in Country X. (The bonds also would be deemed to have their situs in Country X if the decedent had died before November 14, 1966.)

* * * * *

Par. 10. Section 20.2014-4 is amended by revising subdivision (i) of the example in paragraph (a)(1), subparagraph (1) of the example in paragraph (b), and the example in paragraph (c) to read as follows:

§ 20.2014-4 Application of credit in cases involving a death tax convention.

(a) *In general.* (1) * * *

Example. (i) Decedent, a citizen of the United States and a domiciliary of foreign Country X at the time of his death on December 1, 1966, left a gross estate of $1,000,000 which

includes the following: shares of stock issued by a Country X corporation, valued at $400,000; bonds issued in 1962 by the United States and physically located in Country X, valued at $350,000; and real estate located in the United States, valued at $250,000. Expenses, indebtedness, etc., amounted to $50,000. Decedent left his entire estate to his son. There is in effect a death tax convention between the United States and Country X which provides for the allowance of credit by the United States for succession duties imposed by the national government of Country X. The gross Federal estate tax is $307,200, and the credit for State death taxes is $33,760. Country X imposed a net succession duty on the stocks and bonds of $180,000. Under the situs rules referred to in paragraph (a)(3) of § 20.2014-1, the shares of stock comprise the only property deemed to be situated in Country X. (If the decedent had died before November 14, 1966, the bonds also would be deemed to have their situs in Country X.) Under the convention, both the stocks and the bonds are deemed to be situated in Country X. In this example all figures are rounded to the nearest dollar.

* * * * *

(b) *Taxes imposed by both a foreign country and a political subdivision thereof.* * * *

Example. (1) Decedent, a citizen of the United States and a domiciliary of Province Y of foreign Country X at the time of his death on February 1, 1966, left a gross estate of $250,000 which includes the following: bonds issued by Country X physically located in Province Y, valued at $75,000; bonds issued by Province Z of Country X and physically located in the United States, valued at $50,000; and shares of stock issued by a domestic corporation, valued at $125,000. Decedent left his entire estate to his son. Expenses, indebtedness, etc., amounted to $26,000. The Federal estate tax after allowance of the credit for State death taxes is $38,124. Province Y imposed a death tax of 8 percent on the Country X bonds located therein which amounted to $6,000. No death tax was imposed by Province Z. Country X imposed a death tax of 15 percent on the Country X bonds and the Province Z bonds which amounted to $18,750 before allowance of any credit for the death tax of Province Y. Country X allows against its death taxes a credit for death taxes paid to any of its provinces on property which it also taxes, but only to the extent of one-half of the Country X death tax attributable to the property, or the amount of death taxes paid to its province, whichever is less. Country X, therefore, allowed a credit of $5,625 for the death taxes paid to Province Y. There is in effect a death tax convention between the United States and Country X which provides for allowance of credit by the United States for death taxes imposed by the national government of Country X. The death tax convention provides that in computing the "first limitation" for the credit under the convention, the tax of Country X is not to be reduced by the amount of the credit allowed for provincial taxes. Under the situs rules described in paragraph (a)(3) of § 20.2014-1, only the Country X bonds located in Province Y are deemed situated in Country X. (The bonds issued by Province Z also would be deemed to have their situs in Country X if the decedent had died on or after November 14, 1966.) Under the convention, both the Country X bonds and the Province Z bonds are deemed to be situated in Country X. In this example all figures are rounded to the nearest dollar.

* * * * *

(c) *Taxes imposed by two foreign countries with respect to the same property.* * * *

Example. The decedent, a citizen of the United States and a domiciliary of Country X at the time of his death on May 1, 1967, left a taxable estate which included bonds issued by Country Z and physically located in Country X. Each of the three countries involved imposed death taxes on the Country Z bonds. Assume that under the provisions of a treaty between the United States and Country X the estate is entitled to a credit against the Federal estate tax for death taxes imposed by Country X on the bonds in the maximum amount of $20,000. Assume, also, that since the decedent died after November 13, 1966, so that under the situs rules referred to in paragraph (a)(3) of § 20.2014-1 the bonds are deemed to have their situs in Country Z, the estate is entitled to a credit against the Federal estate tax for death taxes imposed by Country Z on the bonds in the maximum amount of $10,000. Finally, assume that the Federal estate tax attributable to the bonds is $25,000. Under these circumstances, the credit allowed the estate with respect to the bonds would be limited to $25,000.

Par. 11. Section 20.2015-1 is amended by revising paragraph (a) to read as follows:

§ 20.2015-1 Credit for death taxes on remainders.

(a) If the executor of an estate elects under section 6163(a) to postpone the time for payment of any portion of the Federal estate tax attributable to a reversionary or remainder interest in property, credit is allowed under sections 2011 and 2014 against that portion of the Federal estate tax for State death taxes and foreign death taxes attributable to the reversionary or remainder interest if the State death taxes or foreign death taxes are paid and if credit therefor is claimed either—

(1) Within the time provided for in sections 2011 and 2014, or

(2) Within the time for payment

of the tax imposed by section 2001 or 2101 as postponed under section 6163 (a) and as extended under section 6163(b) (on account of undue hardship) or, if the precedent interest terminated before July 5, 1958, within 60 days after the termination of the preceding interest or interests in the property.

The allowance of credit, however, is subject to the other limitations contained in sections 2011 and 2014 and, in the case of the estate of a decedent who was a nonresident not a citizen of the United States, in section 2102 (b).

* * * * *

If the taxable estate is:	The tax shall be:
Not over $100,000	5 percent of the taxable estate.
Over $100,000 but not over $500,000	$5,000, plus 10 percent of excess over $100,000.
Over $500,000 but not over $1,000,000	$45,000, plus 15 percent of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$120,000, plus 20 percent of excess over $1,000,000.
Over $2,000,000	$320,000, plus 25 percent of excess over $2,000,000.

[Sec. 2101 as amended by sec. 108(a), Foreign Investors Tax Act 1966 (80 Stat. 1571) [Pub. L. 89-809, 1966-2 C.B. 656]]

Par. 13. Section 20.2101-1 is amended to read as follows:

§ 20.2101-1 Estates of nonresidents not citizens; tax imposed.

Section 2101 imposes a tax on the transfer of the taxable estate of a nonresident who was not a citizen of the United States at the time of his death. In the case of an estate of a decedent dying on or after November 14, 1966, the tax is generally computed at the rates specified in section 2101(a). However, see section 2107 (relating to estates of certain decedents who lost their United States citizenship after March 8, 1965, with a principal purpose of avoiding U.S. income, estate, or gift tax) and section 2108 (relating to estates of decedents who at the time of death were residents of a foreign country with respect to which the President has proclaimed the application of pre-1967 estate tax provisions). Sections 2107 and 2108 provide for the computation of the tax in certain cases of estates of nonresidents not citizens at the rates specified in section 2001 (which is applicable to estates of citizens or residents of the United States). In the case of an estate of a decedent dying before November 14, 1966, the tax imposed by section 2101 is computed at the same rates as the tax which is imposed by section 2001 on the transfer of the taxable estate of a citizen or resident of the United States. For a general description of the method to be used in determining the net estate tax payable in the case of an estate of a nonresident not a citizen, see paragraph (c) of § 20.0-2. For the meanings of the terms "resident," "nonresident," and "United States," as applied to a decedent for purposes of the estate tax, see paragraph (b)(1) and (2) of § 20.0-1. For the presumption applying to the residence of missionaries, see section 2202 and § 20.2202-1. For the liability of the executor for the payment of the tax, see section 2002 and § 20.2002-1.

Par. 14. Section 20.2102 is amended to read as follows:

§ 20.2102 Statutory provisions; credits against tax.

Sec. 2102. *Credits against tax*—(a) *In general.* The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), subject to the special limitation provided in subsection (b).

(b) *Special limitation.* The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term "State death taxes" means the taxes described in section 2011(a).

[Sec. 2102 as amended by sec. 108(b), Foreign Investors Tax Act 1966 (80 Stat. 1572)]

Par. 15. Section 20.2102-1 is amended to read as follows:

§ 20.2102-1 Estates of nonresidents not citizens; credits against tax.

(a) *In general.* In arriving at the net estate tax payable with respect to the transfer of an estate of a non-

resident who was not a citizen of the United States at the time of his death, the following credits are subtracted from the tax imposed by section 2101:

(1) The State death tax credit under section 2011, to the extent permitted by section 2102(b) and paragraph (b) of this section;

(2) The gift tax credit under section 2012; and

(3) The credit under section 2013 for tax on prior transfers.

Except as provided in section 2102(b) and paragraph (b) of this section (relating to a special limitation on the amount of the credit for State death taxes), the amount of each of these credits is determined in the same manner as that prescribed for its determination in the case of estates of citizens or residents of the United States. See §§ 20.2011 through 20.2013-6. Subject to the additional special limitation contained in section 2102(b) in the case of section 2015, the provisions of sections 2015 and 2016, relating respectively to the credit for death taxes on remainders and the recovery of taxes claimed as a credit, are applicable with respect to the credit for State death taxes in the case of the estates of nonresidents not citizens. However, no credit is allowed under section 2014 for foreign death taxes.

(b) *Special limitation*—(1) *In general.* In the case of estates of decedents dying on or after November 14, 1966, other than estates the estate tax treatment of which is subject to a Presidential proclamation made pursuant to section 2108(a), the maximum credit allowable under section 2011 for State death taxes against the tax imposed by section 2101 on the transfer of estates of nonresidents not citizens of the United States is an amount which bears the same ratio to the maximum credit computed as provided in section 2011(b) (and without regard to this special limitation) as the value of the property (determined in the same manner as that prescribed in paragraph (b) of § 20.2031-1 for the estates of citizens or residents of the United States) in respect of which a State death tax was actually paid and which is included in the gross estate under section 2103 or, if applicable, section 2107(b) bears to the value (as so determined) of the total gross estate under section 2103 or 2107(b). For purposes of this special limitation, the term "State death taxes" means the taxes described in section 2011(a) and paragraph (a) of § 20.2011-1.

(2) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example (1). A, a nonresident not a citizen of the United States, died on February 15, 1967, owning real property in State Z valued at $50,000 and stock in various domestic corporations valued at $100,000 and not subject to death taxes in any State. State Z's inheritance tax actually paid with respect to the real property in State Z is $2,000. A's taxable estate for Federal estate tax purposes is $110,000, in respect of which the maximum credit under section 2011 would be $720 in the absence of the special limitation contained in section 2102(b). However, under section 2102(b) and this paragraph the amount of the maximum credit allowable in respect to A's estate for State death taxes is limited to the amount which bears the same ratio to $720 (the maximum credit computed as provided in section 2011(b)) as $50,000 (the value of the property in respect of which a State death tax was actually paid and which is included in A's gross estate under section 2103) bears to $150,000 (the value of A's total gross estate under section 2103). Accordingly, the maximum credit allowable under section 2102 and this section for all State death taxes actually paid is $240 ($720 × $50,000/$150,000).

Example (2). B, a nonresident not a citizen of the United States, died on January 15, 1967, owning real property in State X valued at $100,000, real property in State Y valued at $200,000, and stock in various domestic corporations valued at $300,000 and not subject to death taxes in any State. States X and Y both impose inheritance taxes. State X has, in addition to its inheritance tax, an estate tax equal to the amount by which the maximum State death tax credit allowable to an estate against its Federal estate tax exceeds the amount of the inheritance tax imposed by State X plus the amount of death taxes paid to other States. State Y has no estate tax. The amount of the inheritance tax actually paid to State X with respect to the real property situated in State X is $4,000; the amount of the inheritance tax actually paid to State Y with respect to the real property situated in State Y is $9,000. B's taxable estate for Federal estate tax purposes is $550,000, in respect of which the maximum credit under section 2011 would be $14,400 in the absence of the special limitation contained in section 2102(b). However, under section 2102(b) and this paragraph the amount of the maximum credit allowable in respect of B's estate for State death taxes is limited to the amount which bears the same ratio to $14,400 (the maximum credit computed as provided in section 2011(b)) as $300,000 (the value of the property in respect of which a State death tax was actually paid and which is included in B's gross estate under section 2103) bears to $600,000 (the value of B's total gross estate under section 2103). Accordingly, the maximum credit allowable under section 2102 and this section for all State death taxes actually paid is $7,200 ($14,400 × $300,000/$600,000), and the estate tax of State X is not applicable to B's estate.

Par. 16. Section 20.2103-1 is amended to read as follows:

§ 20.2103-1 Estates of nonresidents not citizens; "entire gross estate."

The "entire gross estate" wherever situated of a nonresident who was not a citizen of the United States at the time of his death is made up in the same way as the "gross estate" of a citizen or resident of the United States. See §§ 20.2031 through 20.2044-1. See paragraphs (a) and (c) of § 20.2031-1 for the circumstances under which real property situated outside the United States is excluded from the gross estate of a citizen or resident of the United States. However, except as provided in section 2107(b) with respect to the estates of certain expatriates, in the case of a nonresident not a citizen, only that part of the entire gross estate which on the date of the decedent's death is situated in the United States is included in his taxable estate. In fact, property situated outside the United States need not be disclosed on the return unless section 2107 is applicable, certain deductions are claimed, or information is specifically requested. See §§ 20.2106-1, 20.2106-2, and 20.2107-1. For a description of property considered to be situated in the United States, see § 20.2104-1. For a description of property considered to be situated outside the United States, see § 20.2105-1.

Par. 17. Section 20.2104 is amended by adding a new subsection (c) to section 2104 and a historical note. These added provisions read as follows:

§ 20.2104 Statutory provisions; property within the United States.

Sec. 2104. *Property within the United States.* * * *

(c) *Debt obligations.* For purposes of this subchapter, debt obligations of—

(1) A United States person, or

(2) The United States, a State of any political subdivision thereof, or the District of Columbia, owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States. With respect to estates of decedents dying after December 31, 1969, deposits with a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business, shall, for purposes of this subchapter, be deemed property within the United States. This subsection shall not apply to a debt obligation to which section 2105(b) applies or to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(B) as income from sources without the United States.

[Sec. 2104 as amended by sec. 108(c), Foreign Investors Tax Act 1966 (80 Stat. 1572) [Pub. L. 89-809, 1966-2 C.B. 656]; sec. 435(b), Tax Reform Act 1969 (83 Stat. 625) [Pub. L. 91-172, 1969-3 C.B. 10]]

Par. 18. Section 20.2104-1 is amended by revising subpararaphs (3), (4), (5), and (6) of paragraph (a) and by adding new subparagraphs (7) and (8) at the end of such paragraph. These amended and added provisions read as follows:

§ 20.2104-1 Estates of nonresidents not citizens; property within the United States.

(a) *In general.* * * *

(3) In the case of an estate of a decedent dying before November 14, 1966, written evidence of intangible personal property which is treated as being the property itself, such as a bond for the payment of money, if it is physically located in the United States; except that this subparagraph shall not apply to obligations of the United States (but not its instrumentalities) issued before March 1, 1941, if the decedent was not engaged in business in the United States at the time of his death. See section 2106(c).

(4) Except as specifically provided otherwise in this section or in § 20.2105-1 (which specific exceptions, in the case of estates of decedents dying on or after November 14, 1966, cause this subparagraph to have relatively limited applicability), intangible personal property the written evidence of which is not treated as being the property itself, if it is issued by or enforceable against a resident of the United States or a domestic corporation or governmental unit.

(5) Shares of stock issued by a domestic corporation, irrespective of the location of the certificates (see, however, paragraph (i) of § 20.2105-1 for a special rule with respect to certain withdrawable accounts in savings and loan or similar associations).

(6) In the case of an estate of a decedent dying before November 14, 1966, moneys deposited in the United States by or for the decedent with any person carrying on the banking business, if the decedent was engaged in business in the United States at the time of his death.

(7) In the case of an estate of a decedent dying on or after November 14, 1966, except as specifically provided otherwise in paragraph (d), (i), (j), or (l) of § 20.2105-1, any debt obligation, including a bank deposit, the primary obligor of which is—

(i) A United States person (as defined in section 7701(a)(30)), or

(ii) The United States, a State or any political subdivision thereof, the District of Columbia, or any agency or instrumentality of any such government.

This subparagraph applies irrespective of whether the written evidence of the debt obligation is treated as being the property itself or whether the decedent was engaged in business in the United States at the time of his death. For purposes of this subparagraph and paragraphs (k) and (l) of § 20.2105-1, a debt obligation on which there are two or more primary obligors shall be apportioned among such obligors, taking into account to the extent appro-

priate under all the facts and circumstances any choate or inchoate rights of contribution existing among such obligors with respect to the indebtedness. The term "agency or instrumentality," as used in subdivision (ii) of this subparagraph, does not include a possession of the United States or an agency or instrumentality of a possession. Currency is not a debt obligation for purposes of this subparagraph.

(b) In the case of an estate of a decedent dying on or after January 1, 1970, except as specifically provided otherwise in paragraph (i) or (l) of § 20.2105-1, deposits with a branch in the United States of a foreign corporation, if the branch is engaged in the commercial banking business, whether or not the decedent was engaged in business in the United States at the time of his death.

* * * * *

Par. 19. Section 20.2105 is amended by revising section 2105(b) and adding a historical note. These amended and added provisions read as follows:

§ 20.2105 Statutory provisions; property without the United States.

Sec. 2105. *Property without the United States.* * * *

(b) *Certain bank deposits, etc.* For purposes of this subchapter—

(1) Amounts described in section 861(c) if any interest thereon, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(A) as income from sources without the United States, and

(2) Deposits with a foreign branch of a domestic corporation or domestic partnership, if such branch is engaged in the commercial banking business,

shall not be deemed property within the United States.

* * * * *

[Sec. 2105 as amended by sec. 108(d), Foreign Investors Tax Act 1966 (80 Stat. 1572)]

Par. 20. Section 20.2105-1 is amended by revising paragraphs (c) and (h) and by adding new paragraphs (i), (j), (k), and (l). These amended and added provisions read as follows:

§ 20.2105-1 Estates of nonresidents not citizens; property without the United States.

* * * * *

(c) In the case of an estate of a decedent dying before November 14, 1966, written evidence of intangible personal property which is treated as being the property itself, such as a bond for the payment of money, if it is not physically located in the United States.

* * * * *

(h) In the case of an estate of a decedent dying before November 14, 1966, moneys deposited in the United States by or for the decedent with any person carrying on the banking business, if the decedent was not engaged in business in the United States at the time of his death.

(i) In the case of an estate of a decedent dying on or after November 14, 1966, and before January 1, 1976, any amount deposited in the United States which is described in section 861(c) (relating to certain bank deposits, withdrawable accounts, and amounts held by an insurance company under an agreement to pay interest), if any interest thereon, were such interest received by the decedent at the time of his death, would be treated under section 862(a)(1) as income from sources without the United States by reason of section 861(a)(1)(A) (relating to interest on amounts described in section 861(c) which is not effectively connected with the conduct of a trade or business within the United States) and the regulations thereunder. If such interest would be treated by reason of those provisions as income from sources without the United States only in part, the amount described in section 861(c) shall be considered situated outside the United States in the same proportion as the part of the interest which would be treated as income from sources without the United States bears to the total amount of the interest. This paragraph applies whether or not the decedent was engaged in business in the United States at the time of his death, and, except with respect to amounts described in section 861(c)(3) (relating to amounts held by an insurance company under an agreement to pay interest), whether or not the deposit or other amount is in fact interest-bearing.

(j) In the case of an estate of a decedent dying on or after November 14, 1966, deposits with a branch outside of the United States of a domestic corporation or domestic partnership, if the branch is engaged in the commercial banking business. This paragraph applies whether or not the decedent was engaged in business in the United States at the time of his death, and whether or not the deposits, upon withdrawal, are payable in currency of the United States.

(k) In the case of an estate of a decedent dying on or after November 14, 1966, except as specifically provided otherwise in paragraph (a)(8) of § 20.2104-1 with respect to estates of decedents dying on or after January 1, 1970, any debt obligation, including a bank deposit, the primary obligor of which is neither—

(1) A United States person (as defined in section 7701(a)(30)), nor

(2) The United States, a State or any political subdivision thereof, the District of Columbia, or any agency or instrumentality of any such government.

This paragraph applies irrespective of whether the written evidence of the debt obligation is treated as being the property itself or whether the decedent was engaged in business in the United States at the time of his death. See paragraph (a)(7) of § 20.2104-1 for

the treatment of a debt obligation on which there are two or more primary obligors. The term "agency or instrumentality," as used in subparagraph (2) of this paragraph, does not include a possession of the United States or an agency or instrumentality of a possession. Currency is not a debt obligation for purposes of this paragraph.

(l) In the case of an estate of a decedent dying on or after November 14, 1966, any debt obligation to the extent that the primary obligor on the debt obligation is a domestic corporation, if any interest thereon, were the interest received from such obligor by the decedent at the time of his death, would be treated under section 862 (a)(1) as income from sources without the United States by reason of section 861(a)(1)(B) (relating to interest received from a domestic corporation less than 20 percent of whose gross income for a 3-year period was derived from sources within the United States) and the regulations thereunder. For such purposes the 3-year period referred to in section 861 (a)(1)(B) is the period of 3 years ending with the close of the domestic corporation's last taxable year terminating before the decedent's death. This paragraph applies whether or not (1) the obligation is in fact interest-bearing, (2) the written evidence of the debt obligation is treated as being the property itself, or (3) the decedent was engaged in business in the United States at the time of his death. See paragraph (a)(7) of § 20.2104-1 for the treatment of a debt obligation on which there are two or more primary obligors.

Par. 21. Section 20.2106-1 is amended by revising that part of paragraph (a) which precedes subparagraph (1), paragraph (a)(3), and paragraph (c) to read as follows:

§ 20.2106-1 Estates of nonresidents not citizens; taxable estate; deductions in general.

(a) The taxable estate of a nonresident who was not a citizen of the United States at the time of his death is determined by adding the value of that part of his gross estate which, at the time of his death, is situated in the United States and, in the case of an estate to which section 2107 (relating to expatriation to avoid tax) applies, any amounts includible in his gross estate under section 2107(b), and then subtracting from the sum thereof the total amount of the following deductions:

* * * * *

(3)(i) In the case of a decedent who is considered under the provisions of section 2209 to be a "nonresident not a citizen of the United States," an exemption which is the greater of—

(*a*)(*1*) $30,000 if the decedent died on or after November 14, 1966, or (*2*) $2,000 if the decedent died after September 14, 1960, and before November 14, 1966; or

(*b*) That proportion of $60,000 (the exemption authorized by section 2052) which the value of that part of the decedent's gross estate which is situated in the United States at the time of his death bears to the value of the decedent's entire gross estate wherever situated.

(ii) In the case of every other decedent who was a nonresident not a citizen of the United States at the time of his death, an exemption in the amount of—

(*a*) $30,000 if the decedent died on or after November 14, 1966, and the estate tax treatment of his estate is not subject to a Presidential proclamation made pursuant to a section 2108(a) (relating to the application of pre-1967 estate tax provisions in the case of a foreign country which imposes a more burdensome tax than the United States), or

(*b*) $2,000 if the decedent died before November 14, 1966, or the estate tax treatment of his estate is subject to such a proclamation,

unless a death tax convention provides for another amount, such as a prorated exemption similar to that described in subdivision (i)(*b*) of this subparagraph.

* * * * *

(c)(1) The exemption described in paragraph (a)(3)(i) of this section may be illustrated by the following example:

Example. The decedent, who died on January 15, 1967, is considered by reason of the provisions of section 2209 to be a nonresident not a citizen of the United States. He was a resident of the Virgin Islands, and his entire gross estate wherever situated included real property valued at $30,000 which was situated in the Virgin Islands and shares of stock issued by domestic corporations, valued at $45,000. Under §§ 20.2104-1 and 20.2105-1 only the shares of stock are considered to be situated in the United States. The amount described in paragraph (a)(3)(i)(*b*) of this section is $36,000, computed as follows:

$$\frac{\$45{,}000 \text{ (value of property in United States)}}{\$75{,}000 \text{ (value of entire gross estate wherever situated)}} \times \$60{,}000 = \$36{,}000$$

Since the amount so computed exceeds $30,000 (the amount specified in paragraph (a)(3)(i)(*a*) of this section), the exemption to be allowed the decedent's estate is $36,000.

(2) In connection with the provisions of section 2106(c), see paragraph (a)(3) and (7) of § 20.2104-1 and paragraph (d) of § 20.2105-1.

Par. 22. Section 20.2106-2 is amended by revising that part of paragraph (a) which follows subparagraph (1), and paragraph (c), to read as follows:

§ 20.2106-2 Estates of nonresidents not citizens; deductions for expenses, losses, etc.

(a) * * *

(2) That proportion of other deduc-

tions under sections 2053 and 2054 is allowed which the value of that part of the decedent's gross estate situated in the United States at the time of his death bears to the value of the decedent's entire gross estate wherever situated. It is immaterial whether the amounts to be deducted were incurred or expended within or without the United States. For purposes of this subparagraph, an amount which is includible in the decedent's gross estate under section 2107(b) with respect to stock in a foreign corporation shall be included in the value of the decedent's gross estate situated in the United States.

No deduction is allowed under this paragraph unless the value of the decedent's entire gross estate is disclosed in the estate tax return. See paragraph (b) of § 20.2106-1.

* * * * *

(c) The application of this section and of § 20.2106-1 may be illustrated by the following examples:

Example (1). The decedent died on June 1, 1967, a nonresident not a citizen of the United States. He was not an expatriate to whom section 2107(a) applies, and the estate tax treatment of his estate is not subject to a Presidential proclamation made pursuant to section 2108(a). His gross estate wherever situated amounts to $1,000,000, of which $200,000 (or 20 percent) represents the value of the property having its situs within the United States. The funeral expenses, administration expenses, and claims against the estate aggregate $175,000, and there are charitable bequests, for use within the United States, amounting to $25,000. The decedent's taxable estate is determined as follows:

That part of the entire gross estate situated in the United States		$200,000
Deductions for expenses and claims (20% of $175,000)	$35,000	
Charitable deduction	25,000	
Exemption	30,000	90,000
Taxable estate		110,000

For the manner of computing the tax on the taxable estate, see § 20.2101-1.

Example (2). Assume the same facts as those given in example (1) except that the decedent was an expatriate to whom section 2107(a) applies and that the part of his property not situated in the United States includes shares of stock issued by a foreign corporation with respect to which $300,000 is included in his gross estate under section 2107(b). Thus, the value of that part of the gross estate situated in the United States equals $500,000 (or 50 percent of $1,000,000). In this case, the decedent's taxable estate is determined as follows:

That part of the entire gross estate situated in the United States	$200,000	
Amount included in gross estate under section 2107 (b) and deemed situated in the United States	300,000	
Total		$500,000
Deductions for expenses and claims (50% of $175,000)	87,500	
Charitable deduction	25,000	
Exemption	30,000	142,500
Taxable estate		357,500

For the manner of computing the tax on the taxable estate, see § 20.2107-1.

Par. 23. Immediately after § 20.2106-2 the following new sections are inserted:

§ 20.2107 Statutory provisions; expatriation to avoid tax.

Sec. 2107. *Expatriation to avoid tax*—(a) *Rate of tax.* A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this section, if after March 8, 1965, and within the 10-year period ending with the date of death such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

(b) *Gross estate.* For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

(1) If such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

(2) If such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of his death, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation,

then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his

death, shall be included in the gross estate of such decedent. For purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, he owned such stock.

(c) *Credits.* The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with section 2102.

(d) *Exception for loss of citizenship for certain causes.* Subsection (a) shall not apply to the transfer of the estate of a decedent whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

(e) *Burden of proof.* If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes in respect of the transfer of his estate, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on the executor of such individual's estate.

[Sec. 2107 as added by sec. 108(f), Foreign Investors Tax Act 1966 (80 Stat. 1573) [Pub. L. 89-809, 1966-2 C.B. 656]]

§ 20.2107-1 Expatriation to avoid tax.

(a) *Rate of tax.* The tax imposed by section 2107(a) on the transfer of the taxable estates of certain nonresident expatriate decedents who were formerly citizens of the United States is computed in accordance with the table contained in section 2001, relating to the rate of the tax imposed on the transfer of the taxable estates of decedents who were citizens or residents of the United States. Except for any amounts included in the gross estate solely by reason of section 2107(b) and paragraph (b)(1)(ii) and (iii) of this section, the value of the taxable estate to be used in this computation is determined as provided in section 2106 and § 20.2106-1. The decedents to which section 2107(a) and this section apply are described in paragraph (d) of this section.

(b) *Gross estate*—(1) *Determination of value*—(i) *General rule.* Except as provided in subdivision (ii) of this subparagraph with respect to stock in certain foreign corporations, for purposes of the tax imposed by section 2107(a) the value of the gross estate of every estate the transfer of which is subject to the tax imposed by that section is determined as provided in section 2103 and § 20.2103-1.

(ii) *Amount includible with respect to stock in certain foreign corporations.* If at the time of his death a nonresident expatriate decedent the transfer of whose estate is subject to the tax imposed by section 2107(a)—

(*a*) Owned (within the meaning of section 958(a) and the regulations thereunder) 10 percent or more of the total combined voting power of all classes of stock entitled to vote in a foreign corporation, and

(*b*) Owned (within the meaning of section 958(a) and the regulations thereunder), or is considered to have owned (by applying the ownership rules of section 958(b) and the regulations thereunder), more than 50 percent of the total combined voting power of all classes of stock entitled to vote in such foreign corporation,

then section 2107(b) requires the inclusion in the decedent's gross estate, in addition to amounts otherwise includible therein under subdivision (i) of this subparagraph, of an amount equal to that proportion of the fair market value (determined at the time of the decedent's death or, if so elected by the executor of the decedent's estate, on the alternate valuation date as provided in section 2032) of the stock of such foreign corporation owned (within the meaning of section 958(a) and the regulations thereunder) by the decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death.

(iii) *Rules of application.* (*a*) In determining the proportion of the fair market value of the stock which is includible in the gross estate under subdivision (ii) of this subparagraph, the fair market value of the foreign corporation's assets situated in the United States and of its total assets shall be determined without reduction for any outstanding liabilities of the corporation.

(*b*) For purposes of subdivision (ii) of this subparagraph, the foreign corporation's assets which are situated in the United States shall be all its property which, by applying the provisions of sections 2104, 2105, and §§ 20.2104-1 and 20.2105-1, would be considered to be situated in the United States if such property were property of a nonresident who was not a citizen of the United States.

(*c*) For purposes of subdivision (ii)(*a*) of this subparagraph, a decedent is treated as owning stock in a foreign corporation at the time of his death to the extent he owned (within the meaning of section 958(a) and the regulations thereunder) the stock at the time he made a transfer of the stock in a transfer described in sections 2035 and 2038, inclusive (relating respectively to transfers made in contemplation of death, transfers with a retained life estate, transfers taking effect at death, and revocable transfers). For purposes of subdivision (ii)(*b*) of this subparagraph, a decedent is treated as owning stock in a foreign corporation at the time of his death to the extent he owned (within the meaning of section 958(a) and the regulations thereunder), or is considered to have owned (by applying

the ownership rules of section 958(b) and the regulations thereunder), the stock at the time he made a transfer of the stock in a transfer described in sections 2035 to 2038, inclusive. In applying the proportion rule of section 2107(b) and subdivision (ii) of this subparagraph where a decedent is treated as owning stock in a foreign corporation at the time of his death by reason of having transferred his interest in such stock in a transfer described in sections 2035 to 2038, inclusive, the proportionate value of the interest includible in his gross estate is based upon the value as of the applicable valuation date described in section 2031 or 2032 of the amount, determined as of the date of transfer, of his interest in the stock. See example (2) in subparagraph (2) of this paragraph.

(*d*) For purposes of applying subdivision (ii)(*b*) of this subparagraph, the same shares of stock may not be counted more than once. See example (2) in subparagraph 2 of this paragraph.

(*e*) The principles applied in paragraph (b) of § 1.957-1 of this chapter (Income Tax Regulations) for determining what constitutes total combined voting power of all classes of stock entitled to vote in a foreign corporation for purposes of section 957 (a) shall be applied in determining what constitutes total combined voting power of all classes of stock entitled to vote in a foreign corporation for purposes of section 2107(b) and subdivision (ii) of this subparagraph. In applying such principles under this paragraph changes in language shall be made, where necessary, in order to treat the nonresident expatriate decedent, rather than U.S. shareholders, as owning such total combined voting power.

(2) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example (1). (a) At the time of his death, H, a nonresident expatriate decedent the transfer of whose estate is subject to the tax imposed by section 2107(a), owned a 60-percent interest in M Company, a foreign partnership, which in turn owned stock issued by N Corporation, a foreign corporation. The stock in N Corporation held by M Company, which constituted 50 percent of the total combined voting power of all classes of stock entitled to vote in N Corporation, was valued at $50,000 at the time of H's death. In additon, W. H's wife, also a nonresident not a citizen of the United States, owned at the time of H's death stock in N Corporation constituting 25 percent of the total combined voting power of all classes of stock entitled to vote in that corporation. The fair market value of the assets of N Corporation which, at the time of H's death, were situated in the United States constituted 40 percent of the fair market value of all assets of that corporation. It is assumed for purposes of this example that the executor of H's estate has not elected to value the estate on the alternate valuation date provided in section 2032.

(b) The test contained in subparagraph (1)(ii)(*a*) of this paragraph is met since at the time of his death H indirectly owned (within the meaning of section 958(a) and the regulations thereunder) 30 percent (60% of 50%) of the total combined voting power of all classes of stock entitled to vote in N Corporation; and the test contained in subparagraph (1)(ii)(*b*) of this paragraph is met since at such time H owned or is considered to have owned (within the meaning of section 958(a) and (b) and the regulations thereunder) 55 percent of the total combined voting power of all classes of stock entitled to vote in N Corporation (having constructive ownership of his wife's 25 percent, in addition to his own indirect ownership of 30 percent, of the total combined voting power). Accordingly, $12,000 is included in H's gross estate by reason of section 2107(b) and this paragraph. This $12,000 is the amount which is equal to 40 percent (the percentage of the fair market value of N Corporation's assets which were situated within the United States at H's death) of $30,000 (the fair market value of the stock then owned by H within the meaning of section 958(a) and the regulations thereunder, *i.e.*, H's 60-percent interest in the $50,000 fair market value of stock held by M Company).

Example (2). (a) Assume the same facts as those given in example (1) except that H made a transfer to W in contemplation of his death (within the meaning of section 2035) of his 60-percent interest in M Company, that on the date of the transfer M Company held stock in N Corporation constituting 80 percent of the total combined voting power of all classes of stock entitled to vote in that corporation (rather than the 50 percent of total combined voting power held by M Company on the date of H's death), and that the 80 percent of total combined voting power owned by M Company on the date of the transfer is valued at $70,000 on that date and at $85,000 at the time of H's death. It is assumed for purposes of this example that the 60-percent interest in M Company was held by W at the time of H's death.

(b) The test contained in subparagraph (1)(ii)(*a*) of this paragraph is met since, under subparagraph (1)(iii)(*c*) of this paragraph, H is treated as owning (within the meaning of section 958(a) and the regulations thereunder), at the time of his death, the 48 percent (60% of 80%) of the total combined voting power of all classes of stock entitled to vote in N Corporation represented by his transferred interest in M Company; and the test contained in subparagraph (1)(ii)(*b*) of this paragraph is met since, under that subparagraph and subparagraph (1)(iii)(*c*) of this paragraph, H is treated as owning (within the meaning of section 958(a) or (b)), at the time of his death, 73 percent (48%

plus 25%) of the total combined voting power of all classes of stock entitled to vote in N Corporation. Accordingly, $20,400 is included in H's gross estate by reason of section 2107 (b) and this paragraph. This $20,400 is the amount which is equal to 40 percent (the percentage of the fair market value of N Corporation's assets which were situated within the United States at H's death) of $51,000 (the fair market value at the time of H's death of the transferred interest which under subparagraph (1)(iii) (*c*) of this paragraph H is considered to own within the meaning of section 958(a) and the regulations thereunder at that time, *i.e.*, the 60-percent interest in the $85,000 fair market value at that time of the 80-percent total combined voting power held by M Company on the date of transfer).

(c) The fact that the stock in N Corporation owned by M Company is considered under subparagraph (1)(ii)(*b*) of this paragraph to be owned by H for two independent reasons (*i.e.*, under section 958(a) and the regulations thereunder, because H transferred his 60-percent interest in M Company to W in contemplation of death, and under section 958(b) and the regulations thereunder, because H is considered to own the stock in N Corporation indirectly owned by his wife, W, by reason of her ownership of such transferred interest) does not cause the shares of stock represented by the transferred interest in M Company to be counted twice in determining whether the test contained in that subparagraph is met. See subparagraph (1)(iii)(*d*) of this paragraph.

Example (3). (a) At the time of his death, H, a nonresident expatriate decedent the transfer of whose estate is subject to the tax imposed by section 2107(a), owned a 40-percent beneficial interest in a domestic trust; at that time he also directly owned stock in P Corporation, a foreign corporation, constituting 15 percent of the total combined voting power of all classes of stock entitled to vote in that corporation. The trust owned stock in P Corporation constituting 51 percent of the total combined voting power of all classes of stock entitled to vote in that corporation. The stock in P Corporation owned directly by H was valued at $20,000 on the alternate valuation date determined pursuant to an election under section 2032. The fair market value of the assets of P Corporation which, at the time of H's death, were situated in the United States constituted 20 percent of the fair market value of all assets of that corporation.

(b) By reason of section 958(b)(2) and the regulations thereunder, the trust is considered to own all the stock entitled to vote in P Corporation since it owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote in that corporation. The test contained in subparagraph (1)(ii)(*a*) of this paragraph is met since at the time of his death H owned (within the meaning of section 958(a) and the regulations thereunder) 15 percent of the total combined voting power of all classes of stock entitled to vote in P Corporation; the stock in P Corporation owned by the trust is not considered to have been owned by H under section 958 (a)(2) since the trust is not a foreign trust. In addition, the test contained in subparagraph (1)(ii)(*b*) of this paragraph is met since at the time of his death H owned or is considered to have owned (within the meaning of section 958(a) and (b) and the regulations thereunder) 55 percent of the total combined voting power of all classes of stock entitled to vote in that corporation (his 15 percent directly owned plus his 40 percent (40% of 100%) considered to be owned). Accordingly, $4,000 is included in H's gross estate by reason of section 2107 (b) and this paragraph. This $4,000 is the amount which is equal to 20 percent (the percentage of the fair market value of P Corporation's assets which were situated within the United States at H's death) of $20,000 (the fair market value of the stock then owned by H within the meaning of section 958(a) and the regulations thereunder). In addition, the value of H's interest in the domestic trust is included in his gross estate under section 2103 to the extent it constitutes property having a situs in the United States.

(c) *Credits.* Credits against the tax imposed by section 2107(a) are allowed for any amounts determined in accordance with section 2102 and § 20.2102-1 (relating to credits against the estate tax for State death taxes, gift tax, and tax on prior transfers). In computing the special limitation on the credit for State death taxes contained in section 2102(b) and paragraph (b) of § 20.2102-1, amounts included in the gross estate under section 2107(b) and paragraph (b)(1) of this section are to be taken into account.

(d) *Decedents to whom the tax imposed by section 2107(a) applies*—(1) *General rule.* The tax imposed by section 2107(a) applies to the transfer of the taxable estate of every decedent nonresident not a citizen of the United States dying on or after November 14, 1966, who lost his U.S. citizenship after March 8, 1965, and within the 10-year period ending with the date of his death, except in the case of the estate of a decedent whose loss of U.S. citizenship either—

(i) Resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487); or

(ii) Did not have for one of its principal purposes (but not necessarily its only principal purpose) the avoidance of Federal income, estate, or gift tax.

Section 301(b) of the Immigration and Nationality Act provides generally that a U.S. citizen, who is born outside the United States of parents one of

whom is an alien and the other is a U.S. citizen who was physically present in the United States for a specified period, shall lose his U.S. citizenship if, within a specified period preceding the age of 28 years, he fails to be continuously physically present in the United States for at least 5 years. Section 350 of that Act provides that under certain circumstances a person, who at birth acquired the nationality of the United States and of a foreign country and who has voluntarily sought or claimed benefits of the nationality of any foreign country, shall lose his U.S. nationality if, after attaining the age of 22 years, he has a continuous residence for 3 years in the foreign country of which he is a national by birth. Section 355 of that Act provides that a person having U.S. nationality, who is under 21 years of age and whose residence is in a foreign country with or under the legal custody of a parent who loses his U.S. nationality under specified circumstances, shall lose his U.S. nationality if he has or acquires the nationality of that foreign country and attains the age of 25 years without having established his residence in the United States. Section 2107 and this section do not apply to the transfer of any estate the estate tax treatment of which is subject to a Presidential proclamation made pursuant to section 2108(a) (relating to the application of pre-1967 estate tax provisions in the case of a foreign country which imposes a more burdensome tax than the United States).

(2) *Burden of proof*—(i) *General rule.* In determining for purposes of subparagraph (1)(ii) of this paragraph whether a principal purpose for the loss of U.S. citizenship by a decedent was the avoidance of Federal income, estate, or gift tax, the Commissioner must first establish that it is reasonable to believe that the decedent's loss of U.S. citizenship would, but for section 2107 and this section, result in a substantial reduction in the sum of (*a*) the Federal estate tax and (*b*) all estate, inheritance, legacy, and succession taxes imposed by foreign countries and political subdivisions thereof, in respect of the transfer of the decedent's estate. Once the Commissioner has so established, the burden of proving that the loss of citizenship by the decedent did not have for one of its principal purposes the avoidance of Federal income, estate, or gift tax shall be on the executor of the decedent's estate.

(ii) *Tentative determination of substantial reduction in Federal and foreign death taxes.* In the absence of complete factual information, the Commissioner may make a tentative determination, based on the information available, that the decedent's loss of U.S. citizenship would, but for section 2107 and this section, result in a substantial reduction in the sum of the Federal and foreign death taxes described in subdivision (i)(*a*) and (*b*) of this subparagraph. This tentative determination may be based upon the fact that the laws of the foreign country of which the decedent became a citizen and the laws of the foreign country of which the decedent was a resident at the time of his death, including the laws of any political subdivisions of those foreign countries, would ordinarily result, in the case of an estate of a nonexpatriate decedent having the same citizenship and residence as the decedent, in liability for total death taxes under such laws substantially lower than the amount of the Federal estate tax which would be imposed on the transfer of a comparable estate of a citizen of the United States. In the absence of a preponderance of evidence to the contrary, this tentative determination shall be sufficient to establish that it is reasonable to believe that the decedent's loss of U.S. citizenship would, but for section 2107 and this section, result in a substantial reduction in the sum of the Federal and foreign death taxes described in subdivision (i)(*a*) and (*b*) of this subparagraph.

§ 20.2108 Statutory provisions; application of pre-1967 estate tax provisions.

Sec. 2108. *Application of pre-1967 estate tax provisions*—(a) *Imposition of more burdensome tax by foreign country.* Whenever the President finds that—

(1) Under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

(2) Such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome that the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

(3) It is in the public interest to apply pre-1967 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country.

the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to amendments made to sections 2101 (relating to tax imposed), 2102 (relating to credits against tax), 2106 (relating to taxable estate), and 6018 (relating to estate tax returns) on or after the date of enactment of this section.

(b) *Alleviation of more burdensome tax.* Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under sub-

section (a) have been modified so that the tax on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country is no longer more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to subsection (a).

(c) *Notification of Congress required.* No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

(d) *Implementation by regulations.* The Secretary or his delegate shall prescribe such regulations as may be necessary or appropriate to implement this section.

[Sec. 2108 as added by sec. 108(f), Foreign Investors Tax Act 1966 (80 Stat. 1573) [Pub. L. 89-809, 1966-2 C.B. 656]]

Par. 24. Section 20.6018 is amended by revising section 6018(a)(2) and adding a historical note. These amended and added provisions read as follows:

§ 20.6018 Statutory provisions; estate tax returns.

Sec. 6018. *Estate tax returns*—(a) *Returns by executor.* * * *

(2) *Nonresidents not citizens of the United States.* In the case of the estate of every nonresident not a citizen of the United States if that part of the gross estate which is situated in the United States exceeds $30,000, the executor shall make a return with respect to the estate tax imposed by subtitle B.

* * * * *

[Sec. 6018 as amended by sec. 108(g), Foreign Investors Tax Act 1966 (80 Stat. 1574)]

Par. 25. Section 20.6018-1 is amended by revising paragraph (b) to read as follows:

§ 20.6018-1 Returns.

* * * * *

(b) *Estates of nonresidents not citizens*—(1) *In general.* Except as provided in subparagraph (2) of this paragraph, a return must be filed on Form 706 or Form 706NA for the estate of every nonresident not a citizen of the United States if the value of that part of the gross estate situated in the United States on the date of his death exceeded $30,000 in the case of a decedent dying on or after November 14, 1966, or $2,000 in the case of a decedent dying before November 14, 1966. Under certain conditions the return may be made only on Form 706. See the instructions on Form 706NA for circumstances under which that form may not be used. Duplicate copies of the return are not required to be filed. For the contents of the return, see § 20.6018-3. For the determination of the gross estate situated in the United States, see §§ 20.2103-1 and 20.2104-1.

(2) *Certain estates of decedents dying on or after November 14, 1966.* In the case of an estate of a nonresident not a citizen of the United States dying on or after November 14, 1966—

(i) *Transfers subject to the tax imposed by section 2107(a).* If the transfer of the estate is subject to the tax imposed by section 2107(a) (relating to expatriation to avoid tax), any amounts includible in the decedent's gross estate under section 2107(b) are to be added to the value on the date of his death of that part of his gross estate situated in the United States, for purposes of determining under subparagraph (1) of this paragraph whether his gross estate exceeded $30,000 on the date of his death.

(ii) *Transfers subject to a Presidential proclamation.* If the transfer of the estate is subject to tax pursuant to a Presidential proclamation made under section 2108(a) (relating to Presidential proclamations of the application of pre-1967 estate tax provisions), the return must be filed on Form 706 or Form 706NA if the value on the date of the decedent's death of that part of his gross estate situated in the United States exceeded $2,000.

* * * * *

Par. 26. Section 20.6018-3 is amended by revising paragraph (b) to read as follows:

§ 20.6018-3 Returns; contents of returns.

* * * * *

(b) *Nonresidents not citizens.* The return of an estate of a decedent who was not a citizen or resident of the United States at the time of his death must contain the following information: (1) An itemized list of that part of the gross estate situated in the United States (see §§ 20.2103-1 and 20.2104-1); (2) in the case of an estate the transfer of which is subject to the tax imposed by section 2107(a) (relating to expatriation to avoid tax), a list of any amounts with respect to stock in a foreign corporation which are includible in the gross estate under section 2107(b), together with an explanation of how the amounts were determined; (3) an itemized list of any deductions claimed (see §§ 20.2106-1 and 20.2106-2); (4) the amount of the taxable estate (see § 20.2106-1); and (5) the gross estate tax, reduced by any credits against the tax (see § 20.2102-1). For the disallowance of certain deductions if the return does not disclose that part of the gross estate not situated in the United States, see §§ 20.2106-1 and 20.2106-2.

* * * * *

Par. 27. Section 20.6018-4 is amended by revising paragraph (c) to read as follows:

§ 20.6018-4 Returns; documents to

accompany the return.

* * * * *

(c) In the case of an estate of a nonresident not a citizen of the United States, the executor must also file with the return, but only if deductions are claimed or the transfer of the estate is subject to the tax imposed by section 2107(a) (relating to expatriation to avoid tax), a copy of the inventory of property filed under the foreign death duty act; or, if no such inventory was filed, a certified copy of the inventory filed with the foreign court of probate jurisdiction.

* * * * *

Par. 28. Section 20.6036-1 is amended by revising paragraph (a) to read as follows:

§ 20.6036-1 Notice of qualification as executor.

(a) *Preliminary notice for estates of decedents dying before January 1, 1971.* (1) A preliminary notice must be filed on Form 704 for the estate of every citizen or resident of the United States whose gross estate exceeded $60,000 in value on the date of his death.

(2) In the case of a nonresident not a citizen of the United States dying on or after November 14, 1966—

(i) Subject to the provisions of subdivisions (ii) and (iii) of this subparagraph, a preliminary notice must be filed on Form 705 if that part of the decedent's gross estate situated in the United States exceeded $30,000 in value on the date of his death (see §§ 20.2103-1 and 20.2104-1).

(ii) If the transfer of the estate is subject to the tax imposed by section 2107(a) (relating to expatriation to avoid tax), any amounts includible in the decedent's gross estate under section 2107(b) are to be added to the value on the date of his death of that part of his gross estate situated in the United States, for purposes of determining under subdivision (i) of this subparagraph whether his gross estate exceeded $30,000 in value on the date of his death.

(iii) If the transfer of the estate is subject to tax pursuant to a Presidential proclamation made under section 2108(a) (relating to Presidential proclamations of the application of pre-1967 estate tax provisions), a preliminary notice must be filed on Form 705 if the value on the date of the decedent's death of that part of his gross estate situated in the United States exceeded $2,000.

(3) A preliminary notice must be filed on Form 705 for the estate of every nonresident not a citizen of the United States dying before November 14, 1966, if the value on the date of his death of that part of his gross estate situated in the United States exceeded $2,000.

(4) The value of the gross estate on the date of death governs with respect to the requirement for filing the preliminary notice irrespective of whether the value of the gross estate is, at the executor's election, finally determined pursuant to the provisions of section 2032 as of a date subsequent to the date of death. If there is doubt as to whether the gross estate exceeds $60,000, $30,000, or $2,000, as the case may be, the notice shall be filed as a matter of precaution in order to avoid the possibility of penalties attaching.

(5) The primary purpose of the preliminary notice is to advise the Internal Revenue Service of the existence of taxable estates, and filing shall not be delayed beyond the period provided for in § 20.6071-1 merely because of uncertainty as to the exact value of the assets. The estimate of the gross estate called for by the notice shall be the best approximation of value which can be made within the time allowed. Duplicate copies of the preliminary notice are not required to be filed.

(6) For criminal penalties for failure to file a notice and filing a false or fraudulent notice, see sections 7203, 7207, and 7269. See § 20.6091-1 for the place for filing the notice. See § 20.6071-1 for the time for filing the notice.

* * * * *

Par. 29. Section 20.6325-1 is amended by revising paragraph (b) to read as follows:

§ 20.6325-1 Release of lien or partial discharge of property; transfer certificates in nonresident estates.

* * * * *

(b)(1) In the case of a nonresident not a citizen of the United States dying on or after November 14, 1966—

(i) Subject to the provisions of subdivisions (ii) and (iii) of this subparagraph, a transfer certificate is not required with respect to the transfer of any property of the decedent if the value on the date of his death of that part of his gross estate situated in the United States did not exceed $30,000.

(ii) If the transfer of the estate is subject to the tax imposed by section 2107(a) (relating to expatriation to avoid tax), any amounts which are includible in the decedent's gross estate under section 2107(b) are to be added to the value on the date of his death of that part of his gross estate situated in the United States, for purposes of determining under subdivision (i) of this subparagraph whether his gross estate did or did not exceed $30,000 in value on the date of his death.

(iii) If the transfer of the estate is subject to tax pursuant to a Presidential proclamation made under section 2108(a) (relating to Presidential proclamations of the application of pre-1967 estate tax provisions), a transfer certificate is not required with respect to the transfer of any property of the decedent if the value on the date of his death of that part of his gross estate situated in the United States did not exceed $2,000.

(2) In the case of a nonresident not a citizen of the United States dying before November 14, 1966, a transfer certificate is not required with respect to the transfer of (i) any prop-

erty of the decedent, if the value on the date of his death of that part of his gross estate situated in the United States did not exceed $2,000, or (ii) bonds owned by such a decedent if it is shown that the bonds were not physically situated in the United States at the time of his death.

(3) A corporation, transfer agent, bank, trust company, or other custodian will not incur liability for a transfer of the decedent's property without a transfer certificate if the corporation or other person, having no information to the contrary, first receives from the executor or other responsible person, who may be reasonably regarded as in possession of the pertinent facts, a statement of the facts relating to the estate showing that the sum of the value on the date of the decedent's death of that part of his gross estate situated in the United States, and, if applicable, any amounts includible in his gross estate under section 2107(b), is such an amount that, pursuant to the provisions of subparagraph (1) or subparagraph (2)(i) of this paragraph, a transfer certificate is not required.

(4) For the determination of the gross estate situated in the United States, see §§ 20.2103-1 and 20.2104-1.

* * * * *

GIFT TAX REGULATIONS
(26 CFR Part 25)

Paragraph 30. Section 25.0-1 is amended by striking out the last sentence of paragraph (a)(1).

Par. 31. Section 25.2501-1 is amended by revising paragraph (a) to read as follows:

§ 25.2501-1 Imposition of tax.

(a) *In general.* (1) The tax applies to all transfers by gift of property, wherever situated, by an individual who is a citizen or resident of the United States, to the extent the value of the transfers exceeds the amount of the exclusions authorized by section 2503 and the deductions authorized by sections 2521, 2522, and 2523. For the first calendar quarter of 1971 and each calendar quarter thereafter, the tax described in this subparagraph is imposed on the transfer of property by gift during such calendar quarter. For calendar years after 1954 and before 1971, the tax described in this subparagraph is imposed on the transfer of property by gift during such calendar year.

(2) The tax does not apply to a transfer by gift of intangible property before January 1, 1967, by a nonresident not a citizen of the United States, unless the donor was engaged in business in the United States during the calendar year in which the transfer was made.

(3) (i) The tax does not apply to any transfer by gift of intangible property on or after January 1, 1967, by a nonresident not a citizen of the United States (whether or not he was engaged in business in the United States), unless the donor is an expatriate who lost his U.S. citizenship after March 8, 1965, and within the 10-year period ending with the date of transfer, and the loss of citizenship—

(*a*) Did not result from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401 (b), 1482, or 1487) (For a summary of these sections, see paragraph (d)(1) of § 20.2107-1 of this chapter (Estate Tax Regulations)), and

(*b*) Had for one of its principal purposes (but not necessarily its only principal purpose) the avoidance of Federal income, estate, or gift tax.

(ii) In determining for purposes of subdivision (i)(*b*) of this subparagraph whether a principal purpose for the loss of U.S. citizenship by a donor was the avoidance of Federal income, estate, or gift tax, the Commissioner must first establish that it is reasonable to believe that the donor's loss of U.S. citizenship would, but for section 2501(a)(3) and this subparagraph, result in a substantial reduction for the calendar quarter in the sum of (*a*) the Federal gift tax and (*b*) all gift taxes imposed by foreign countries and political subdivisions thereof, in respect of the transfer of property by gift. Once the Commissioner has so established, the burden of proving that the loss of citizenship by the donor did not have for one of its principal purposes the avoidance of Federal income, estate, or gift tax shall be on the donor. In the absence of complete factual information, the Commissioner may make a tentative determination, based on the information available, that the donor's loss of U.S. citizenship would, but for section 2501(a)(3) and this subparagraph, result in a substantial reduction for the calendar quarter in the sum of the Federal and foreign gift taxes described in (*a*) and (*b*) of this subdivision on the transfer of property by gift. This tentative determination may be based upon the fact that the laws of the foreign country of which the donor became a citizen and the laws of the foreign country of which the donor was a resident at the time of the transfer, including the laws of any political subdivision of those foreign countries, would ordinarily result, in the case of a nonexpatriate donor having the same citizenship and residence as the donor, in liability for total gift taxes under such laws for the calendar quarter substantially lower than the amount of the Federal gift tax which would be imposed for such quarter on an amount of comparable gifts by a citizen of the United States. In the absence of a preponderance of evidence to the contrary, this tentative determination shall be sufficient to establish that it is reasonable to believe that the donor's loss of U.S. ciizenship would, but for section 2501(a)(3) and this subparagraph, result in a substantial reduction for the calendar quarter in the sum of the Federal and foreign gift taxes described in (*a*) and (*b*) of this subdivision on the transfer of property by gift.

(iii) The term "calendar quarter,"

as used in subdivision (ii) of this subparagraph, shall be construed to mean "calendar year" in the case of gifts made during calendar years before 1971.

(4) For additional rules relating to the application of the tax to transfers by nonresidents not citizens of the United States, see section 2511 and § 25.2511-3.

* * * * *

Par. 32. Section 25.2511 is amended by revising section 2511(b) and adding a historical note. These amended and added provisions read as follows:

§ 25.2511 Statutory provisions; transfers in general.

Sec. 2511. *Transfers in general.*

* * *

(b) *Intangible property.* For purposes of this chapter, in the case of a nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)—

(1) Shares of stock issued by a domestic corporation, and

(2) Debt obligations of—

(A) A United States person, or

(B) The United States, a State or any political subdivision thereof, or the District of Columbia,

which are owned and held by such nonresident shall be deemed to be property situated within the United States.

[Sec. 2511 as amended by sec. 109(b), Foreign Investors Tax Act 1966 (80 Stat. 1575) [Pub. L. 89-809, 1962-2 C.B. 656]]

Par. 33. Section 25.2511-1 is amended by revising paragraph (b) to read as follows:

§ 25.2511-1 Transfers in general.

* * * * *

(b) In the case of a gift by a nonresident not a citizen of the United States—

(1) If the gift was made on or after January 1, 1967, by a donor who was not an expatriate to whom section 2501(a)(2) was inapplicable on the date of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of § 25.2501-1, or

(2) If the gift was made before January 1, 1967, by a donor who was not engaged in business in the United States during the calendar year in which the gift was made.

the gift tax applies only if the gift consisted of real property or tangible personal property situated within the United States at the time of the transfer. See §§ 25.2501-1 and 25.2511-3.

* * * * *

Par. 34. Section 25.2511-3 is amended to read as follows:

§ 25.2511-3 Transfers by nonresidents not citizens.

(a) *In general.* Sections 2501 and 2511 contain rules relating to the taxation of transfers of property by gift by a donor who is a nonresident not a citizen of the United States. (See paragraph (b) of § 25.2501-1 for the definition of the term "resident" for purposes of the gift tax.) As combined these rules are:

(1) The gift tax applies only to the transfer of real property and tangible personal property situated in the United States at the time of the transfer if either—

(i) The gift was made on or after January 1, 1967, by a nonresident not a citizen of the United States who was not an expatriate to whom section 2501(a)(2) was inapplicable on the date of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of § 25.2501-1, or

(ii) The gift was made before January 1, 1967, by a nonresident not a citizen of the United States who was not engaged in business in the United States during the calendar year in which the gift was made.

(2) The gift tax applies to the transfer of all property (whether real or personal, tangible or intangible) situated in the United States at the time of the transfer if either—

(i) The gift was made on or after January 1, 1967, by a nonresident not a citizen of the United States who was an expatriate to whom section 2501(a)(2) was inapplicable on the date of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of § 25.2501-1, or

(ii) The gift was made before January 1, 1967, by a nonresident not a citizen of the United States who was engaged in business in the United States during the calendar year in which the gift was made.

(b) *Situs of property.* For purposes of applying the gift tax to the transfer of property owned and held by a nonresident not a citizen of the United States at the time of the transfer—

(1) *Real property and tangible personal property.* Real property and tangible personal property constitute property within the United States only if they are physically situated therein.

(2) *Intangible personal property.* Except as provided otherwise in subparagraphs (3) and (4) of this paragraph, intangible personal property constitutes property within the United State if it consists of a property right issued by or enforceable against a resident of the United States or a domestic corporation (public or private), irrespective of where the written evidence of the property is physically located at the time of the transfer.

(3) *Shares of stock.* Irrespective of where the stock certificates are physically located at the time of the transfer—

(i) Shares of stock issued by a domestic corporation constitute property within the United States, and

(ii) Shares of stock issued by a corporation which is not a domestic corporation constitute property situated outside the United States.

(4) *Debt obligations.* (i) In the case of gifts made on or after January 1, 1967, a debt obligation, including a bank deposit, the primary

obligor of which is a United States person (as defined in section 7701(a)(30)), the United States, a State or any political subdivision thereof, the District of Columbia, or any agency or instrumentality of any such government constitutes property situated within the United States. This subdivision applies—

(*a*) In the case of a debt obligation of a domestic corporation, whether or not any interest on the obligation would be treated under section 862(a)(1) as income from sources without the United States by reason of section 861(a)(1)(B) (relating to interest received from a domestic corporation less than 20 percent of whose gross income for a 3-year period was derived from sources within the United States) and the regulations thereunder;

(*b*) In the case of an amount described in section 861(c) (relating to certain bank deposits, withdrawable accounts, and amounts held by an insurance company under an agreement to pay interest), whether or not any interest thereon would be treated under section 862(a)(1) as income from sources without the United States by reason of section 861(a)(1)(A) (relating to interest on amounts described in section 861(c) which is not effectively connected with the conduct of a trade or business within the United States) and the regulations thereunder;

(*c*) In the case of a deposit with a domestic corporation or domestic partnership, whether or not the deposit is with a foreign branch thereof engaged in the commercial banking business; and

(*d*) Irrespective of where the written evidence of the debt obligation is physically located at the time of the transfer.

For purposes of this subdivision, a debt obligation on which there are two or more primary obligors shall be apportioned among such obligors, taking into account to the extent appropriate under all the facts and circumstances any choate or inchoate rights of contribution existing among such obligors with respect to the indebtedness. The term "agency or instrumentality," as used in this subdivision, does not include a possession of the United States or an agency or instrumentality of a possession.

(ii) In the case of gifts made on or after January 1, 1967, a debt obligation, including a bank deposit, not deemed under subdivision (i) of this subparagraph to be situated within the United States, constitutes property situated outside the United States.

(iii) In the case of gifts made bebore January 1, 1967, a debt obligation the written evidence of which is treated as being the property itself constitutes property situated within the United States if the written evidence of the obligation is physically located in the United States at the time of the transfer, irrespective of who is the primary obligor on the debt. If the written evidence of the obligation is physically located outside the United States, the debt obligation constitutes property situated outside the United States.

(iv) Currency is not a debt obligation for purposes of this subparagraph.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 7, 1973.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 11, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 12, 1973, 38 F.R. 34190)

Part III.—Gross Estate

Section 2031.—Definition of Gross Estate

26 CFR 20.2031-2: Valuation of stocks and bonds.

The proceeds of corporate-owned life insurance excluded from the estate of a shareholder-decedent is one of the "other relevant factors" to be considered in valuation of the stock of the corporation held by the decedent at the time of his death. See T.D. 7312, page 277.

Section 2032.—Alternate Valuation

26 CFR 20.2032-1: Alternate valuation.

Alternate valuation date; computation of time. Where there is no day in the sixth month following the decedent's death which corresponds numerically to the date of death, the correct alternate valuation date under section 2032(a)(2) of the Code is the last day of the sixth month.

Rev. Rul. 74-260

Advice has been requested whether assets in a decedent's gross estate that were not disposed of within six months after the death of the decedent were valued on the correct date, for the purposes of section 2032(a)(2) of the Internal Revenue Code of 1954, in the following circumstances.

The decedent died on October 31, 1972. His executor elected to value the estate under the alternate valuation provisions of section 2032 of the Code. The executor chose May 1, 1973, as the alternate valuation date for those assets not previously disposed of, since the sixth month following the decedent's death, April, has no day which numerically corresponds to the thirty-first day of October, the date of death.

Section 2032(a)(2) of the Code provides as follows:

In the case of property not distributed, sold, exchanged, or otherwise disposed of, within 6 months after the decedent's death such property shall be valued as of the date 6 months after the decedent's death.

Section 6075 of the Code requires that the estate tax return "shall be filed within 9 months after the date of the decedent's death."

Section 20.6075-1 of the Estate Tax Regulations provides as follows:

* * * The due date, with respect to a decedent dying after December 31, 1970, is, unless an extension of time for filing has been granted, the day of the ninth calendar month after the decedent's death numerically corresponding to the day of the calendar month on which death occurred, except that, if there is no numerically corresponding day in such ninth month, the last day of the ninth month is the due date. For example, if the decedent dies on July 31, 1972, the estate tax return and tax payment must be made on or before April 30, 1973. * * * For rules with respect to the right to elect to have the property valued as of a date or dates subsequent to the decedent's death, see section 20.2032-1 * * *.

Both of the Code sections quoted above concern stated periods of "months"; and section 20.6075-1 of the regulations refers to the corresponding regulation under section 2032 of the Code. Therefore, the methods set forth in section 20.6075-1 for ascertaining the proper due date for the estate tax return are, by analogy, applicable to the determination of the proper alternate valuation date under section 2032(a)(2).

Accordingly, where there is no day in the sixth month following the death of a decedent which corresponds numerically to the date of death, the alternate valuation date under section 2032(a)(2) of the Code, with respect to assets in the decedent's gross estate that were not disposed of within six months after the date of death, is the last day of such sixth month. In the present case, the correct alternate valuation date is April 30, 1973.

Section 2033.—Property in Which the Decedent had an Interest

26 CFR 20.2033-1: Property in which the decedent had an interest.

Wife's interest in community property; New Mexico. As a result of changes in New Mexico law that equalized the community property interest of each spouse, the value of a wife's one-half interest in New Mexico community property is includible in her gross estate if she predeceases her husband after June 30, 1973.

Rev. Rul. 74-284

Advice has been requested whether the value of a wife's interest in community property acquired under the law of the State of New Mexico is includible in her gross estate for Federal estate tax purposes if she dies on or after July 1, 1973.

Section 2033 of the Internal Revenue Code of 1954 provides that the value of a decedent's interest in property must be included in the gross estate for Federal estate tax purposes.

With respect to decedents in New Mexico dying prior to July 1, 1973, for Federal estate tax purposes, one-half the value of community property is includible in the estate of a husband who predeceases his wife, and the full value is includible if he survives his wife. None of the value of such community property is includible in the estate of a wife who predeceases her husband. See *Hernandez v. Becker*, 54 F. 2d 542 (10th Cir. 1931). In that case, at 548, the court stated:

The interests of the two spouses are not equal, because on the death of the wife her interest ceases, while on the death of the husband one half [sic] of the community descends to the wife and the other half is subject to testamentary disposition of the husband.

On November 7, 1972, the voters of the State of New Mexico approved an amendment to Article 2, Section 18 of the State constitution. As amended, it provides:

No person shall be deprived of life, liberty or property without due process of law; nor shall any person be denied equal protection of the laws. Equality of rights under law shall not be denied on account of the sex of any person. The effective date of this amendment shall be July 1, 1973.

Pursuant to this constitutional amendment, Section 29-1-8 of the New Mexico statutes was repealed and Section 29-1-9 was amended and now provides, in part:

DEATH OF SPOUSE—COMMUNITY PROPERTY—Upon the death of a spouse the entire community property goes to the surviving spouse, subject to the deceased's power of testamentary disposition over one-half of the community property.

The effect of the changes is to equalize the interest of each spouse in New Mexico community property as of July 1, 1973. Thereafter, the wife has a vested and indefeasible ownership interest in an undivided one-half share of New Mexico community property.

Accordingly, the value of a wife's one-half interest in New Mexico community property is includible in her gross estate for Federal estate tax purposes if she predeceases her husband on or after July 1, 1973.

Section 2039.—Annuities

26 CFR 20.2039-2: Annuities under "qualified plans" and section 403(b) annuity contracts.
(Also Section 2517; 25.2517-1.)

Annuity; self-employment plan. No portion of an annuity attributable to contributions made on behalf of a self-employed individual may be excluded from gross estate under section 2039(c) of the Code or from the total amount of gifts under section 2517.

Rev. Rul. 74-119

Advice has been requested regarding the application of sections 2039(c) and 2517 of the Internal Revenue Code of 1954 to self-employed individuals.

Where the payment of an annuity to a beneficiary by reason of surviving a deceased employee is provided by a plan described in sections 401(a) or 403(a) of the Code, section 2039 includes in the decedent's gross estate only the portion of the annuity attributable to his contributions to the

plan. The portion attributable to the employer's contribution is excluded under section 2039(c). That subsection further provides that contributions on behalf of the decedent while he was a self-employed individual "shall be considered to be contributions or payments made by the decedent." However, the applicability of that provision is specifically limited to the purposes of section 2039(c). A similar provision and limitation appear in section 2517 with respect to the gift tax.

H.R. Rep. No. 378, 87th Cong., 1st Sess. 14 (1961), 1962-3 C.B. 261, 274, accompanying H.R. 10, which became Pub.L. 87-792 (Self-Employed Individuals Retirement Act of 1962), states:

> With respect to the estate and gift tax exemption in the case of retirement plan benefits, your committee's bill does not change present law as it applies to ordinary employees, including owner-managers of corporations. However, the bill does not extend these exemptions to the self-employed (whether or not they are owner-employees) insofar as contributions were made to the plan by or for the individual while he was a self-employed person. The estate and gift tax exclusions will continue to apply with respect to any employer contributions made while the individual was not a self-employed person.

S. Rep. No. 992 at 24 (1961), 1962-3 C.B. 303, 326, contains identical language.

All the contributions are considered to have been made by the decedent in his capacity as employee for purposes of sections 2039(c) and 2517(c) of the Code. Accordingly, no portion of an annuity attributable to contributions on behalf of a self-employed individual may be excluded from his gross estate under section 2039(c) or from the total amount of gifts under section 2517.

Section 2042.—Proceeds of Life Insurance

26 CFR 20.2042-1: Proceeds of life insurance.
(Also Section 2031; 20.2031-2.)

T.D. 7312 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 20.—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Treatment of corporate-owned life insurance where the decedent is a shareholder.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

By a notice of proposed rule making appearing in the Federal Register for Friday, August 25, 1972 (37 F.R. 17206), amendments to the Estate Tax Regulations (26 CFR Part 20) under sections 2031 and 2042 of the Internal Revenue Code of 1954 were proposed in order to clarify the estate tax treatment of corporate-owned life insurance where the decedent was a shareholder. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, certain changes were made, and the proposed amendments, subject to the changes indicated below, are adopted by this document.

Under section 2042 of the Code, if a decedent died possessed of any incidents of ownership in a life insurance policy on his life, the entire proceeds of the policy will be included in his gross estate for estate tax purposes. The term "incidents of ownership" is described in § 20.2042-1(c)(2) as including "a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder."

A problem was presented in Revenue Ruling 71-463, 1971-2 C.B. 333, which ruling was later withdrawn by Revenue Ruling 72-167, 1972-1 C.B. 307, as to whether a controlling stockholder should be treated the same as a "sole stockholder" for purposes of section 2042. The position taken in the proposed rules is that a controlling stockholder should be so treated. However, where a corporation is the beneficiary of any portion of the proceeds of a life insurance policy, there is no need for that portion to be included in the gross estate under 2042 because it directly affects the value of the stock that is included in the decedent's gross estate.

Accordingly, § 20.2042-1(c) is amended by this document to provide that, with respect to proceeds of corporate-owned life insurance which are payable to either the corporation or a third party for a valid business purpose, incidents of ownership held by the corporation will not be attributed to the decedent through his stock ownership. To the extent that the proceeds of corporate-owned life insurance are not payable to the corporation or a third party for a valid business purpose, the incidents of ownership will be attributed to the insured decedent who is the sole or controlling stockholder. An amendment is also made to § 20.2031-2(f) to clarify that the portion of the life insurance proceeds excluded from the gross estate under the amendment to § 20.2042-1(c) shall be taken into consideration when evaluating the stock held by the decedent at the time of his death.

The proposed regulations stated that a decedent would not be deemed to be the controlling stockholder unless he had "actual legal or equitable ownership of stock possessing more than 50 percent of the total voting power of the corporation." The amendments adopted by this document change this provision by limiting the consideration of equitable owner-

[1] This publication of the Treasury Decision contains the full text of the regulations. The individual instructions for modifying the notice of proposed rulemaking have been omitted.

ship to only those situations in which the decedent had an interest in either a voting trust or a trust with respect to which he was regarded, prior to his death, as the owner under subpart E, part I, of subchapter J of chapter 1 of the Code.

The amendments adopted by this document also differ from the proposed regulation by providing rules with respect to the joint ownership of securities. These rules assure that the joint owner, who acquired the securities for an adequate and full consideration, is the one to whom ownership is attributed for purposes of determining control. For this purpose, the provisions of section 2040 (relating to joint interests) and the regulations thereunder are incorporated by reference.

Based upon comments concerning the applicability of the proposed regulations to both split dollar and group-term life insurance policies, it was decided that the final regulations would specifically exclude only the power to cancel or surrender group-term life insurance policies as an incident of ownership attributable to a controlling stockholder. "Group-term life insurance" is defined by reference to the regulations under section 79 of the Code.

Adoption of amendments to the regulations

On Friday, August 25, 1972, a notice of proposed rule making was published in the Federal Register (37 F.R. 17206) in order to clarify the estate tax treatment of corporate-owned life insurance where the decedent was a shareholder. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

Paragraph 1. Paragraph (f) of § 20.2031-2 is amended to read as follows:

§ 20.2031-2 Valuation of stocks and bonds.

* * * * *

(f) *Where selling prices or bid and asked prices are unavailable.* If the provisions of paragraphs (b), (c), and (d) of this section are inapplicable because actual sale prices and bona fide bid and asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(1) In the case of corporate or other bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors; and

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors. Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. In addition to the relevant factors described above, consideration shall also be given to nonoperating assets, including proceeds of life insurance policies payable to or for the benefit of the company, to the extent such nonoperating assets have not been taken into account in the determination of net worth, prospective earning power and dividend-earning capacity. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the applicable valuation date.

* * * * *

Par. 2. In § 20.2042-1, paragraphs (a)(3) and (c)(2) are amended and paragraph (c)(6) is added to read as follows:

§ 20.2042-1 Proceeds of life insurance.

(a) *In general.* * * *

(3) Except as provided in paragraph (c)(6), the amount to be included in the gross estate under section 2042 is the full amount receivable under the policy. If the proceeds of the policy are made payable to a beneficiary in the form of an annuity for life or for a term of years, the amount to be included in the gross estate is the one sum payable at death under an option which could have been exercised either by the insured or by the beneficiary, or if no option was granted, the sum used by the insurance company in determining the amount of the annuity.

* * * * *

§ 20.2042-1 Proceeds of life insurance.

* * * * *

(c) *Receivable by other beneficiaries* * * *

(2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. See subparagraph (6) of this paragraph for rules relating to the circumstances under which incidents of ownership held by a corporation are attributable to a decedent through his stock ownership.

* * * * *

(6) In the case of economic benefits of a life insurance policy on the

decedent's life that are reserved to a corporation of which the decedent is the sole or controlling stockholder, the corporation's incidents of ownership will not be attributed to the decedent through his stock ownership to the extent the proceeds of the policy are payable to the corporation. Any proceeds payable to a third party for a valid business purpose, such as in satisfaction of a business debt of the corporation, so that the net worth of the corporation is increased by the amount of such proceeds, shall be deemed to be payable to the corporation for purposes of the preceding sentence. See § 20.2031-2(f) for a rule providing that the proceeds of certain life insurance policies shall be considered in determining the value of the decedent's stock. Except as hereinafter provided with respect to a group-term life insurance policy, if any part of the proceeds of the policy are not payable to or for the benefit of the corporation, and thus are not taken into account in valuing the decedent's stock holdings in the corporation for purposes of section 2031, any incidents of ownership held by the corporation as to that part of the proceeds will be attributed to the decedent through his stock ownership where the decedent is the sole or controlling stockholder. Thus, for example, if the decedent is the controlling stockholder in a corporation, and the corporation owns a life insurance policy on his life, the proceeds of which are payable to the decedent's spouse, the incidents of ownership held by the corporation will be attributed to the decedent through his stock ownership and the proceeds will be included in his gross estate under section 2042. If in this example the policy proceeds had been payable 40 percent to decedent's spouse and 60 percent to the corporation, only 40 percent of the proceeds would be included in decedent's gross estate under section 2042. For purposes of this subparagraph, the decedent will not be deemed to be the controlling stockholder of a corporation unless, at the time of his death, he owned stock possessing more than 50 percent of the total combined voting power of the corporation. Solely for purposes of the preceding sentence, a decedent shall be considered to be the owner of only the stock with respect to which legal title was held, at the time of his death, by (i) the decedent (or his agent or nominee); (ii) the decedent and another person jointly (but only the proportionate number of shares which corresponds to the portion of the total consideration which is considered to be furnished by the decedent for purposes of section 2040 and the regulations thereunder); and (iii) by a trustee of a voting trust (to the extent of the decedent's beneficial interest therein) or any other trust with respect to which the decedent was treated as an owner under subpart E, part I, subchapter J, chapter 1 of the Code immediately prior to his death. In the case of group-term life insurance, as defined in paragraph (b)(1)(i) and (iii) of § 1.79-1 of this chapter (Income Tax Regulations), the power to surrender or cancel a policy held by a corporation shall not be attributed to any decedent through his stock ownership.

* * * * *

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved April 19, 1974.

FREDERICK W. HICKMAN,
Assistant Secretary of the Treasury.

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Part IV.—Taxable Estate

Section 2055.—Transfers For Public, Charitable, and Religious Uses

26 CFR 20.2055-1: Deduction for transfers for public, charitable, and religious uses; in general.

(Also Section 103; 1.103-1.)

Charitable deduction; bequest to Zuni Indian Pueblo. The Zuni Indian Pueblo of New Mexico is not a political subdivision of the U.S., the State of New Mexico, or a Territory, and a decedent's bequest to the Pueblo is not allowable as a charitable deduction under section 2055(a)(1) of the Code. Rev. Rul. 68-231 modified.

Rev. Rul. 74-179

Advice has been requested whether a bequest of one-third of a decedent's residuary estate to the Zuni Indian Pueblo, Zuni, New Mexico, qualifies for the charitable deduction allowable under section 2055(a) of the Internal Revenue Code of 1954.

The Zuni Indian Pueblo is a recognized Indian tribe organized under a Constitution ratified by the Indians of the Pueblo on July 9, 1970. On August 13, 1970, the Secretary of the Interior approved the Constitution of the Zuni Indian Pueblo under authority of section 16 of the Act of June 18, 1934 (48 Stat. 984), as amended by the Act of June 15, 1935 (49 Stat. 378).

Section 2055(a)(1) of the Code provides that the value of a decedent's taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of the United States, any State, Territory, and political subdivision thereof, or the District of Columbia, for exclusively public purposes.

The Zuni Indian Pueblo is neither the United States nor the District of

Columbia. Neither is it a State or Territory. *Ex parte Morgan,* 20 F. 298 (W.D. Ark. 1883). Thus, in order for the bequest to be deductible under section 2055(a)(1) of the Code, the Zuni Indian Pueblo must qualify as a political subdivision of the United States, a State, or a Territory within the meaning of this section.

Neither the Code nor the regulations contain a definition of the term "political subdivision" for the purposes of section 2055(a)(1) of the Code, nor has there been a judicial definition of the term. However, the term has long had a consistent definition in income and excise tax provisions:

> The term "political subdivision" is broad and comprehensive and denotes any division of the State made by the proper authorities thereof, acting within their constitutional power for the purpose of carrying out a portion of those functions of the State which by long usage and the inherent necessities of government have always been regarded as public. 30 O.A.G. 252, 253 (1914).

See also 38 O.A.G. 563 (1937); sec. 1.103-1, Income Tax Regulations.

Indian pueblos, just as other Indian tribes, have a unique position in the United States and much has been written with respect to their status under our Government. In the early case of *Worcester v. Georgia,* 31 U.S. 515 (1832), Chief Justice Marshall recognized that Indian tribes had always been considered as distinct political communities. Again, in *United States v. Kagama,* 118 U.S. 375, 381 (1866), the Court described their status in the following language:

> * * * They were, and always have been, regarded as having a semi-independent position when they preserved their tribal relations; not as States, not as nations, not as possessed of the full attributes of sovereignty, but as a separate people, with the power of regulating their internal and social relations, and thus far not brought under the laws of the Union or of the State within whose limits they reside.

More recently, the status of Indian pueblos or tribes, preserving their political entity under the decisions of the Supreme Court, has been summed up in U.S. Interior Department, *Federal Indian Law* 398 (1958), as follows:

> The whole course of judicial decision on the nature of Indian tribal powers is marked by adherence to three fundamental principles: (1) An Indian tribe possessed, in the first instance, all the powers of any sovereign state. (2) Conquest rendered the tribe subject to the legislative power of the United States, and, in substance, terminated the external powers of sovereignty of the tribe, e.g., its power to enter into treaties with foreign nations, but did not by itself terminate the internal sovereignty of the tribe, i.e. its powers of local self-government. (3) These internal powers were, of course, subject to qualification by treaties and by express legislation of Congress, but, save as thus expressly qualified, many powers of internal sovereignty have remained in the Indian tribes and in their duly constituted organs of government.

The powers of self-government which Indian tribes or pueblos exercise stem from their original sovereignty. The Supreme Court has recognized that although these powers are subject to the paramount authority of Congress, such powers do not spring from the United States. *Talton v. Mayes,* 163 U.S. 376 (1896).

These declarations by the Supreme Court have been adhered to in a long line of cases. See *Native American Church v. Navajo Tribal Council,* 272 F. 2d 131 (1959), and the cases cited therein.

For similar reasons, Pueblos of New Mexico do not derive their governmental power from the State of New Mexico. See *United States v. Sandoval,* 231 U.S. 28 (1913); *Your Food Stores, Inc. v. Village of Espanola,* 361 P.2d 950 (1961). In the case of *Toledo v. Pueblo de Jemez,* 119 F. Supp. 429 (D.C. N. Mex. 1954), it was argued that the Pueblo was, in effect, a political subdivision of the State of New Mexico, by virtue of section 54-1601, New Mexico Statutes, 1941 (now section 51-17-1). Under this provision of the statute, all of the Pueblos of New Mexico were constituted bodies politic and corporate with the right to sue and be sued in certain types of cases. However, the court stated in *Toledo* at page 432:

> * * * the New Mexico Statute does not purport to vest any governmental powers, rights or duties in the Pueblos of New Mexico which are dependent Indian communities, Indian Tribes, under the guardianship of the United States * * *
>
> At least since the *Sandoval* decision in 1913, it has been clear that the Pueblos do not derive their governmental powers from the State of New Mexico. It has, indeed, been held that the powers of an Indian tribe do not spring from the United States although they are subject to the paramount authority of Congress. *Talton v. Maye,* 163 U.S. 376, 16 S. Ct. 986, 41 L. Ed. 196.

In view of the foregoing, it is concluded that the Zuni Indian Pueblo is not a political subdivision of the United States, the State of New Mexico, or a Territory as that term is used in section 2055(a)(1) of the Code. Accordingly, the value of decedent's bequest to the Zuni Indian Pueblo is not deductible under section 2055(a)(1) of the Code.

Rev. Rul. 68-231, 1968-1 C.B. 48, in holding that the interest on obligations issued by the Swinomish Indian Tribal Community is not excludable from the gross income of the recipient under section 103 of the Code, states that "the powers of the Tribal Community are delegated to it by the United States Government rather than the State of Washington in which it is located" and that "since it exercises its governing powers by virtue of Federal, rather than State authority, the bonds in question are not issued on behalf of the State within the meaning of the regulations." These statements are misleading in that they suggest that the Indian tribe is a political subdivision of the United States, in contradiction to the conclusion set forth above.

Rev. Rul. 68-231 is modified to remove the language relating to the derivation of Indian powers that implies that an Indian tribe is a political subdivision of the United States.

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26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Charitable deduction; ascertainable remainder. A decedent's bequest of his residuary estate to charitable organizations, after specified monthly payments to be made to his widow during the predictable period his estate would be administered, results in an ascertainable amount allowable as a deduction under section 2055 of the Code. Section 201 of the Tax Reform Act of 1969 does not apply in this instance as the will was executed before Oct. 9, 1969, and the testator died before Oct. 9, 1972.

Rev. Rul. 74-97

Advice has been requested whether a deduction is allowable under section 2055 of the Internal Revenue Code of 1954 for a bequest to charitable organizations under the circumstances described below.

The decedent died on September 30, 1972. In his will, which he executed before October 9, 1969, he provided that 500*y* dollars be distributed outright to his widow. From the residue of his estate, the decedent directed that his executor should pay to his widow 2*y* dollars per month for her support during the administration of his estate. The remainder is to be paid to organizations of the type described in section 2055(a)(2) of the Code. The value of the residue is approximately 400*y* dollars. The widow was aged *x* years at her birthday nearest the date of decedent's death. Also, there is no known prospect of extensive litigation involving the estate, and there was no ancillary administration of the estate.

On the basis of relevant facts, particularly the size and nature of the decedent's estate and the probate court practices in the county in which he was domiciled and in which his estate is being administered, it is *highly unlikely* that the administration of the decedent's estate could extend more than 7 years beyond his death.

Section 2055(a)(2) of the Code provides that a deduction is allowable from the gross estate in the amount of bequests to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes. Section 20.2055-2(a) of the Estate Tax Regulations provides that if property is transferred for both a charitable and noncharitable purpose, a deduction is allowable only insofar as the value of the charitable interest is presently ascertainable, and hence severable from the noncharitable interest.

In order for the value of such charitable interest to be presently susceptible of valuation and hence severable from the noncharitable interest, a power to vary that interest must be limited by a fixed, objective standard calculable in money. *Ithaca Trust Company v. United States*, 279 U.S. 151 (1929), Ct. D. 61, VIII-1 C.B. 313 (1929). As the payments to the decedent's widow are in a stated dollar amount, the diversion to noncharitable purposes is limited by such an ascertainable standard provided the period of noncharitable payments can be reliably predicted on the basis of data available at the date of decedents' death.

Since the relevant facts known at the date of decedent's death indicate that it is *highly unlikely* that the administration of his estate could extend more than 7 years beyond his death, the maximum amount that charity can be said to be certain to receive may be computed by reducing the value of the residue by an amount which represents the potential diversion to the widow. This amount is the present value of 24*y* dollars per year, payable monthly, for 7 years or until the prior death of a woman aged *x*, the age of the widow at the date of decedent's death, as determined under section 20.2031-10 of the Estate Tax Regulations.

Accordingly, a deduction is allowable under section 2055 of the Code equal to the value of the residue of the estate less the value of the support payment for the maximum probable term of administration of the estate. (Since the will was executed before October 9, 1969, and the decedent died before October 9, 1972, the Tax Reform Act of 1969, section 201, 26 U.S.C. section 2055(e) (1971), does not apply to the present situation.)

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26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Agreement with respect to exercise by trustee of administrative and investment powers. See Rev. Proc. 74-6, page 417.

Section 2056.—Bequests, etc., to Surviving Spouse

26 CFR 20.2056(a)-2: Marital deduction; "deductible interests" and "nondeductible interests."

Formula marital deduction clause. The value of life insurance proceeds, not included in the gross estate, that was paid to decedent's wife on policies transferred to her 13 years prior to decedent's death does not reduce the allowable marital deduction under a formula marital deduction clause in the decedent's will containing the words "which qualify for the marital deduction," without any clearly expressed modification indicating a special or restricted meaning of such words.

Rev. Rul. 74-42

Advice has been requested as to the marital deduction allowable pursuant to section 2056 of the Internal Revenue Code of 1954, under the circumstances described below.

In 1957, the decedent transferred all his respective rights, title and interest in ten life insurance policies on his life to his wife who received $50,000, the amount of the proceeds, at his death in 1970.

The decedent's will contains the following formula marital bequest to his wife:

> If my wife survives me, I give, bequeath, devise and appoint to her one-half of my adjusted gross estate, which is the amount equal to the maximum estate tax marital deduction allowable in determining the Federal estate tax on my estate, *diminished, however, by the value of all other items which qualify for the marital deduction* and which pass or have passed to my wife under other provisions of this will or outside this will by operation of law or *otherwise.* (emphasis added)

Under the decedent's will, the balance of his property is left to other noncharitable beneficiaries and their share of the estate is charged with the payment of all death taxes occasioned by the decedent's death.

The value of the decedent's gross estate is $300,000, and does not include the value of the life insurance proceeds that were paid to his wife. The aggregate value of the allowable deductions for administration expenses, debts, taxes and losses is $50,000, so that the value of the adjusted gross estate is $250,000.

Section 2056(a) of the Code provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed to the surviving spouse from the decedent, "but only to the extent that such interest is included in determining the value of the gross estate." Section 2056(c) provides that the aggregate amount of the deductions allowed under section 2056 shall not exceed 50 percent of the value of the adjusted gross estate.

Section 20.2056(a)-2 of the Estate Tax Regulations provides that property interests which pass from a decedent to his surviving spouse fall within two general categories: (1) those with respect to which the marital deduction is authorized, and (2) those with respect to which the marital deduction is not authorized. These categories are referred to as "deductible interests" and "nondeductible interests," respectively. An interest passing to a decedent's surviving spouse is a "deductible interest" if its does not fall into one of the following categories of "nondeductible interests": (1) a property interest which is not included in the gross estate; (2) a property interest which is deductible as an administration expense or a debt of the decedent; (3) a property interest which is deductible as a loss which occurs during the administration of the estate; and (4) a property interest which is a "nondeductible terminable interest" as described in section 20.2056(b)-1 of the regulations.

Since the words "which qualify for the marital deduction," as used in the decedent's will, are not expressly limited to indicate his intention to refer only to property included in his gross estate, the question presented is whether the allowable marital deduction is $125,000 (which is one-half of the adjusted gross estate) or $75,000 (which is one-half of the adjusted gross estate diminished by the insurance proceeds that passed to the decedent's wife under the insurance contracts).

If a decedent uses words in his will which have a definite and well understood technical meaning, the prima facie presumption will be that he intended to use them in their technical sense, unless it appears plainly from the context that another meaning was intended. See *Page on Wills,* Bowe-Parker Revision, section 30.21; *Hoffman v. McGinnes,* 277 F. 2d 598 (3rd Cir. 1960). The term "adjusted gross estate" is a concept that was created by the Revenue Act of 1948, and its sole function is to furnish a ceiling for the allowable Federal estate tax marital deduction. In order to claim the exact amount of the marital deduction allowable to an estate, the property left by will to the surviving spouse is customarily described by some formula, such as one-half of the adjusted gross estate less any other interests passing to the surviving spouse which qualify for the marital deduction.

If the term "which qualify for the marital deduction" is contained in a formula marital deduction clause and it is used without any clearly expressed modification which indicates that a special or restricted meaning was intended, such words apply only to "deductible interests" (that is, interests which are included in the gross estate) and not to "nondeductible interests."

Accordingly, since the insurance proceeds which passed to the decedent's wife are not includible in his gross estate, the amount of the allowable marital deduction is $125,000.

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26 CFR 20.2056(b)-5: Marital deduction; life estate with power of appointment in surviving spouse.

Marital deduction; life estate with power of appointment; New York. A testamentary bequest of a life estate in trust to a surviving spouse giving to her the power to appoint by her will the remainder interest in the trust "to such person or persons whom she designates" constitutes a power to appoint to her own estate under New York law, thereby qualifying the value of the interest subject to such power for the marital deduction under section 2056(b)(5) of the Code.

Rev. Rul. 74-120

Advice has been requested whether a bequest in trust of a life estate by a decedent to his surviving wife that includes the power of the wife to appoint the remainder interest in the trust to any "person or persons" by her will includes a power to appoint to her own estate under New York law, thereby qualifying the value of the interest subject to the power for the marital deduction on the basis that it meets the requirements of section 2056(b)(5) of the Internal Rev-

enue Code of 1954.

The decedent died testate on March 4, 1968, a resident of New York State. In paragraph SECOND of his will, the decedent bequeathed his residuary estate to his trustees, as follows:

To hold, manage, invest and reinvest the same, collect and receive the income therefrom and to pay the entire net income therefrom monthly to my wife, during her life. Upon my wife's death, my trustees are to pay the corpus remaining in said trust to the person or persons whom she designates in her Last Will and Testament by making specific reference in such Last Will and Testament to this power of appointment.

Section 2056(b)(1) of the Code provides that in general no marital deduction is allowable with respect to a terminable property interest that passes or has passed from the decedent to the surviving spouse if an interest in the same property passes or has passed from the decedent to persons other than the surviving spouse.

An exception to the terminable interest rule is set forth in section 2056 (b)(5) of the Code as follows:

LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

One of the requirements set forth by section 20.2056(b)-5(a) of the Estate Tax Regulations that must be met under section 2056(b)(5) of the Code is the surviving spouse must have the power to appoint the property interest to herself or her estate. Under section 20.2056(b)-5(e) of the regulations, whether the requirements set forth in section 20.2056(b)-5(a) are satisfied must be determined by the provisions of the State law under which the interest passes.

The statutory law in New York provides that "the scope of the donee's authority as to appointees and as to the time and manner of the appointment is unlimited except as the donor manifests a contrary intention." *N.Y. Est., Powers & Trusts Law* section 10-5.1 (McKinney Supp. 1972). Therefore, unless there is an affirmative expression of the decedent's intention as donor of a power, that indicates an intention to limit the donee's power, then, under New York law, such power includes the right to appoint to the survivor's estate or whomsoever the survivor pleases.

In *Geneva Trust Co. v. Sill,* 27 N.Y.S. 2d 289 (Sup. Ct. 1941), a power to appoint property held in trust was created. The trustee was directed to pay the principal plus any accrued interest in the trust "*to such persons* and in such shares, interest and proportion as said Ruth E. Sill should, by her last will and testament . . . designate and appoint . . ." (Emphasis added.) Ruth E. Sill died testate leaving the above-mentioned trust fund to her husband for life with the remainder to pass to her residuary estate at his death. The court determined that the exercise of the power in favor of the donee's own estate was valid; and, furthermore, the court specifically stated:

The trust agreement conferred on Ruth a general and unrestricted power over the corpus of the inter vivos trust. She was given the right to appoint the property "to such persons, and in such shares, interest and proportions" as she should "by her last will and testament, duly executed in writing, designate and appoint, . . ." The power was general and unconfined. The donee was free to choose the beneficiaries and interests and estates to be given to them.

For similar holdings, see *In re: Hyde's Will,* 118 N.Y.S. 2d 243 (Sur. Ct. 1953); *In re: Adler's Estate,* 193 Misc. 19, 83 N.Y.S. 2d 153 (Sur. Ct. 1948); *In re: Lathers' Will,* 64 N.Y.S. 2d 757 (Sur. Ct. 1946), and *In re: Wainwright's,* 248 App. Div. 336, 289 N.Y.S. 510 (1936).

The phrase "person or persons" as used in a will or trust instrument, where State law places a technical construction on such term as in New York, includes an estate unless the individual utilizing the phrase clearly manifests a contrary intention.

Accordingly, in this case the grant of the power to the spouse to appoint "to such person or persons whom she designates," without other qualification, is a power to appoint to her own estate, which thereby satisfies the requirements of section 2056(b)(5) of the Code so as to allow the marital deduction for those interests passing subject to the power.

Subchapter B. Estates of Nonresidents not Citizens

Section 2101.—Tax Imposed

26 CFR 20.2101: Statutory provisions; tax imposed.

Rates of tax for estates of decedents dying on or after November 14, 1966. See T.D. 7296, page 255.

Section 2102.—Credits Against Tax

26 CFR 20.2102: Statutory provisions; credits against tax.

The maximum credit allowed under section 2100 against the tax imposed by section 2101 for State death taxes. See T.D. 7296, page 255.

Section 2104.—Property within the United States

26 CFR 20.2104: Statutory provisions; property within the United States.

Whether certain debt obligations are deemed property within the United States. See T.D. 7296, page 255.

Section 2105.—Property without the United States

26 CFR 20.2105: Statutory provisions; property without the United States.

Whether certain bank deposits are deemed property without the United States. See T.D. 7296, page 255.

Section 2106.—Taxable Estate

26 CFR 20.2106-1: Estate of nonresidents not citizens; taxable estate; deductions in general.

Exemption for estates of decedents who were nonresidents not citizens and who died on or after November 14, 1966. See T.D. 7296, page 255.

Section 2107.—Expatriation to Avoid Tax

26 CFR 20.2107: Statutory provisions; expatriation to avoid tax.

Estate tax treatment for certain decedents who made tax-motivated expatriations from the U.S. See T.D. 7296, page 255.

Section 2108.—Application of Pre-1967 Estate Tax Provisions

26 CFR 20.2108: Statutory provisions; application of pre-1967 estate tax provisions.

Imposition of more burdensome tax by foreign country. See T.D. 7296, page 255.

Subchapter C. Miscellaneous

Section 2208.—Certain Residents of Possessions Considered Citizens of the United States

26 CFR 20.2208-1: Certain residents of possessions considered citizens of the United States.

Application of the Federal estate tax to the estate of a resident of a United States possession who acquired United States citizenship by virtue of his citizenship, birth or residence in another United States possession. See Rev. Rul. 74-25, below.

Section 2209.—Certain Residents of Possessions Considered Nonresidents Not Citizens of the United States

26 CFR 20.2209-1: Certain residents of possessions considered nonresidents not citizens of the United States.
(Also Section 2208; 20.2208-1.)

Decedent born in Puerto Rico and resident of Virgin Islands at death. A decedent who acquired his U.S. citizenship solely by virtue of his birth in Puerto Rico and was a resident of the Virgin Islands at his death is considered a nonresident not a citizen for Federal estate tax purposes under section 2209 of the Code.

Rev. Rul. 74-25

Advice has been requested whether a decedent who was a resident of a United States possession at his death shall be deemed a nonresident not a citizen of the United States, for Federal estate tax purposes, under the circumstances described below.

The decedent was a United States citizen solely by reason of his birth in Puerto Rico. He died in 1970, a resident of the Virgin Islands.

Section 2208 of the Internal Revenue Code of 1954 provides that a decedent shall be considered a "citizen" of the United States for Federal estate tax purposes if he was a United States citizen and a resident at his death of a United States possession, unless he acquired his United States citizenship solely by reason of (1) his being a citizen of such possession or (2) his birth or residence within such possession. Section 2209 of the Code provides that a deceased United States citizen shall be considered a "nonresident not a citizen of the United States" for Federal estate tax purposes if at his death he was a resident of a United States possession but he had acquired his United States citizenship solely by virtue of (1) his being a citizen of such possession or (2) his birth or residence within such possession.

Since the decedent at his death was a resident of the Virgin Islands, a United States possession other than the one through which he acquired United States citizenship, the issue is whether he must have acquired his United States citizenship solely through his connection with the Virgin Islands, his residence, in order to be considered a nonresident not a citizen of the United States under sections 2208 and 2209 of the Code.

Prior to the addition to the Code of section 2208 in 1958 and of section 2209 in 1960, United States citizens who were also citizens and residents of United States possessions were held as a matter of statutory interpretation to be completely exempt from the Federal estate tax. *Albert D. Smallwood,* 11 T.C. 740 (1948), *acq.,* 1949-1 C.B. 3; *Clotilde Santiago Rivera,* 19 T.C. 271 (1953), *acq.,* 1958-2 C.B. 7, *aff'd.* 214 F. 2d 60 (2d Cir. 1954); *Arthur S. Fairchild,* 24 T.C. 408 (1955), *acq.,* 1956-2 C.B. 5. The courts found no clear expression of congressional intent to tax estates of citizens of United States possessions, whether or not they otherwise were United States citizens. As a result of these decisions, Congress amended the Code to cover these persons.

First, section 2208 of the Code made subject to the estate tax, in the same manner as is generally true with respect to resident citizens of the United States, the estates of those residents of the possessions who acquired their United States citizenship completely independently of their connection with the possessions. Then, with the addition of section 2209, Congress dealt with the problem of those residents of a possession whose United States citizenship was derived from the possession, subjecting these persons to the estate tax, in general, to the same extent as in the case of nonresidents not citizens of the United States.

A literal interpretation of the language in the statute would limit extension of "nonresident alien" status to those residents of United States possessions who acquired United States citizenship by virtue of their connections with the same possession as that

in which they resided at death. This construction of the statute, however, is not consistent with the purpose of Congress in enacting sections 2208 and 2209 of the Code, as indicated by their legislative histories. *Senate Report No. 1767,* 86th Cong., 2d Sess. (1960), 1960-2 C.B. 829, 832, indicates that Congress, by enacting sections 2208 and 2209, intended to close the loophole that enabled United States citizens to move from the United States and establish citizenship in United States possessions and thereby remove their estates from the application of the estate tax. There is no indication of a Congressional intent to distinguish between possession citizens who were residents of the same possession at the time of their death as that through which they acquired citizenship, and those who were not.

Accordingly, the decedent, who was a resident of the Virgin Islands at his death and who was a United States citizen by reason of his birth in Puerto Rico, is thereby considered a nonresident not a citizen for Federal estate tax purposes under section 2209 of the Code.

Chapter 12.—Gift Tax
Subchapter A. Determination of Tax Liability

Section 2501.—Imposition of Tax

26 CFR 25.2501-1: Imposition of tax.

Gift tax treatment of gifts made on or after January 1, 1967, by nonresidents not citizens of the United States. See T.D. 7296, page 255.

Section 2503.—Taxable Gifts

26 CFR 25.2503-2: Exclusions from gifts.

Gift to political organizations; evidentiary requirements. The $3,000 gift tax exclusion is allowable only for a contribution to a bona fide political committee where in fact: (1) the contribution was made by the donor or his agent to the political committee; (2) the named officers of the committee were its officers; (3) the committee had a bank account and/or records evidencing receipt of the contributions; (4) the committee disbursed contributions for campaign purposes; and (5) the committee filed any required Federal and State reports consistent with the foregoing; Rev. Rul. 72-355 amplified.

Rev. Rul. 74-199

Advice has been requested concerning the evidentiary requirements that must be met in determining, pursuant to Rev. Rul. 72-355, 1972-2 C.B. 532, whether a contribution was in fact made to a bona fide political committee for purposes of the $3,000 gift tax exclusion allowable under section 2503(b) of the Internal Revenue Code of 1954.

Rev. Rul. 72-355 discusses the circumstances under which political organizations will be recognized as separate donees for purposes of the exclusion. It also contains examples illustrating the circumstances under which political organizations will be either recognized as separate donees or treated as one organization for purposes of the exclusion.

The $3,000 exclusion is allowable only for contributions to bona fide committees or organizations where in fact, rather than form, they were the actual recipients of the contributions. Contributions will ordinarily be so treated only if the following evidentiary requirements are met:

(a) The contribution was actually made to the particular committee claimed to be the donee. If the contribution was made through an agent, the agent must have been that of the donor;

(b) The persons named as officers of the committee were actuallv its officers;

(c) The committee had a bank account and/or records evidencing the receipt of the contribution in question;

(d) The committee disbursed contributions for campaign purposes (including transfers to other organizations for such purposes); and

(e) The committee filed whatever Federal and state reports were required of it in respect to its activities, receipts or disbursements, and that the receipts and disbursements shown on such reports are consistent with the receipts and disbursements asserted by the contributor and the committee.

Separate $3,000 exclusions are allowed only with respect to separate bona fide committees which meet the separateness tests spelled out in Rev. Rul. 72-355 and its examples. The donor's exclusion with respect to a contribution or several contributions in a calendar year to any one donee is limited to the lesser of the value of the present interest given, or $3,000.

Rev. Rul. 72-355 is hereby amplified to include the above evidentiary requirements.

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26 CFR 25.2503-4: Transfer for the benefit of a minor.

Gift to minor in trust; right to compel immediate distribution of corpus. A gift to a minor under a trust that confers on its beneficiary upon reaching age 21 the right to compel immediate distribution of the corpus by written notice to the trustee that is either (1) a continuing right or permits the trust to remain on its own terms or (2) a right for a limited period that, if not exercised, will permit the trust to continue on its own terms is not a gift of a future interest and qualifies for the exclusion provided in section 2503(b) of the Code; Rev. Rul. 60-218 revoked.

Rev. Rul. 74-43

The Internal Revenue Service has given further consideration to Rev. Rul. 60-218, 1960-1 C.B. 378. That Revenue Ruling holds that a gift to a minor by means of a trust, which provides that the beneficiary, upon reaching age 21, may compel immediate distribution of the trust or may elect to extend the term of the trust and receive distribution of the corpus according to the provisions set forth in the trust instrument, is not considered

to be a gift of a present interest so as to qualify under the provisions of section 2503(c) of the Internal Revenue Code of 1954 for the exclusion provided for in section 2503(b). Stated otherwise, if a beneficiary is required to perform a positive act to terminate a trust, upon reaching the age of 21, the gift does not qualify for the annual exclusion.

Section 2503(b) of the Code provides an exclusion of the first $3,000 of gifts made to any person by the donor during the calendar year. This exclusion applies to all gifts other than gifts of future interests. A future interest is defined in section 25.2503-3 (a) of the Gift Tax Regulations to include reversions, remainders, and other interests or estates, whether vested or contingent and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future time.

Section 2503(c) of the Code provides:

> Transfer for the Benefit of a Minor.—No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and the income therefrom—
>
> (1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and
>
> (2) will to the extent not so expended—
>
> (A) pass to the donee on his attaining the age of 21 years, and
>
> (B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

Contrary to the Service's argument, Rev. Rul. 60-218 was not followed in *Griffith v. United States*, 63-1 U.S.T.C. 88, 397 (S.D. Tex. 1962), where the donor conveyed various properties in trust to three minor children and gave them (or their guardians) the right to terminate the trusts at any time, if legally capable of acting for themselves. If the trusts were not sooner terminated, they were to automatically terminate when the beneficiary reached age 30.

In *Martha J. Heidrich*, 55 T.C. 746 (1971), Rev. Rul. 60-218 was distinguished on the basis that in *Heidrich* the beneficiary, upon reaching age 21, had a *continuing* right to terminate the trust by giving written notice to the trustee. If the trust was not sooner terminated, it was to automatically terminate when the beneficiary reached age 25. In allowing the annual exclusion, the court held that:

> * * * [W]here the only impediment to the donee's use and possession of the unexpended trust funds will be the submission of a written demand to the trustee and where the written demand will be purely within the donee's power to make, we must conclude that the trust funds will pass to the donee at the time the right to make written demand accrues.

By reason of the trend of the foregoing decisions, the Service will no longer take the position that anything other than an "automatic termination" at age 21 will disqualify a trust for the benefit of a minor that otherwise meets the requirements of section 2503(c) as a present interest.

Accordingly, a gift to a minor in trust, with the provision that the beneficiary has, upon reaching age 21, either (1) a continuing right to compel immediate distribution of the trust corpus by giving written notice to the trustee, or to permit the trust to continue by its own terms, or (2) a right during a limited period to compel immediate distribution of the trust corpus by given written notice to the trustee which if not exercised will permit the trust to continue by its own terms, will not be considered to be the gift of a future interest as the gift satisfies the requirements of section 2503(c) of the Code, and the exclusion provided for in section 2503(b) is allowable.

Rev. Rul. 60-218 is hereby revoked.

Subchapter B. Transfers

Section 2511.—Transfers in General

26 CFR 25.2511: Statutory provisions; transfers in general.

Gift tax treatment of gifts made on or after January 1, 1967, by nonresidents not citizens of the United States. See T.D. 7296, page 255.

Section 2517.—Certain Annuities Under Qualified Plans

26 CFR 25.2517-1: Employees' annuities.

Whether any portion of an annuity attributable to contributions on behalf of a self-employed individual may be excluded from the total amount of gifts. See Rev. Rul. 74-119, page 276.

Subtitle C.—Employment Taxes

Chapter 21.—Federal Insurance Contributions Act

Subchapter A.—Tax on Employees

Section 3101.—Rate of Tax

26 CFR 31.3101-1: Measure of employee taxes.

Unpaid employment taxes attributable to a subsidiary in a parent-subsidiary relationship. See Rev. Proc. 74-16, page 437.

26 CFR 31.3101-1: Measure of employee taxes.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

Section 3102.—Deduction of Tax from Wages

26 CFR 31.3102-1: Collection of, and liability for, employee tax.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

Subchapter B.—Tax on Employers

Section 3111.—Rate of Tax

26 CFR 31.3111-1: Measure of employer tax.

Unpaid employment taxes attributable to a subsidiary in a parent-subsidiary relationship. See Rev. Proc. 74-16, page 437.

Subchapter C.—General Provisions

Section 3121.—Definitions

26 CFR 31.3121(a)-1: Wages.
(Also Sections 1371, 3306, 3401; 1.1371-1, 31.3306(b)-1, 31.3401(a)-1.)

Small business corporation dividends paid instead of salaries. Dividends that two sole shareholders of an electing small business corporation arranged to receive instead of reasonable compensation in the same amounts for services they performed constituted "wages" for which the corporation was liable for the taxes imposed by the FICA and the FUTA and the withholding of income tax.

Rev. Rul. 74-44

Advice has been requested whether, under the circumstances described below, an electing small business corporation incurred liability for the taxes imposed by the Federal Insurance Contributions Act, Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The corporation is a small business corporation with two shareholders, that has elected, pursuant to section 1371(a) of the Code, not to be subject to corporate income tax, but to have all its income taxed directly to its shareholders.

In 1972, the shareholders performed services for the corporation. However, to avoid the payment of Federal employment taxes, they drew no salary from the corporation but arranged for the corporation to pay them "dividends" of 100*x* dollars, which is the amount they would have otherwise received as reasonable compensation for services performed.

Sections 3121(a) and 3306(b) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, define the term "wages," with certain specific exceptions not material here, as "all remuneration for employment." Section 3401 (a) of the Code, relating to the withholding of income tax, contains a similar definition.

In the instant case, the "dividends" paid to the shareholders in 1972 were in lieu of reasonable compensation for their services. Accordingly, the 100*x* dollars paid to each of the shareholders was reasonable compensation for services performed by him, rather than a distribution of the corporation's earnings and profits. Such compensation was "wages" and liability was incurred for the taxes imposed by the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

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26 CFR 31.3121(a)-1: Wages.
(Also Sections 3306, 3401; 31.3306(b)-1, 31.3401(a)-1.)

Dismissal payment made under terms of an employment contract. Payments made to an employee, following his involuntary termination, under the terms of a 3-year contract permitting the employer to terminate the employment relationship provided the employee is paid an amount equal to an additional 6-months salary, are in the nature of dismissal payments and are wages for purposes of the FICA, FUTA, and income tax withholding; Rev. Rul. 58-301 distinguished.

Rev. Rul. 74-252

Advice has been requested whether, under the circumstances described below, payments made by a company to a former employee upon the termination of their employment relationship are "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

In the instant case the employee entered into an employment contract that stipulated that he would perform services for the company for a period of three years. Under the terms of the contract, the employer could terminate the relationship at any time provided the individual was paid an amount equal to an additional six months salary. The employer subsequently terminated the employment relationship and began paying the stipulated monthly amounts.

Sections 3121(a) and 3306(b) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, define the term "wages," with certain exceptions not here material, as "all remuneration for employment." Section 3401(a) of the Code, relating to the withholding of income tax, contains a similar definition.

Sections 31.3121(a)-1(i), 31.3306 (b)-1(i), and 31.3401(a)-1(a)(5) of the Employment Tax Regulations provide that remuneration for employment, unless specifically excepted, constitutes "wages" even though at the time paid the individual is no longer an employee.

Section 31.3401(a)-1(b)(4) of the regulations specifically provides, for purposes of income tax withholding, that all payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, constitute "wages" regardless of whether the employer is legally bound by contract, statute, or otherwise to make the payments.

Although there is no similar provision in the regulations which applies for purposes of the Federal Insurance Contributions Act or the Federal Unemployment Tax Act, the law has been that they both apply to such payments since the Social Security Act Amendments of 1950, Pub. L. No. 734, 81st Cong., 2d Sess. (August 28, 1950), 1950-2 C.B. 217, eliminated

the provision of prior law which had excluded dismissal payments from "wages" if the employer was not legally required to make them. *See H.R. Rep. No. 1300,* 81st Cong., 1st Sess. 124 (1949), 1950-2 C.B. 255, 277, 300.

Rev. Rul. 58-301, 1958-1 C.B. 23, holds that the consideration received by an employee for the cancellation of his employment contract is not "wages" for purposes of taxes imposed by the Federal Insurance Contributions Act and for purposes of Federal income tax withholding.

In this case the payments were made by the company to the employee upon his involuntary separation from the service of the company and were in the nature of dismissal payments. They were made pursuant to the provisions of the contract rather than as consideration for the relinquishment of interests the employee had in his employment contract in the nature of property.

Accordingly, it is held in the instant case that these payments are "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

Rev. Rul. 58-301 is hereby distinguished since the payments in this case were in the nature of dismissal payments and were not consideration for the cancellation of the employment contract of the individual as in that Revenue Ruling.

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26 CFR 31.3121(a)-1: Wages.

Unpaid employment taxes attributable to the subsidiary in a parent-subsidiary relationship. See Rev. Proc. 74-16, page 437.

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26 CFR 31.3121(a)(1)-1: Annual wage limitation.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

26 CFR 31.3121(b)(7)-1: Services in employ of States or their political subdivisions or instrumentalities.

Services performed by "off-duty" policemen. See Rev. Rul. 74-162, page 297.

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26 CFR 31.3121(b)(10)-2: Services performed in the employ of a school, college, or university by certain students.

Graduate student and research assistant university employees; summer studies. Services performed by graduate students and research assistants who work for a university that has waived its exemption from FICA taxes and who use the summer vacation for independent study and research, and during that time are not enrolled or regularly attending classes, are not excepted from "employment" in each summer calendar quarter that they are paid $50 or more.

Rev. Rul. 74-109

Advice has been requested whether, under the circumstances described below, services performed by graduate students and research assistants who work for a university during the summer vacation months are excepted from "employment" under section 3121(b)(10) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

Certain graduate students and research assistants who work for the university use the summer months to conduct research related to Ph.D. dissertations or for independent study and research related to preliminary examinations. These students do not register for courses or attend classes but are considered by the university to research which is an integral part of be engaged full time in the study and their degree programs.

The university is exempt from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3), and has filed with the Internal Revenue Service an effective Form SS-15, Certificate Waiving Exemption from Taxes Under the Federal Insurance Contributions Act, together with an accompanying list of employees who concur in the filing, Form SS-15a. Therefore, the services of its employees are "employment" unless otherwise excepted therefrom. See section 3121(b)(8)(B) of the Federal Insurance Contributions Act.

Section 3121(b)(10)(B) of the Act excepts from the definition of "employment" service performed in the employ of a school, college, or university if such service is performed by a student who is enrolled and is regularly attending classes at such school, college, or university. In addition, section 3121(b)(10)(A) of the Act excepts from "employment" service performed in any calendar quarter in the employ of any organization exempt from Federal income tax under section 501(a) (other than an organization described in section 401(a)) or under section 521, if the remuneration for such service is less than $50.

For their services to be excepted from "employment," it is necessary that the students be enrolled and be regularly attending classes at the university. The fact that the students are graduate students or research assistants does not prevent their services from being excepted from "employment." Rev. Rul. 72-142, 1972-1 C.B. 317, holds that services performed for a university by a student during the summer vacation, when he is not enrolled or regularly attending classes, are not excepted from "employment" if he earns $50 or more in the calendar quarters of the summer vacation.

Although, in the instant case, the students are considered by the university to be engaged full time in independent study and research during the summer, they are not enrolled and regularly attending classes during this period. Accordingly, if the remunera-

tion earned by a student in the calendar quarters of the summer vacation period amounts to $50 or more, the services performed are not excepted from "employment" under section 3121(b)(10) of the Federal Insurance Contributions Act.

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26 CFR 31.3121(b)(14)-1: Services in delivery or distribution of newspapers, shopping news, or magazines. (Also Sections 3306, 3401; 31.3306(c)(15)-1, 31.3401(a)(10)-1.)

Magazine subscription salespeople. Services performed by individuals who sell magazine subscriptions door to door on a full-time basis for a publishing company, do not deliver the magazines but merely send in the orders, receive compensation based partly on the number of subscriptions sold, and have the status of employees under the usual common law rules applicable in determining an employer-employee relationship are not excepted from "employment" for FICA and FUTA purposes and the remuneration paid for such services is not excepted from "wages" for income tax withholding purposes.

Rev. Rul. 74-232

Advice has been requested whether, under the circumstances described below, the provisions of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C of the Internal Revenue Code of 1954) that are applicable to the sale of newspapers and magazines also apply to individuals who sell magazine subscriptions.

A publishing company engages sales individuals on a full time basis to sell magazine subscriptions door to door. Each individual has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. After a sale is made the employee sends the order to the company and the magazines are sent directly to the subscriber. The employees' earnings are based, in part, on the number of subscriptions sold.

Section 3121(b)(14)(B) of the Federal Insurance Contributions Act and section 3306(c)(15)(B) of the Federal Unemployment Tax Act except from the term "employment," service performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such service, or is entitled to be credited with the unsold newspapers or magazines turned back.

For purposes of income tax withholding, section 3401(a)(10)(B) of the Code contains a similar provision to that cited above and excepts from the term "wages" amounts paid newspaper and magazine salespeople.

In this case, the compensation received by the subscription sales employees is not based on the retention of the excess of the price of the magazines over the price charged to the employee, but is, in part, affected by the number of subscriptions sold. The sales employees do not purchase the magazines from the publisher for resale to the public and, therefore, do not risk the potential loss that the vendors of magazines or newspapers would face if all or a portion of the goods were destroyed or unsold and not returnable. Further, the salespeople do not physically deliver the magazines to the ultimate consumers, but merely arranges for the magazines to be received in the future by the ultimate consumers by selling the right to receive them at such time.

Accordingly, it is held that the services performed by the magazine subscription salespeople in the instant case are not excepted from "employment" under section 3121(b)(14)(B) of the Federal Insurance Contributions Act and section 3306(c)(15)(B) of the Federal Unemployment Tax Act, and the remuneration paid for such services is not excepted from "wages" under section 3401(a)(10)(B) of the Code, relating to the Collection of Income Tax at Source on Wages.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)-1, 31.3401(c)-1.)

Baby sitter; day care service. A trained baby sitter who performs day care services for a county approved organization that retains the right to determine the nature of services to be performed and the manner of performance of such services is an employee of the organization for purposes of the FICA, FUTA, and income tax withholding; Rev. Rul. 56-70 distinguished.

Rev. Rul. 74-45

Advice has been requested whether workers performing babysitting services, under the circumstances described below, are employees for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

An organization provides day care services for children that live in the county in which it operates. The organization is required to apply annually to the county for permission to provide such services and must submit, along with its application, a program format and a budget forecast which the county uses to negotiate the program cost with the organization. Part of the negotiations includes the deter-

mination of the baby sitters' rate of pay. The negotiated rate of pay that is formally adopted by the county government may not be changed or modified by the organization.

The organization serves as an intermediary between working mothers and the baby sitters. The working mother contacts the organization, which arranges a meeting between her and the prospective sitter to determine, through their mutual consent, (1) whether the services are to be performed in the sitter's home or the mother's home, and (2) the hours that will be satisfactory and convenient to both parties.

The sitters submit semimonthly reports to the organization of the number of hours they work, and they are paid semimonthly by the organization. The organization solicits evaluations from the mothers to determine whether they actually received the services and whether they were satisfied. It replaces any sitter the mothers desire to have replaced. Should a sitter become ill or otherwise unable to care for children placed with her, she is required to call the organization so that the children may be placed with other sitters.

Before the sitters are permitted to perform day care services for the organization, they are required, by the State in which they work, to attend at least ten hours of classroom training in family day care services. The premises where the services are to be performed must meet certain State requirements, such as minimum floor space per child, exists, and general conditions. The State further requires the sitters to provide the children in their charge an opportunity for both indoor and outdoor play on a daily basis and to provide periods of quiet rest after periods of activity. Toys must be suitable for the ages of the children and must be kept in a good state of repair. It is also the responsibility of the sitters to see that the school age children under their care go to, and return from, school at the proper time, and that they attend regularly. The organization must observe all State requirements and enforce them and may discharge sitters if they do not comply with such requirements.

When Federal or State training grants are available, the organization uses these funds to train its baby sitters. However, when such grants are not available, prospective sitters are referred to the local schools that offer courses in child care and they must pay their own fees for the courses.

Although no written agreement between the organization and the sitters prevents them from making separate contracts to perform day care services for other parents who have not contracted with the organization, there is a State requirement that limits the number of children that a sitter may care for at one time.

The organization provides supplies such as games, etc., and social and health services for the children. However, it does not require the sitters to use such supplies or services. Any breakage, wear and tear, or destruction of the premises where the services are performed is at the risk of the owner of the premises. Sitters are free to accept or reject any assignment and need not attend monthly meetings conducted by the organization for the purposes of exchanging ideas with each other. The arrangement with the sitters contemplates that substantially all the services are to be performed by the sitters personally.

The sitters who use their own homes in caring for the children are responsible for whatever expenses they incur and are not required to render an accounting of such expenses.

An individual is an employee for Federal employment tax purposes if he has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are set forth in three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1(c), 31.3306(i)-1, and 31.3401(c)-1.

Generally, such relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct and control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in each case, are the furnishing of tools and the furnishing of a place to work.

In addition, consideration must be given to such factors as the continuity of the relationship and whether or not the individual's services are an integral part of the business of the employer as distinguished from an independent trade or business of the individual himself in which he assumes the risks of realizing a profit or suffering a loss. See *U.S. v. Silk and Greyvan Lines, Inc.*, 331 U.S. 704 (1947), 1947-2 C.B. 167 and *Bartels v. Birmingham*, 332 U.S. 126 (1947), 1947-2 C.B. 174.

Rev. Rul. 233, 1953-2 C.B. 294, holds that babysitters performing services for the customers of an establishment, engaged in a babysitter service, that furnishes rules instructing them in their conduct while on assignment and the nature of services to be performed as well as the manner of performance of such services are employees of that establishment for Federal

employment tax purposes, including income tax withholding.

Rev. Rul. 56-70, 1956-1 C.B. 460, holds that an individual who performs child care services in her own home and determines the nature of the services to be performed and the manner of performance of such services is not an employee, for Federal employment tax purposes, of the parents for whom she performs such services. In that Revenue Ruling the parents rely on the worker's judgment and generally issue no instructions. The worker makes her own determinations as to the amount of attention the child requires, the meals to be served, the manner in which she shall cope with any situation likely to arise, and she is free to perform her own household chores at any time she feels the child does not require her personal attention.

Although there are certain factors indicative of a lack of direction and control exercised over the baby sitters in the instant case, they perform personal services for the organization at frequent intervals pursuant to a continuing relationship. Their services are both necessary and incident to part of the activities conducted by the organization. The sitters are not engaged in an independent enterprise in which they assume the usual business risks. In addition, since they are trained they do not require constant supervision, but the organization does retain the right to supervise them to the extent necessary for the satisfactory conduct of its business, in order to protect its reputation and to insure the receipt of adequate income in return for its financial risks. The organization has the right to determine not only what the sitters do, but how it shall be done, and the fact that some of the authority stems from statutory regulations does not negate the right to direct and control which is the dispositive test under the common law.

Accordingly, it is held that the workers are employees of the organization for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

Rev. Rul. 56-70 is distinguishable since the facts therein do not establish a sufficient right to direct and control on the part of the parents. Some of the factors in the instant case not present in Rev. Rul. 56-70 are that (1) the baby sitters' salaries are negotiated between the organization and the county and must be accepted by the sitters, (2) the sitters must notify the organization if they become ill or otherwise unable to take care of the children placed with them so that the children may be placed with others, (3) the sitters must report to the organization on a semimonthly basis in order to be paid by it, and (4) the sitters must conform to State regulations that are enforced by the organization.

Rev. Rul. 56-70 is distinguished.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)-1, 31.3401(c)-1.)

Homeworkers; Christmas wreath makers. Individuals solicited by a company to weave Christmas wreaths in their own homes, using their own materials, on company supplied frames but without company instruction, direction, or control and who are under no obligation to sell the finished wreaths to the company are not employees for purposes of FICA, FUTA and income tax withholding.

Rev. Rul. 74-62

Advice has been requested whether certain Christmas wreath makers performing services under the circumstances described below are employees of a company for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (Chapters 21, 23, and 24 respectively, subtitle C, Internal Revenue Code of 1954).

Each fall a company solicits workers through newspaper advertisements and other means to weave Christmas wreaths from evergreen tips. Persons who respond to the company's advertisements and wish to make wreaths on a unit price basis are furnished, without charge or obligation, wire rings by the company on which the wreaths are made.

The worker takes the wire rings to his home and then, either personally or with the help of his famliy, collects evergreen tips, which are the basic material used for constructing Christmas wreaths, and which are subsequently woven around the wire ring in the symmetrical design, dimension, weight, texture, and color recommended by the company. The workers have differing arrangements by which they obtain the evergreen tips. Some grow and harvest their own evergreen tips on their own property, some contract with landowners and pay a certain amount per pound for the evergreen tips, and some obtain their evergreen tips without charge. The company does not supervise any of the work performed by the workers.

The company may either go to the homes of the workers or the workers may bring the finished wreaths to it or other wreath distributors. While each worker is paid a specific amount per finished wreath that is accepted by the company, he is under no obligation to sell his finished wreaths to the company and is even free to sell his finished wreaths to the company's competitors. The worker may terminate his services at any time and may sell or dispose of any rejected wreaths in any manner he sees fit. Likewise, the company buys only those finished wreaths that meet its specifications and is under no obligation to purchase any wreaths from a worker.

The wire rings the company fur-

nishes to the workers bear no identification and the company has no way of determining whether the wreaths purchased by it are made with the rings furnished by it. Each wire ring costs the company approximately three cents but the company furnishes them without charge to the workers with the hope that they will feel obligated to sell their finished wreaths back to it rather than to another distributor.

A number of workers bring finished wreaths to the company who were never contacted or given wire rings by it. Some workers buy their wire rings directly from a manufacturer and sell their finished wreaths to the company.

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1(c), 31.3306(i)-1, and 31.3401(c)-1. Generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed, it is sufficient if he has the right to do so.

The facts in the instant case show that the company does not exercise, or have the right to exercise, over the workers in the performance of their services the degree of direction and control necessary to establish an employer-employee relationship under the usual common law rules. Accordingly, the workers in the instant case are not employees of the company for purposes of the Federal Unemployment Tax Act or the Collection of Income Tax at Source on Wages.

With respect to the taxes imposed by the Federal Insurance Contributions Act, section 3121(d)(3)(C) of the Act, with certain exceptions not material here, includes within the definition of "employee" any individual (other than an individual who is an employee as an officer of a corporation or a common law employee) who performs services for remuneration for any person as a homeworker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person delegated by him if the contract of service contemplates that substantially all of such services are to be performed personally by such individual.

Although in this case the company furnishes the workers with wire rings that cost approximately three cents each, it does not furnish the workers with the evergreen tips which are the basic material used in constructing the wreaths. Moreover, the workers are not required to return their finished wreaths to the company. Therefore, the workers in the instant case do not meet the tests in section 3121(d)(3)(C) of the Federal Insurance Contributions Act and are not employees of the company for purposes of the Federal Insurance Contributions Act.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)-1, 31.3401(c)-1.)

Salesman performing services for manufacturers' representative. An individual engaged by a manufacturers' representative under an oral agreement to perform sales services as a "sub-agent" in a specific territory with all sales made in the name of the representative or the firms he represents, who is paid a commission based on a percentage of sales, is allowed a weekly draw, and is required to follow up on furnished leads to prospective customers, reports daily to the representative, submits weekly sales reports, and whose services may be terminated at any time by either party, is an employee of the manufacturers' representative for purposes of FICA, FUTA, and income tax withholding.

Rev. Rul. 74-98

Advice has been requested whether an individual performing services for a manufacturers' representative, under the circumstances described below, is an employee of the manufacturers' representative for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The manufacturers' representative, who is an independent contractor for Federal employment tax purposes, engaged a worker under an oral agreement to perform sales services as a "sub-agent" in a specific territory. Under the agreement the worker performs his sales services from 8:30 a.m. to 5:00 p.m., Monday through Friday, with all sales made in the name of the manufacturers' representative or the firms he represents.

The prices, terms, and conditions of sale are established by the firms. The worker is paid a commission by the manufacturers' representative based on a percentage of sales and he is allowed a weekly draw. No pensions, bonuses, or other benefits are offered. However, in the event of temporary sickness, the weekly draw would continue to be paid.

The worker is furnished and required to follow up on leads to prospective customers. He reports, daily

by telephone, to the manufacturers' representative and submits a weekly written report on his sales activities. The manufacturers' representative periodically works with the worker in his territory, and reviews his sales efforts. The worker is not required to meet a minimum quota of sales. While the manufacturers' representative furnishes samples, brochures, and calling cards, the worker pays all other selling expenses he incurs.

The worker's services may be terminated at any time by either party. The worker signed a statement that he is an independent contractor as to his sales activities.

An individual is an employee for Federal employment tax purposes if he has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1.

The regulations provide that generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient that he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer.

The facts in the instant case show that the manufacturers' representative exercises or has the right to exercise, over the worker the degree of direction and control necessary to establish an employer-employee relationship under the usual common law rules. Under the circumstances, the fact that the worker has signed a statement that he is an independent contractor is immaterial. A contractual provision is not conclusive of the relationship between the parties if it contradicts all the other facts and circumstances in the case bearing upon a determination of the true relationship between the various parties for employment tax purposes. See *Bartels v. Birmingham,* 332 U.S. 126 (1947), 1947-2 C.B. 174.

Accordingly, it is held, that the "sub-agent" is the employee of the manufacturers' representative for the purposes of the taxes imposed by the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)-1, 31.3401(c)-1.)

Stonecutters. Stonecutters performing services for a business that provides the working space and all large equipment, makes all the business arrangements for obtaining the stone and delivering the finished product, supervises the workers to the extent necessary, and may terminate the workers' services at any time are employees of the owner for purposes of the FICA, FUTA, and income tax withholding.

Rev. Rul. 74-110

Advice has been requested whether stone cutters performing services in the manufacture of whetstones, under the circumstances described below, are employees for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The owner of a business that manufacturers and sells whetstones engaged two stone cutters under oral agreements to cut and rough finish whetstones on a piece work basis. The stone cutters perform a two step operation and under the agreement they receive a specified amount for each slab they cut from a stone and a specified amount for each whetstone that is cut from the slab and rough finished. They are not guaranteed any minimum pay and they are not eligible for pensions, bonuses, paid vacations, or sick pay.

The owner furnishes the shop where the workers perform their services and all the large equipment to cut the stones into slabs. The owner makes all the arrangements for obtaining the stone and delivering the end product. The workers furnish their own hand tools. Since the two workers and the owner are the only individuals involved in the operation, they mutually agree upon the hours to be worked. No work quota is set. The stone cutters are skilled workmen and require no supervision insofar as workmanship is concerned. The owner often works with the stone cutters and in certain instances the workers may even instruct him as to how to perform the work to be accomplished. The owner may terminate a worker's service at any time.

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1.

As stated in the regulations, generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services,

not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services.

Whether an employer-employee relationship exists depends upon the particular facts in each case. The stone cutters in this case perform personal services pursuant to a continuing relationship created under an oral agreement terminable at any time and their services are both necessary and incident to the business conducted by the company. They are not engaged in an independent enterprise in which they assume the usual business risks. Since they are skilled workmen, they do not require constant supervision.

Although the stone cutters may be well qualified to perform work without detailed supervision and do perform services with considerable freedom of action, these facts are not controlling in reaching a decision as to their employment status since the ultimate test for determining whether there is an employment relationship is whether the person for whom the services are performed retains the right to exercise direction and control over them in the performance of their services.

In the instant case the company provides the working space and all the large equipment used, as well as making all the business arrangements for obtaining the stone used and delivering the finished product. The company supervises the workers to the extent necessary under the circumstances to obtain an acceptable finished product. The company may terminate the services of the workers at any time.

Accordingly, it is held that the stone cutters are the employees of the owner for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 3306, 3401; 31.3306(i)-1, 31.3401(c)-1.)

Salesmen; cable television system subscriptions. Salesmen selling cable television system subscriptions at prescribed prices and terms within assigned territories, under written agreements describing them as independent contractors, who receive only commissions and are required to pay all their own expenses, but who are required to follow up leads furnished by the company, appear at the company premises and submit daily reports, and may be terminated on the basis of an unfavorable comparison of sales to non-sales, are employees of the company for purposes of FICA, FUTA, and income tax withholding.

Rev. Rul. 74-111

Advice has been requested whether salesmen performing services under the circumstances described below are employees of a company for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24 respectively, subtitle C, Internal Revenue Code of 1954).

The company is in the business of obtaining subscriptions to cable television systems (CATV) and enters into written agreements with the salesmen to sell CATV subscriptions. In the written agreements the salesmen are called independent contractors. The salesmen do not have to follow a sales routine established by the firm or work a specified number of hours per week. They perform their services on a door-to-door basis within a territory specified by the company.

The salesmen are furnished leads by the company and are required to follow up and report on such leads. The salesmen must adhere to prices and terms established by the company and they record each sale on a card that must be turned over to the company. The company keeps a percentage record of sales to non-sales and may use this percentage as a basis for terminating their services. The salesmen are required to make out a daily report and to report to the company's premises each evening to record their sales.

The salesmen are provided training by the company and are required to pass a test on their knowledge of selling techniques and CATV systems in general before selling the company's subscriptions. They operate under the company's name and do not hold themselves out to the public as available to perform services of a similar or related nature.

The salesmen are paid on a commission basis and are not guaranteed a minimum amount of compensation. They are not allowed a drawing account and are not eligible for pensions or bonuses. The salesmen must pay all of their own expenses and are not reimbursed for these expenses by the company.

An individual as an employee for Federal employment tax purposes if he has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in

three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1.

As stated in the regulations, generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient that he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than employee and employer, such as independent contractor, is immaterial.

The facts in the instant case show that the company exercises, or has the right to exercise, over the salesmen the degree of direction and control necessary to establish an employer-employee relationship under the common law rules. The fact that the salesmen are described as independent contractors in their written agreements with the company is immaterial.

Accordingly, the salesmen in the instant case are employees of the company for the purposes of the taxes imposed by the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

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26 CFR 31.3121(d)-1: Who are employees. (Also Sections 1402, 3306, 3401, 6015, 6017; 1.1402(c)-1, 31.3306(i)-1, 31.3401(c)-1, 1.6015(a)-1, 1.6017-1.)

Gravediggers. An individual engaged in digging graves, under an arrangement with the operator of a funeral establishment who does not give instructions other than those received from the family of the deceased, supervise except to see that such instructions are carried out, furnish equipment, pay the individual's fee except as an accommodation to the deceased's family, or derive benefit other than goodwill from making the service available, is not an employee of the operator but is engaged in a trade or business; Rev. Rul. 54-368 superseded.

Rev. Rul. 74-219

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Rev. Rul. 54-368, 1954-2 C.B. 330.

The question presented is whether an individual performing services as a gravedigger, under the circumstances described below, is an employee of the operator of a funeral establishment for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The operator of a funeral establishment offers to the public, for a single, specified sum, a complete funeral service which includes embalming services, a casket, use of a chapel, as well as other professional and personal services. The service of opening and closing a grave usually is included only in a funeral for a still-born baby, in which case the operator performs such service personally. However, the operator will, at the request of the family of the deceased, make arrangements with the individual for such services.

The individual is contacted by the operator and furnished with instructions from the family. Such instructions concern the location and size of the grave and the date and time at which it is to be opened and closed. The operator supervises the work only to the extent of insuring that the instructions of the family have been carried out. The individual is free to turn down a request for his services from the operator. The individual furnishes a truck and any other machinery and equipment necessary in the performance of his services. He determines the fee that is to be charged for his services, with the approval of the operator.

The only benefit derived by the operator in these matters is the enhancement of his business good will. The family of the deceased may pay the individual directly or advance the operator the funds to pay him. Occasionally, the operator, as an accommodation to the family, may pay the individual, in which case the fee for the services is shown as a separate item on the bill the operator presents for the funeral services.

An individual is an employee for Federal employment tax purposes if he has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining whether that relationship exists are found in three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1. Generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as

to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is the employer. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.

The facts in this case show that the individual offers to furnish a service to the family of a deceased through the operator. However, the arrangement between the parties does not give the operator the right to control and direct the means and methods by which the services are to be performed, but only the result to be accomplished in keeping with the instructions from the family of the deceased.

In the instant case, the operator does not exercise, or have the right to exercise, the degree of direction and control over the individual necessary to establish the employer-employee relationship.

Accordingly, the individual is not an employee of the operator for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, or the Collection of Income Tax at Source on Wages.

Furthermore, the individual is engaged in a "trade or business" for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A of the Code), the income from which should be considered in computing net earnings from self-employment as contemplated by that Act and in determining whether he is required to file declaration of income tax and self-employment tax returns under sections 6015 and 6017, respectively, of the Code.

Rev. Rul. 54-368, is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)-1:Who are employees. (Also Sections 1402, 3306, 3401, 6015, 6017; 1.1402(c)-1, 31.3306(i)-1, 31.3401 (c)-1, 1.6015(a)-1, 1.6017-1.)

Telephone directory distributors. An individual engaged for three or four days in a year to deliver new and pick up old telephone directories, paid on a piece-work basis, using his own means, manner, and methods, and paying his own expenses which may include payments to assistants he hires, is not an employee of the delivery-service corporation but is engaged in a trade or business; Rev. Rul. 54-459 superseded.

Rev. Rul. 74-220

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in Rev. Rul. 54-459, 1954-2 C.B. 337.

The question presented is whether individuals who perform services, under the circumstances described below, for a delivery-service corporation are employees of the corporation for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The delivery-service corporation enters into contracts with various telephone companies for the distribution of new telephone directories to their subscribers. The names and addresses of the subscribers are furnished by the telephone companies on individual delivery tickets. A new directory is furnished for each delivery ticket. The corporation separates the tickets by geographical areas, and where possible by streets. It also separates the entire group of tickets into quantities which can be conveniently handled by an individual using an automobile or small truck. The corporation sends a representative to a given area to rent space to be used as an operating center, to receive the new directories from the printers, and to engage individuals, through advertisements in the local newspapers, to distribute the directories. Generally, the distributors are utilized only one time during a calendar year for a 3 to 4 day period.

The distributors agree to deliver the new directories to subscribers at the locations shown on the delivery record, attempt to pick up an old directory for each new directory delivered, return all delivery records and undelivered new directories, notify the corporation at once if delivery of the directories cannot be completed within the time limit, and tie the old directories in bundles and return them to the delivery office or operating center. Each distributor furnishes his own vehicle and pays all expenses in connection therewith. The distributors determine the means, manner and method of making the deliveries and may hire, supervise and pay any assistants they engage. The distributors perform no other services for the corporation.

The corporation furnishes form letters to the distributors suggesting means for performing the work efficiently. As a rule, the corporation has no contact with the distributors from the time they leave the operating center to begin delivery until the job is completed.

When the deliveries are completed, the corporation makes a spot check by telephone for the purpose of determining whether the deliveries reported have actually been made. A check or draft in payment of the service is mailed to each distributor after the spot check has been completed. The remuneration for the services is on a piece-work basis, that is, a certain amount for each new directory delivered and each old directory returned.

An individual is an employee for

Federal employment tax purposes if he has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining whether that relationship exists are found in three substantially similar sections of the Employment Tax Regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1. Generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is the employer. Another factor characteristic of an employer, but not necessarily present in every case, is the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result he is not an employee.

The facts in this case show that the corporation has no right to control and is interested only in the result to be accomplished by the work of the distributors and not as to the means by which that result is accomplished. The distributors have obligated themselves to furnish a service to the corporation. They have not agreed to perform the services personally and, in fact, retain the right to employ someone else for this purpose. The fact that the corporation arranges for an operating center and furnishes a form letter which suggests an efficient method for performing the delivery is not sufficient to establish the relationship of employer and employee between the distributors and the corporation.

Accordingly, the distributors are not employees of the corporation for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, or the Collection of Income Tax at Source on Wages.

Furthermore, the distributors are engaged in a "trade or business" for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A of the Code), the income from which should be considered in computing net earnings from self-employment as contemplated by that Act and in determining whether they are required to file declaration of estimated income tax and self-employment tax returns under sections 6015 and 6017, respectively, of the Code.

Rev. Rul. 54-459, is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

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26 CFR 31.3121(d)-1: Who are employees.

Whether police officers performing services on a bank's premises are its employees. See Rev. Rul. 74-162, below.

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26 CFR 31.3121(d)-2: Who are employers. (Also 31.3121(b)(7)-1, 31.3121(d)-1.) (Also Sections 3306, 3401; 31.3306(a)-1, 31.3306(c)(7)-1, 31.3306(i)-1, 31.3401(c)-1, 31.3401(d)-1.)

Off-duty policemen; directing traffic at bank. Off-duty policemen who volunteer for assignment to direct traffic at a bank auto drive-in facility, who are controlled by the police department, and who are paid by the city from the bank's payments to the police department for the service, are employees of the city excepted from "employment" under FICA and FUTA but their pay is subject to income tax withholding.

Rev. Rul. 74-162

Advice has been requested whether a bank or the city is the employer of "off-duty" policemen performing services, under the circumstances described below, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

The bank and the police department have an arrangement under which two off-duty policemen report to the bank each day it is open to direct traffic into and out of the bank's auto drive-in facility. Each policeman works a shift of four hours. The police department assigns only policemen who have expressed an interest in such traffic control services in the area of the auto drive-in facility owned by the bank.

The traffic assignments are made and scheduled by two members of the police department who have been assigned the job of coordinating extra work assignments and who are designated by the department as the extra work coordinators. The bank has no voice in selecting the policemen assigned to the work and does not negotiate with individual policemen or give them instructions as to the manner of performing the services. While performing the services, the policemen are subject to all of the departmental rules of a police officer on regular duty and may be recalled by their superiors at any time.

The remuneration the policemen receive for the traffic control services in this case is established by the City Council. The bank pays a fixed amount for such services to the police department upon receipt of a bill from the extra work coordinators. The coordinators then authorize the payment

of a part of the amount to the policemen as compensation for their services. The traffic control services provided are also available on similar terms when required by the operations of other firms.

The Employment Tax Regulations in discussing who are employers identify them generally as persons who employ employees (sections 31.3121(d)-2 and 31.3306(a)-1) and as any person for whom services are performed as an employee (section 31.3401(d)-1).

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are set forth in three substantially similar sections of the regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1. The regulations require the finding of a legal relationship of contractual nature that may be examined to determine whether it comprises an employer-employee relationship. Generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

In the instant case, the bank entered into an agreement with the police department to supply off-duty policemen to direct traffic at its auto drive-in facility for a specified rate of pay. The bank did not enter into contracts with the policemen. Therefore, the legal relationship is between the city's police department and the policemen while they are performing their services at the bank's auto drive-in facility.

While performing the services, the policemen are at all times subject to the direction and control of the city's police department. The fact that such policemen receive their remuneration for performing services on the bank's premises as a result of the bank's paying the police department does not of itself make them employees of the bank. Accordingly, in the instant case, the city is the employer of the off-duty policemen performing services in the area of the auto drive-in facility owned by the bank.

Section 3121(b)(7) of the Federal Insurance Contributions Act excepts from "employment" service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, with exceptions not here material. Section 3306(c)(7) of the Federal Unemployment Tax Act contains a similar provision. Accordingly, the services performed by the policemen at the auto drive-in facilities owned by the bank are excepted from "employment" by sections 3121(b)(7) and 3306(c)(7) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, and remuneration for such services is not subject to the taxes imposed by the Acts. However, it is subject to Federal income tax withholding on wages under section 3402 of the Code.

When social security coverage is desired for employees whose services are excepted from "employment" by section 3121(b)(7) of the Federal Insurance Contributions Act, the coverage may be obtained only pursuant to an agreement between the State and the Secretary of Health, Education, and Welfare entered into under section 218 of the Social Security Act, as amended, 42 U.S.C. 418 (1970).

Compare Rev. Rul. 54-616, 1954-2 C.B. 346 and Rev. Rul. 56-154, 1956-1 C.B. 477, which illustrate situations in which city policemen perform services for outside businesses and the third party is the employer. See Rev. Rul. 70-504, 1970-2 C.B. 204, which illustrates a situation, similar to that in this case, in which the policemen are employees of the city.

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26 CFR 31.3121(d)-2: Who are employers. (Also Sections 3306, 3401; 31.3306(a)-1, 31.3401(d)-1.)

Employer; corporation or its partner-owners. For purposes of FICA, FUTA, and income tax withholding, workers continue to be employees of a corporation, that provides engineering consultation and rehabilitation services in municipal sewer system construction in its home State, when they are working outside the State on the corporation's subcontract with a partnership whose equal partners own all the corporation's outstanding stock.

Rev. Rul. 74-180

Advice has been requested whether, under the circumstances described below, a partnership or a corporation is the employer of workers performing services, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24, respectively, subtitle C, Internal Revenue Code of 1954).

Two individuals who own all the outstanding stock of a corporation are also equal partners in a partnership. The corporation is in the business of providing engineering consultation services, as well as rehabilitation services, in the construction of municipal sewer systems within its home State. The partnership is in the business of securing similar work outside the State and engages salesmen, who are its employees, to perform sales services outside the State. After an

out-of-State sale is made and a contract entered into, the partnership, as a general contractor, enters into a contract with the corporation, as a subcontractor. The actual work performed under the contract is done by the same individuals who are employees of the corporation and who perform services in its home State and the partnership does not exercise, or have the right to exercise, any direct control or supervision over them. The corporation schedules and supervises all the out-of-State jobs obtained by the partnership in the same manner that it schedules and supervises jobs that it performs for itself or other general contractors within its home State.

The workers who perform under the contract of services between the partnership and the corporation are controlled and paid by the corporation for their out-of-State work in the same manner as they are controlled and paid in performing work within the State. The corporation bills the partnership for work performed by the corporation's workers based on fixed rates for various kinds of labor.

The Employment Tax Regulations in discussing who are employers identify them generally as persons who employ employees (sections 31.3121(d)-2 and 31.3306(a)-1) and as any person for whom services are performed as an employee (section 31.3401(d)-1).

An individual is an employee for Federal employment tax purposes if he has the status of employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are set forth in three substantially similar sections of the regulations, namely, sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1. The regulations require the finding of a legal relationship of contractual nature that may be examined to determine whether it comprises an employer-employee relationship. Generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

In this case the corporation continues to direct, control, and pay the workers who perform the services on out-of-State jobs secured by the partnership. While the corporation has a separate relationship with the partnership under which certain services are furnished it, there is no legal employment relationship between the workers and the partnership and the partnership does not exercise, or have the right to exercise, any direct control or supervision over the workers in their performance of services under the out-of-State contracts.

Accordingly, it is held in the instant case that the workers who perform services on out-of-State jobs secured by the partnership, remain employees of the corporation for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages.

Chapter 22.—Railroad Retirement Tax Act
Subchapter A.—Tax on Employees

Section 3201.—Rate of Tax

26 CFR 31.3201-1: Measure of employee tax.

Employment tax imposed under the Railroad Retirement Tax Act with respect to compensation paid during 1974 for services rendered between 1968 and 1973. See Rev. Proc. 74-13, page 435.

Subchapter B.—Tax on Employee Representatives

Section 3211.—Rate of Tax

26 CFR 31.3211-1: Measure of employee representative tax.

Employment tax imposed under the Railroad Retirement Tax Act with respect to compensation paid during 1974 for services rendered between 1968 and 1973. See Rev. Proc. 74-13, page 435.

Subchapter C.—Tax on Employees

Section 3221.—Rate of Tax

RAILROAD RETIREMENT BOARD
Railroad Retirement Supplemental Annuity Program
Quarterly Excise Tax Rate

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. 3221(c)) as amended by section 5(a) of Public Law 91-215 [1970-1 C.B. 360], the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each man-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning April 1, 1974, shall be at the rate of seven and one-half cents.

Dated: February 14, 1974.

By authority of the Board.

R. F. BUTLER,
Secretary of the Board.

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RAILROAD RETIREMENT BOARD

RAILROAD RETIREMENT SUPPLEMENTAL ANNUITY PROGRAM

Determination of Quarterly Rate of Excise Tax

In accordance with directions in Section 3221(c) of the Railroad Re-

tirement Tax Act (26 U.S.C. § 3221 (c) as amended by Section 5(a) of Public Law 91-215 [1970-1 C.B. 360], the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each man-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning July 1, 1974, shall be at the rate of seven and one-half cents.

Dated: May 17, 1974.

By Authority of the Board.

[SEAL] R. F. BUTLER,
Secretary of the Board.

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26 CFR 31.3221-1: Measure of employer tax.

Employment tax imposed under the Railroad Retirement Tax Act with respect to compensation paid during 1974 for services rendered between 1968 and 1973. See Rev. Proc. 74-13, page 435.

Subchapter D.—General Provisions

Section 3231.—Definitions

26 CFR 31.3231(a)-1: Who are employers.

Railroad retirement; real estate company owned by railroad. In similar situations the Internal Revenue Service, for purposes of the RRTA, will follow the decision in **Southern Development Company** that a real estate company, wholly-owned by a railroad, which leased space in one of its properties to its parent for the parent's ticket selling and general office operations, was an employer.

Rev. Rul. 74-121

Advice has been requested whether the taxes imposed by the Railroad Retirement Tax Act (chapter 22, subtitle C, Internal Revenue Code of 1954) are applicable in a situation similar to that in the case of *Southern Development Company v. Railroad Retirement Board,* 243 F. 2d 351 (8th Cir. 1957), involving the applicability of the Railroad Retirement Act of 1937, as amended, 45 U.S.C. chapter 9 (1970) and the Railroad Unemployment Insurance Act, as amended, 45 U.S.C. chapter 11 (1970).

In that case Southern Development Co. (Southern) owned an office building in which Kansas City Southern Railway Company (Railway), which controlled Southern, leased offices. Approximately 64 percent of the building's rental space was utilized by Railway for ticket selling and general offices. The rent from Railway was 73 percent of Southern's total rents from the building. Southern also owned other properties. Approximately 39 percent of Southern's total income was from the rent received from Railway. Southern's only employees were engaged in the operation of the office building, such as engineers, janitors, and elevator operators.

Under these facts Southern was held to be an employer for purposes of the Railroad Retirement Act and the Railroad Unemployment Insurance Act.

In arriving at its decision the Court stated at page 355, as follows:

> Maintaining a building almost exclusively for use by a railroad company for ticket selling and general offices could reasonably be considered a service connected with and supportive of rail transportation. * * * The furnishing of the office space and its maintenance, care and repair are certainly supportive of transportation and essential to its proper functioning. If such services were performed or furnished by Railway, they would be considered part of the transportation service and, of course, the Acts would then apply. The mere fact that these services are performed by a subsidiary, wholly owned and controlled by Railway, does not remove them from the Acts' embrace. * * *

Section 3231 of the Railroad Retirement Tax Act provides as follows:

> (a) Employer.—For purposes of this chapter, the term 'employer' means any carrier (as defined in subsection (g)), and any company which is directly or indirectly owned or controlled by one or more such carriers or under common control therewith, and which operates any equipment or facility or performs any service (except trucking service, casual service, and the casual operation of equipment or facilities) in connection with the transportation of passengers or property by railroad, * * *

The definitions of "employer" under the Railroad Retirement Tax Act, the Railroad Retirement Act, and the Railroad Unemployment Insurance Act are the same.

Accordingly, in situations similar to that in the *Southern Development Company* case, the taxes imposed by the Railroad Retirement Tax Act are applicable.

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26 CFR 31.3231(e)-1: Compensation.

Whether remuneration received by a seasonal employee of a railroad company is compensation. See Rev. Rul. 74-50, page 22.

Chapter 23.—Federal Unemployment Tax Act

Section 3306.—Definitions

26 CFR 31.3306(a)-1: Who are employers.

Whether a bank is the employer of "off-duty" policemen who perform services on its premises. See Rev. Rul. 74-162, page 297.

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26 CFR 31.3306(a)-1: Who are employers.

Whether employees of a corporation engaged in activities related to the construction of municipal sewer systems, pursuant to contracts secured by the corporation within a particular state, continue to be the corporation's employees when performing out-of-state contracts secured by a partnership that is owned by the same two individuals who own all the outstanding stock of the corporation. See Rev. Rul. 74-180, page 298.

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26 CFR 31.3306(b)-1: Wages.

Whether an electing small business corporation can avoid paying the tax imposed by the Federal Unemployment Tax Act on a major shareholder who actively participates in the corporation. See Rev. Rul. 74-44, page 287.

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26 CFR 31.3306(b)-1: Wages.

Whether payments made by an employer to an employee upon the involuntary separation of the employer-employee relationship pursuant to the terms of an employment contract are dismissal payments. See Rev. Rul. 74-252, page 287.

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26 CFR 31.3306(c)(7)-1: Services in employ of States or their political subdivisions or instrumentalities.

Services performed by "off-duty" policemen. See Rev. Rul. 74-162, page 297.

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26 CFR 31.3306(c)(15)-1: Services in delivery or distribution of newspapers, shopping news, or magazines.

Whether magazine subscription salespeople are excepted from "employment." See Rev. Rul. 74-232, page 289.

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26 CFR 31.3306(i)-1: Who are employees.

Whether workers performing babysitting services are employees. See Rev. Rul. 74-45, page 289.

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26 CFR 31.3306(i)-1: Who are employees.

Individuals making Christmas wreaths for a company. See Rev. Rul. 74-62, page 291.

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26 CFR 31.3306(i)-1: Who are employees.

Status of a "sub-agent" performing services as a salesman for a manufacturers' representative. See Rev. Rul. 74-98, page 292.

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26 CFR 31.3306(i)-1: Who are employees.

Whether stone cutters are employees of the firm for which they perform services. See Rev. Rul. 74-110, page 293.

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26 CFR 31.3306(i)-1: Who are employees.

Status of salesmen performing services for a cable television subscription firm. See Rev. Rul. 74-111, page 294.

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26 CFR 31.3306(i)-1: Who are employees.

Whether "off-duty" policemen performing services on a bank's premises are employees of the bank. See Rev. Rul. 74-162, page 297.

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26 CFR 31.3306(i)-1: Who are employees.

Whether a gravedigger is an employee of the operator of a funeral establishment. See Rev. Rul. 74-219, page 295.

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26 CFR 31.3306(i)-1: Who are employees.

Whether a distributor is an employee of a delivery-service corporation. See Rev. Rul. 74-220, page 296.

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26 CFR 31.3306(j)-1: State, United States, and citizen.

Citizens of Guam; employees of American employer. Amounts paid by an American employer to Guamanian citizens, not otherwise citizens of the U.S., for services performed in Guam are not subject to FUTA taxes payable to the U.S.

Rev. Rul. 74-304

Advice has been requested whether taxes are payable to the United States with respect to amounts paid by an American employer to Guamanian citizens for services performed in Guam, by reason of the tax imposed by the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954), in the light of the amendments made to the Act by the Employment Security Amendments of 1970, 1970-2 C.B. 348, 350.

Section 3306(c) of the Federal Unemployment Tax Act, as amended by the Employment Security Amendments of 1970, includes in the term "employment," services performed after 1971 outside the United States (with exceptions not here material), if performed by a citizen of the United States as an employee of an American employer.

Section 3306(j) of the Federal Unemployment Tax Act defines the term "United States," when used in a geographical sense, as the States, the District of Columbia, and the Commonwealth of Puerto Rico. Thus, for purposes of section 3306(j), Guam is outside the United States in the geographical sense. The section also provides that an individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered for purposes of this section as a citizen of the United States.

There is no similar provision with respect to citizens of Guam, who are citizens of the United States for purposes of the Organic Act of Guam, section 4(a), 48 U.S.C. 1421*l* (1970). Hence, individuals who are citizens of Guam but not otherwise citizens of the United States are not citizens of the United States for purposes of the Federal Unemployment Tax Act. The definitions of the terms "United States" and individuals who are "citizens" thereof were not changed by the Employment Security Amendments of 1970.

Accordingly, amounts paid to Guamanian citizens, not otherwise citizens of the United States, for services performed on the Island of Guam for an American employer do not give rise to taxes payable to the United States under the provisions of the Federal Unemployment Tax Act.

Chapter 24.—Collection of Income Tax at Source on Wages

Section 3401.—Definitions

26 CFR 31.3401(a)-1: Wages.

Whether an electing small business corporation can avoid withholding Federal income tax on a major shareholder who actively participates in the corporation. See Rev. Rul. 74-44, page 287.

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26 CFR 31.3401(a)-1: Wages.

Whether remuneration received by a seasonal employee of a railroad company is wages. See Rev. Rul. 74-50, page 22.

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26 CFR 31.3401(a)-1: Wages.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

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26 CFR 31.3401(a)-1: Wages.

Whether payments made by an employer to an employee upon the involuntary sepa-

ration of the employer-employee relationship pursuant to the terms of an employment contract are dismissal payments. See Rev. Rul. 74-252, page 287.

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26 CFR 31.3401(a)(10)-1: Remuneration for services in delivery or distribution of newspapers, shopping news, or magazines.

Whether amounts paid to magazine subscription salespeople are excepted from "wages." See Rev. Rul. 74-232, page 289.

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26 CFR 31.3401(c)-1: Employee.

Whether workers performing babysitting services are employees. See Rev. Rul. 74-45, page 289.

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26 CFR 31.3401(c)-1: Employee.

Individuals making Christmas wreaths for a company. See Rev. Rul. 74-62, page 291.

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26 CFR 31.3401(c)-1: Employee.

Status of a "sub-agent" performing services as a salesman for a manufacturers' representative. See Rev. Rul. 74-98, page 292.

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26 CFR 31.3401(c)-1: Employee.

Whether stone cutters are employees of the firm for which they perform services. See Rev. Rul. 74-110, page 293.

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26 CFR 31.3401(c)-1: Employee.

Status of salesmen performing services for a cable television subscription firm. See Rev. Rul. 74-111, page 294.

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26 CFR 31.3401(c)-1: Employee.

Whether "off-duty" policemen performing services on a bank's premises are employees of the bank. See Rev. Rul. 74-162, page 297.

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26 CFR 31.3401(c)-1: Employee.

Whether a gravedigger is an employee of the operator of a funeral establishment. See Rev. Rul. 74-219, page 295.

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26 CFR 31.3401(c)-1: Employee.

Whether a distributor is an employee of a delivery-service corporation. See Rev. Rul. 74-220, page 296.

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26 CFR 31.3401(d)-1: Employer.

Whether a bank is the employer of "off-duty" policemen who perform services on its premises. See Rev. Rul. 74-162, page 297.

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26 CFR 31.3401(d)-1: Employer.

Whether employees of a corporation engaged in activities related to the construction of municipal sewer systems, pursuant to contracts secured by the corporation within a particular state, continue to be the corporation's employees when performing out-of-state contracts secured by a partnership that is owned by the same two individuals who own all the outstanding stock of the corporation. See Rev. Rul. 74-180, page 298.

Subtitle D.—Miscellaneous Excise Taxes
Chapter 31.—Retailers Excise Taxes
Subchapter E. Special Fuels

Section 4041.—Imposition of Tax

26 CFR 48.4041-1: Tax on diesel fuel and special motor fuel.
(Also Section 4221.)

Exempt aircraft supplies; company aircraft engaged in foreign trade. A company using its own aircraft in noncommercial aviation to transport clothing materials sold to and finished garments purchased from its subsidiary in Puerto Rico is engaged in trade between the U.S. and one of its possessions, and the fuel used in such trade constitutes "supplies for vessels or aircraft" within the meaning of section 4221(d)(3) of the Code and is exempt from the retailers tax.

Rev. Rul. 74-112

Advice has been requested as to the applicability of the Federal excise tax on fuel used in noncommercial aviation imposed by section 4041(c) of the Internal Revenue Code of 1954, under the circumstances described below.

X corporation is in the clothing manufacturing business in the United States. *X* sells materials to *Y*, *X*'s subsidiary corporation in Puerto Rico, that fabricates the materials into garments and sells the completed garments to *X*. *X* uses its own aircraft to transport the materials from the United States to Puerto Rico and to transport the garments to the United States on return flights. The price that *X* charges *Y* for the sale of the materials is an arm's-length price taking into account the cost of transporting the material to Puerto Rico.

The specific question presented is whether *X*'s privately-owned aircraft used in the manner described above is engaged in "trade" between the United States and Puerto Rico for purposes of section 4221(d)(3) of the Code.

Section 4041(c) of the Code imposes a tax on gasoline and any other liquid either (1) sold by any person to an owner, lessee, or other operator of an aircraft, for use as a fuel in the aircraft in noncommercial aviation, or (2) used by any person as a fuel in an aircraft in noncommercial aviation, unless there was a taxable sale of such a liquid under section 4041(c).

Section 4041(g) of the Code provides, in essence, that the tax imposed by section 4041(c) shall not be imposed on any liquid sold for use or used as supplies for vessels or aircraft within the meaning of section 4221(d)(3).

The term "supplies for vessels," as defined in section 4221(d)(3) of the Code, includes supplies for civil aircraft actually engaged in trade between the United States and any of its possessions.

Section 7701(c) of the Code provides that references to possessions of the United States shall be treated as also referring to the Commonwealth of Puerto Rico.

Section 314.28 of Regulations 44, made applicable to the 1954 Code by T.D. 6091, 1954-2 C.B. 47, provides that the term trade includes the transportation of persons or property for hire.

Rev. Rul. 56-332, 1956-2 C.B. 816, concerns an aircraft that is owned and used by a company in transporting its

personnel to or from its business properties in a foreign country. The ruling holds that since the aircraft is not engaged in the transportation of persons or property for hire, the exemption from the Federal excise tax on fuel supplies used on the aircraft does not apply, and that the sales of gasoline, lubricating oil, and special motor fuels used in the aircraft are subject to the Federal excise tax.

Although not specifically indicated by the regulations, the term trade in section 4221(d)(3) of the Code also includes the ordinary meaning of the purchase, sale, or exchange of goods, and transportation incident to such purchases, sales, or exchanges. *See Standard Oil Co. v. United States,* 120 F. 2d 340 (C.C.P.A.), *cert. denied,* 314 U.S. 669 (1941).

The purpose of section 4221(d)(3) of the Code is to encourage vessels making commercial voyages outside the United States to buy their supplies in United States ports by exempting them from the excise tax on those supplies. See *S. Rep. No. 58,* 73d Cong., 1st Sess. 3 (1933), 1939-1 (Part 2) C.B. 884, 885.

Since *X* can buy its aircraft supplies in the United States, in Puerto Rico, or at foreign ports in between, it is the kind of situation in which Congress intended to encourage the purchase of supplies in United States ports. Furthermore, since *X* sells materials to *Y* and *Y* sells garments to *X*, and these materials and garments are flown between the United States and Puerto Rico, the transactions between *X* and *Y* are trade.

Accordingly, *X*'s aircraft is engaged in trade between the United States and one of its possessions within the meaning of section 4221(d)(3) of the Code. and the fuel used for that purpose is exempt under section 4041(g) from the tax imposed by section 4041(c).

The holding in Rev. Rul. 56-332 was stated in terms that the aircraft was not engaged in the transportation of persons or property for hire because the aircraft was not engaged in the transportation of goods purchased, sold, or exchanged.

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26 CFR 48.4041-4: Sales of diesel and special motor fuel; rules of general application.

Diesel or special fuels; liability of seller for reporting and paying tax. A supplier of diesel or special motor fuel is liable for the tax on his sales of the fuel regardless of whether he accepts or acknowledges a written statement tendered by the purchaser at the proper time indicating that all the fuel delivered by the supplier into the purchaser's storage tank is to be put to a taxable use.

Rev. Rul. 74-261

Advice has been requested as to the applicability of the retailers excise tax on diesel fuel imposed by section 4041(a) of the Internal Revenue Code of 1954, under the circumstances described below.

A purchaser of diesel fuel in bulk furnishes his supplier with a statement that all of the fuel delivered by the supplier into the purchaser's storage tank is for use by him for a taxable purpose in diesel-powered highway vehicles. Generally, it is the practice of the supplier to acknowledge receipt of the purchaser's statement by indicating that he (the supplier) accepts the responsibility of collecting and reporting the tax on diesel fuel. A copy of the acknowledgment is retained by both the supplier and the purchaser. Occasionally, however, the supplier does not acknowledge receipt of the purchaser's statement, nor does he indicate his awareness or acceptance of liability for the tax.

The question presented is whether acceptance and acknowledgment of the purchaser's statement by the supplier is necessary to make the supplier liable for tax on his sales of diesel fuel covered by the statement.

Section 4041(a) of the Code imposes a tax upon diesel fuel (1) sold by any person to an owner, lessee, or other operator of a diesel-powered highway vehicle, for use as a fuel in such vehicle; or (2) used by any person as fuel in a diesel-powered highway vehicle unless there was a taxable sale of such liquid under (1). Section 4041(b) imposes a similar tax on special motor fuels sold for use, or used, in a motor vehicle or motorboat.

Section 48.4041-4(a) of the Manufacturers and Retailers Excise Tax Regulations provides that the sale of diesel fuel to an owner, lessee, or other operator of a diesel-powered highway vehicle, or of special motor fuel to an owner, lessee, or other operator of a motor vehicle or motorboat shall be considered a taxable sale of such liquid (1) if the liquid is delivered by the seller into the fuel supply tank of the vehicle or motorboat, or (2) where not so delivered, the purchaser indicates in writing to the seller prior to or at the time of the sale that the entire quantity of the liquid covered by the sale is for use by him for a taxable purpose as a fuel in such a vehicle or motorboat. The regulations further provide that if such a written statement is not furnished by the purchaser, he shall be liable for the tax at the applicable rate on that quantity of the liquid which is used by him as fuel in such a vehicle or motorboat, or which is sold by him in a taxable transaction.

When it is established that a purchaser of diesel fuel or special motor fuel has furnished a written statement, at the proper time, to the seller indicating that all of the fuel purchased is to be put to a taxable use, a taxable sale has occurred under the statute. The seller of the fuel is liable for reporting and paying the tax. There is no provision in the regulations that permits the seller's acknowledgment of receipt of the statement to be considered necessary to establish liability so that he may ignore or refuse the

statement and thereby avoid liability. Accordingly, once the purchaser in the instant case has tendered the statement at the proper time, the supplier is liable for the tax on related sales of diesel fuel, whether or not he either acknowledges receipt of the purchaser's statement, or notifies the purchaser that he will be responsible for reporting and paying the tax.

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26 CFR 154.1-1: Tax-free sales and purchases of fuel under section 4041(c); registration.

Exemption for aircraft fuel sold for use as supplies for civil aircraft employed in foreign trade and registered in Zaire. See Rev. Rul. 74-48, page 315.

Subchapter F. Special Provisions Applicable to Retailers Tax

Section 4055.—State and Local Government Exemption

Whether a certain comprehensive health planning organization qualifies for exemption from the retailers excise taxes. See Rev. Rul. 74-253, page 316.

Section 4057.—Exemption for Nonprofit Educational Organizations

26 CFR 148.1-4: Tax-free sales or services to certain nonprofit educational organizations.
(Also Sections 4221, 4294; 148.1-4.)

Exemptions; "involvement drama" or "participation theater" organization. A nonprofit organization engaged solely in an activity known as "involvement drama" or "participation theater," that is educational in nature, but that does not meet the requirements relating to faculty, curriculum, and enrolled student body, does not qualify as a nonprofit educational organization for purposes of the exemption from the retailers, manufacturers, and communications taxes.

Rev. Rul. 74-46

Advice has been requested whether the organization described below is a "nonprofit educational organization" for purposes of the Federal excise tax exemptions provided by sections 4057(a), 4221(a)(5), and 4294(a) of the Internal Revenue Code of 1954.

A nonprofit organization is engaged solely in conducting an activity known as "involvement drama" or "participation theater." The purpose of this type of presentation is to encourage an audience, composed mainly of children, to participate in the dramatic performance and become a part of it by singing, clapping, thumping, noisemaking, dancing, or some similar means of spontaneous expression. In conducting this activity, the organization travels constantly from one location to another within a particular geographical area.

The organization performs in public and private schools, in institutions for the handicapped, and in children's wards of hospitals. The principal actors (or leaders) are usually college-age students specializing in involvement drama. No stage is required and the children generally sit on the floor in areas designated by the actors before a performance begins. The audience is limited in size for each performance to allow for maximum participation. Pre-program material is made available before a performance for distribution to educators or others for use in connection with the performance. While the plays are intended and most suited for children in kindergarten through the sixth grade, older children and adults often are observers.

The organization is recognized as exempt from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3).

Sections 4057(a) and 4221(a)(5) of the Code provide that, under regulations prescribed by the Secretary of the Treasury or his delegate, no retailers excise taxes or manufacturers excise taxes shall be imposed with respect to the sale of taxable articles to a nonprofit educational organization for its exclusive use, or in the case of a tax imposed by section 4041, with respect to the use by a nonprofit educational organization of any liquid as a fuel.

Section 4294(a) of the Code provides that, under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under section 4251 on any amount paid by a nonprofit educational organization for services or facilities furnished to such organization.

Under the provisions of sections 4057(b), 4221(d)(5), and 4294(b) of the Code, the term "nonprofit educational organization" means an educational organization described in section 170(b)(1)(A)(ii) that is exempt from income tax under section 501(a). Section 170(b)(1)(A)(ii) describes an educational organization as an organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

The fact that an organization may have been granted exemption from Federal income tax as an organization described in section 501(c)(3) of the Code does not, of itself, determine the applicability of the exemptions from the aforementioned excise taxes. In order for these exemptions to apply, the organization must meet the prescribed requirements of section 170(b)(1)(A)(ii) to come within the meaning of a "nonprofit educational organization."

Although the organization described above is engaged in an activity that in many respects is educational in nature, the organization does not *normally* maintain a *regular* faculty nor does it *normally* have a *regularly enrolled* body of pupils or students, in the sense that the words *normally, regular faculty,* and *regularly enrolled* are used in the statute. Furthermore,

the material and subject matter presented at the performances by the organization do not constitute a curriculum within the meaning of the statute.

Accordingly, the organization does not meet the statutory requirements of section 170(b)(1)(A)(ii) of the Code so as to come within the definition of "nonprofit educational organization" contained in sections 4057(b), 4221(d)(5), and 4294(b). Therefore, the exemptions from the retailers excise taxes and the manufacturers excise taxes, provided by section 4057(a) and 4221(a)(5), do not apply to sales of taxable articles to the organization. Likewise, the exemption from the communications taxes, provided by section 4294(a), does not apply to any amount paid by the organization for communication services or facilities furnished to the organization.

Chapter 32.—Manufacturers Excise Taxes
Subchapter A. Automotive and Related Items
Part I—Motor Vehicles

Section 4061.—Imposition of Tax

26 CFR 48.4061(a)-1: Imposition of tax.

Motor homes with incomplete bodies; converted to trucks. Sales by manufacturers of motor homes with incomplete bodies are not taxable but purchasers of the incomplete motor homes who convert them for sale or use as trucks are manufacturers of truck chassis and bodies subject to the manufacturers tax.

Rev. Rul. 74-262

Advice has been requested as to the application of the manufacturers excise tax on highway motor vehicle bodies and chassis imposed by section 4061(a) of the Internal Revenue Code of 1954 under the circumstances described below.

A certain automotive vehicle manufacturer manufactures a motor home that has an incomplete body. When sold by the manufacturer the exterior of the body has the appearance of a typical motor home, but the interior is bare except for wiring harnesses, insulation, and a driver's seat. The vehicle has the conformation and size of a truck van, and its gross vehicle weight is in excess of 10,000 pounds. The chassis of the vehicle is completely manufactured and is specially designed to accommodate a motor home body.

Most of the described vehicles are sold to manufacturers who complete the manufacture of the motor home bodies. A number of the incomplete vehicles are sold to manufacturers who complete them as vehicles other than motor homes, such as mobile labs, clinics, libraries, etc. The bodies of the latter vehicles are truck or bus bodies within the meaning of section 4061(a)(1) of the Code.

The question presented is what are the excise tax consequences when these vehicles are sold to manufacturers who convert the bodies into articles subject to the tax imposed by section 4061(a)(1) of the Code.

Section 4061(a)(1) of the Code imposes a manufacturers excise tax on certain enumerated highway motor vehicle bodies and chassis.

Motor home bodies and chassis are not among those articles enumerated in section 4061(a)(1) of the Code and are not subject to tax. However, when purchasers of the incomplete motor home vehicles convert them into trucks subject to the tax imposed by section 4061(a)(1), the purchasers are manufacturers of taxable truck chassis and bodies, and are subject to the tax imposed by that section on their sale or use of the converted vehicles, even though no actual structural modifications are made to the chassis. See Rev. Rul. 69-205, 1969-1 C.B. 277, and Rev. Rul. 73-197, 1973-1 C.B. 423, which state that when a chassis is sold with a body installed the classification of the body governs the classification of the chassis.

26 CFR 48.4061(a)-1: Imposition of tax.

Highway vehicle; hay loader-unloader. A self-propelled four-wheel motor vehicle designed for use in picking up, transporting, and unloading bales of hay on farms and not primarily designed for highway use is not subject to the manufacturers tax.

Rev. Rul. 74-285

A company manufactures and sells a self-propelled four-wheel motor vehicle (with a gross vehicle weight over 10,000 pounds) that is designed for use in picking up and transporting bales of hay from fields to storage points on farms where the bales are then unloaded. The vehicle consists of a special chassis upon which is mounted a flat bed body, without side supports, specifically designed for use in connection with the chassis. The body is 96 inches wide but may be equipped with optional foldover sides that increase the width to 108 inches to accommodate additional bales of hay. A snout, equipped with a chain conveyor, is permanently attached to the front of the vehicle and extends forward for the purpose of loading and unloading bales of hay. When bales of hay are being picked up, the front of the snout equipped with a bale catcher rests on the ground. When the vehicle is in motion, the snout is suspended off the ground by a lift device. At a storage point, the snout can be connected to an extension and raised to heights of at least 19 feet for unloading bales of hay into lofts, sheds, etc.

The chassis is equipped with a standard industrial engine designed to be center-mounted between the frame rails. The radiator is mounted onto the right front-end of the body and the driver's seat and control panel are on the left with the snout in between. A cab with windshield wipers is available as optional equipment. The chassis is also equipped with a heavy-duty transmission, hydraulic steering,

four-wheel hydraulic brakes, tail lights, standard highway-type axles and tires, and tractor field lights for night operations. The vehicle has a turning radius of 38 feet, a low center of gravity for stability, and a maximum unloaded speed of 45 miles per hour. Generally, the vehicle travels on the public highway only in moving from one farm to another.

Held, sales by the manufacturer of the body and chassis of the vehicle described above are not subject to the tax imposed by section 4061(a)(1) of the Internal Revenue Code of 1954, since the facts indicate that the articles are not primarily designed for highway use.

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26 CFR 48.4061(a)-1: Imposition of tax.

Application of the manufacturers excise tax to a conveyor discharge system sold on or in connection with the sale of a dump trailer. See Rev. Rul. 74-173, page 309.

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26 CFR 48.4061(a)-1: Imposition of tax.

Basis for manufacturers excise tax where the cost of tools and dies is charged to a customer by the manufacturer, or tools and dies are sold to a customer by the manufacturer. See Rev. Rul. 74-201, page 314.

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26 CFR 48.4061(a)-1: Imposition of tax.

Whether the sale of a bus for the use of a Sunday school under described conditions is subject to the manufacturers excise tax imposed by section 4061(a) of the Code. See Rev. Rul. 74-234, page 316.

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26 CFR 48.4061(b)-1: Imposition of tax.

Sale price; sleeper cabs; installation of mattresses and painting. The installation of custom-made mattresses in sleeper cabs and painting the cabs to meet customers' specifications are part of the manufacturing process and the charges are includible in the tax base even though billed separately.

Rev. Rul. 74-151

Advice has been requested whether certain amounts charged by a manufacturer of truck "sleeper cabs" are includible in the sales price of such articles, for purposes of computing the manufacturers excise tax imposed on sales of automotive parts or accessories by section 4061(b)(1) of the Internal Revenue Code of 1954.

A company manufactures and sells truck sleeper cabs of the type that are held to be subject to the tax imposed on automotive parts or accessories in Rev. Rul. 64-140, 1964-1 (Part 1) C.B. 374. The cabs are designed for permanent installation directly behind the regular cabs of automobile truck chassis or highway tractors to provide sleeping quarters for the drivers of the vehicles. In marketing its cabs, the company purchases mattresses that are made specifically for use in the company's sleeper cabs. The company installs the mattresses in the berths of the cabs, and when the cabs are sold a separate charge is made for the mattresses and the installation thereof.

The sleeper cabs are constructed of aluminum and many are sold unpainted. However, at a customer's request, the company will paint the cab according to the customer's specifications. For such painting, the company also makes a separate charge.

Section 4061(b)(1) of the Code imposes a tax on parts or accessories (other than tires and inner tubes) for any article enumerated in section 4061(a)(1) sold by the manufacturer, producer, or importer.

The tax imposed by section 4061(b)(1) of the Code applies to the total sale price of the taxable article. That section contemplates an article that is complete as to all component parts essential for the operation or appearance of the article, as well as any article sold on or in connection with the part or accessory that is intended to improve its performance or appearance. Thus, the sale price must contain all charges attributable to the manufacturing process that result in the final completed article.

The custom-made mattresses in the instant case are essential components of the completed sleeper cabs and their installation is considered part of the manufacturing process. Similarly, the painting of a sleeper cab by the company is considered but a final step in the manufacturing process to produce a completed painted cab, whether the paint is added to preserve the cab or to improve its appearance. See Rev. Rul. 62-4, 1962-1 C.B. 214, which holds that a charge by a company that manufactures automobile truck tank bodies for applying a "finish" coat of paint in accordance with instructions of the purchaser is includible in the tax base. However, under Rev. Rul. 62-4, any charges for special lettering or painting a company's name, address or symbols, and other related work would not be included in the tax base since these items do not serve any significant function in connection with the cab itself.

Accordingly, the charges attributable to the mattresses and their installation and to the painting, except for special lettering or painting indicated above, are includible in the total sales price of the sleeper cabs for purposes of computing the tax imposed by section 4061(b)(1) of the Code, even though such charges are stated separately.

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26 CFR 48.4061(b)-1: Imposition of tax.

Basis for manufacturers excise tax where the cost of tools and dies is charged to a customer by the manufacturer, or tools and dies are sold to the customer by the manufacturer. See Rev. Rul. 74-201, page 314.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Ratchet tie down system; replacement straps. A ratchet tie down system designed to be attached to and primarily used in securing loads on trucks, trailers, and semitrailers, and replacement straps that are sold separately, are taxable parts or accessories.

Rev. Rul. 74-33

Advice has been requested as to the applicability of the manufacturers excise tax on automotive parts or accessories, imposed by section 4061(b)(1) of the Internal Revenue Code of 1954, to the article described below.

A company manufactures and sells a ratchet type tie down system designed for use in securing loads on trucks, trailers, and semitrailers. The system consists of a ratchet, nylon strap, and hooks. The ratchet may be easily welded to a cross member of the truck or trailer body. The nylon strap is neoprene impregnated and has a tensile strength of 10,000 or 18,000 pounds, depending on the model. The strap is occasionally sold separately for replacement purposes.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer. Among the articles enumerated in section 4061(a)(1) are chassis and bodies for trucks, trailers, and semitrailers.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

The ratchet tie down system and replacement straps are designed to be attached to and are primarily used in connection with taxable trucks, truck trailers, and semitrailers. Therefore, the articles are parts or accessories within the meaning of section 4061(b)(1) of the Code and sales thereof by the manufacturer are subject to the tax imposed by that section.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Power take-off systems. Power take-off systems designed to operate taxable bodies or equipment are taxable parts or accessories; systems designed to operate nontaxable equipment are nontaxable; and systems designed to operate both taxable and nontaxable equipment are not taxable if primarily designed to operate nontaxable equipment; Rev. Ruls. 58-569 and 59-288 modified.

Rev. Rul. 74-47

The Internal Revenue Service has been asked whether the components of certain described power take-off systems are subject to the manufacturers excise tax on automotive parts or accessories imposed by section 4061(b)(1) of the Internal Revenue Code of 1954.

Various companies manufacture power take-off systems that transfer or convert power from highway motor vehicle engines to operate various types of equipment. In some instances chassis or body manufacturers offer the systems to their customers as optional accessories. At other times they are sold by manufacturers of equipment other than chassis and bodies as a means of linking their equipment with the power source available on a highway motor vehicle. The equipment sold by these manufacturers may, or may not, be articles taxable as automotive parts or accessories. The chassis, body, and equipment manufacturers may manufacture their own power take-off systems, or purchase them from other manufacturers.

Power take-off is accomplished either mechanically, hydraulically, electrically, or by a combination of the foregoing methods. The systems are identified both by the method used to transfer power, and by the location of the power take-off point on the chassis (transmission, drive shaft, etc.).

Mechanical power take-off systems transmit power from the take-off point on the highway motor vehicle chassis to the equipment by means of such parts as an adapter plate, a stub shaft or idler gear, a dampening device, one or more gear boxes (including the "transfer case") and belts or pulleys, drive shafts, universal joints, a clutch, a chain or gear transmission, and assorted other gears and mechanisms.

Hydraulic power take-off systems not only transfer power, but also convert the power medium from mechanical to hydraulic before application to the equipment. These systems utilize such components as an adapter plate, a stub shaft, a dampening device, a hydraulic pump, hydraulic fluid, hydraulic fluid tubing or hoses, fluid couplings, valves for speed and direction control, a response control apparatus, a hydraulic fluid reservoir, a hydrostatic motor, a chain or gear transmission, and assorted other gears and devices.

Section 4061(a)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain motor vehicle articles. The articles enumerated are chassis and bodies for automobile trucks, automobile buses, and truck and bus trailers and semitrailers, as well as tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

Section 4061(b)(1) of the Code imposes a tax on parts or accessories (other than tires and inner tubes) for any article enumerated in section 4061(a)(1).

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or acces-

sories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use. Such term also includes all articles which have reached such a stage of manufacture as to be commonly known as parts or accessories whether or not fitting operations are required in connection with their installation. The regulations further provide, however, that an article shall not be deemed to be a taxable part or accessory even though it is designed to be attached to the vehicle or to be primarily used in connection therewith if the article is in effect the load being transported and the primary function of the article is to serve a purpose unrelated to the vehicle as such.

The power take-off systems and the components thereof that are designed to be attached to or used in connection with highway type vehicles taxable under section 4061(a)(1) of the Code, that add to the utility of these vehicles as such, are taxable as parts or accessories under section 4061(b). Power take-off systems and components thereof that do not add to the utility of the vehicle as such are not taxable but are regarded as a nontaxable load.

A power take-off system adds to the utility of a vehicle as such if it is designed to perform a function relating to the transportation of persons or property over the highway, including a function relating to the loading and unloading of the vehicle. Accordingly, power take-off systems and components thereof that are designed to operate taxable bodies or equipment perform a function relating to the utility of the vehicle as such and are taxable, whereas systems designed to operate nontaxable equipment are nontaxable. When a system is designed to operate both taxable and nontaxable equipment, it is not taxable under section 4061(b) of the Code if it is primarily designed to operate nontaxable equipment.

It should be noted that taxable power take-off systems or components purchased for use as replacement parts are subject to the tax imposed by section 4061(b)(1) of the Code, regardless of the type of equipment with which the replacement parts are used. See Rev. Rul. 59-362, 1959-2 C.B. 255.

Rev. Rul. 58-569, 1958-2 C.B. 767, holds that a transmission power take-off for operation of a nontaxable hydraulic pump is a taxable part or accessory. Also, Rev. Rul. 59-288, 1959-2 C.B. 250, holds that a transmission power take-off that operates nontaxable cranes is a taxable part or accessory. The conclusions in Rev. Rul. 58-569 and Rev. Rul. 59-288 taxing the power take-offs is in conflict with the position taken in this ruling and therefore those revenue rulings are hereby modified.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Reel locks. Sales of "reel locks," devices used to secure cable reels that are carried on spindle bars mounted on utility trucks and trailers, are subject to the tax imposed on parts or accessories under section 4061(b)(1) of the Code.

Rev. Rul. 74-100

Advice has been requested whether sales by the manufacturer of "reel locks" are subject to the manufacturers excise tax imposed by section 4061(b)(1) of the Internal Revenue Code of 1954.

The reel lock is a device used to secure cable reels that are carried on spindle bars mounted on utility trucks and trailers. If unsecured, the reels may move from side to side along the spindle bar while the vehicle is in transit or while cable is being reeled out. The reel locks are placed over the spindle bar on either side of one reel, securing the reel in place but not preventing cable from being reeled out. The reel locks are not designed to serve any other function.

Section 4061(b)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1). Among the articles enumerated in section 4061(a)(1) are automobile truck bodies and truck trailer and semitrailer bodies.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use. This section provides further that articles contributing to the load-carrying function of the truck or other vehicle are taxable parts or accessories.

The reel locks described above are designed to be attached to and primarily used in connection with automobile trucks and truck trailers. The locks add to their utility by contributing to their load-carrying function in holding cable reels in place. Accordingly, such reel locks are parts or accessories within the meaning of section 4061(b)(1) of the Code and

sales thereof by the manufacturer are subject to the tax imposed by that section.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Fifth-wheel wrecker unit. A fifth-wheel wrecker unit designed to be temporarily mounted on the fifth wheel of a truck-tractor for the purpose of towing disabled tractors or tractor-trailer combinations over the highway is a part or accessory subject to manufacturers tax.

Rev. Rul. 74-122

Advice has been requested whether sales by the manufacturer of a "fifth-wheel wrecker unit" are subject to the manufacturers excise tax imposed by section 4061(b)(1) of the Internal Revenue Code of 1954.

The wrecker unit is designed to be temporarily mounted on the fifth wheel of a truck-tractor for the purpose of towing disabled tractors or tractor-trailer combinations over the highway. The unit is attached to the fifth wheel with a pin, and extends back to rest on the rear of the chassis frame where it is chained in place. The lift mechanism at the rear of the unit is electro-hydraulically operated, deriving its power from the battery of the towing vehicle. In operation, the unit lifts the front end of the disabled vehicle, and the truck-tractor to which it is attached may then tow such vehicle.

Section 4061(b)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1). Among the articles enumerated in section 4061(a)(1) are tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

The fifth-wheel wrecker unit described above is designed to be attached to and primarily used in connection with a taxable truck-tractor to add to its utility. Therefore, the unit is part or accessory within the meaning of section 4061(b)(1) of the Code and sales thereof by the manufacturer are subject to the tax imposed by that section.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Fiberglass liners for pickup truck bodies. Fiberglass liners designed to be attached to pickup truck bodies by means of bolts to provide greater strength and weather resistance for the bed and inner sides are taxable parts and accessories.

Rev. Rul. 74-136

Advice has been requested whether sales by the manufacturer of the article described below are subject to the manufacturers excise tax imposed by section 4061(b)(1) of the Internal Revenue Code of 1954.

A company manufactures a fiberglass liner designed to fit the bodies of most pickup trucks. The purpose of the liner is to provide greater strength and weather resistance for the bed and inner sides of the pickup truck body. The liner is attached to the body by means of bolts.

Section 4061(b)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1). Among the articles enumerated in section 4061(a)(1) are automobile truck bodies.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

The fiberglass liner described above is designed to be attached to and primarily used in connection with a pickup truck body to add to its utility. Accordingly, it is a part or accessory within the meaning of section 4061(b)(1) of the Code, and sales thereof by the manufacturer are subject to the tax imposed by that section.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.
(Also 48.4061(a)-1.)

Conveyor discharge system used with semitrailer and powered from truck-tractor. A conveyor discharge system designed to be attached to and used in connection with a bottom-dump semitrailer for unloading is a part or accessory and its separate sale by the manufacturer is subject to the tax imposed by section 4061(b)(1) of the Code. When sold with a semitrailer taxable under section 4061(a)(1) it is to be included in the tax base of the semitrailer.

Rev. Rul. 74-173

Advice has been requested as to the applicability of the manufacturers excise tax on automotive parts or accessories imposed by section 4061(b)(1) of the Internal Revenue Code of 1954 to the article described below.

A company manufacturers a conveyor discharge system that it sells for use with a taxable bottom dump semitrailer. The semitrailer is designed to be towed by a highway truck-tractor equipped with a fifth wheel to haul bituminous road material, sand, gravel, and other bulk materials. The conveyor discharge system is attached to the bottom of the semitrailer by means of pins. When attached, it extends from the normal discharge point to a point behind the semitrailer so as to facilitate the discharge of the load of the semitrailer to the rear by use of a conveyor belt. The conveyor is powered from a truck-tractor transmission by a hydraulic power pack system. The conveyor system can be installed or removed in approximately two hours.

Section 4061(a)(1) of the Code imposes a tax on the sale of certain enumerated motor vehicle articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) by the manufacturer, producer, or importer. Among the enumerated articles are chassis and bodies for truck trailers and semitrailers.

Section 4061(b)(1) of the Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use. For example, an article such as a towing cradle or loading or unloading equipment designed to be attached to or to be primarily used in connection with a truck is a taxable part or accessory inasmuch as the article contributes to the load-carrying function of the truck.

The conveyor discharge system is designed to be attached to and used in connection with the semitrailer for unloading, which contributes to the load-carrying function of the semitrailer. Therefore, it is a part or accessory within the meaning of section 4061(b)(1) of the Code and sales thereof by the manufacturer are subject to the tax imposed by that section.

However, if a conveyor discharge system is sold on or in connection with a semitrailer by the semitrailer manufacturer, the tax imposed by section 4061(a)(1) of the Code applies to the total price for which the semitrailer and system is sold.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Assembly kits; sides for flatbed truck or trailer bodies. Kits designed to be assembled on and attached to flatbed truck or trailer bodies to provide completely enclosed sides that facilitate use of the bodies for hauling particular cargos, and which are readily detachable so the trucks or trailers may be used as regular flatbeds, are taxable as parts or accessories sold in knockdown condition.

Rev. Rul. 74-233

Advice has been requested concerning the applicability of the manufacturers excise tax imposed by section 4061(b)(1) of the Internal Revenue Code of 1954 to sales of the kits described below.

A company manufactures and sells certain kits that are designed to be assembled on flatbed truck or trailer bodies. The kits, when assembled and attached to the bodies, provide completely enclosed sides to facilitate the use of the bodies in hauling particular kinds of cargo. Each kit contains all essential components, including aluminum posts, aluminum rod bows, plywood panels, and stakes. In addition, each kit also includes a fitted, vinyl-coated nylon tarp that serves as a protective cover. The tarp is equipped with a roll-away feature that provides easy access to the cargo. One of the kits is sold especially for use in hauling grain and other dry bulk commodities and contains a dump mechanism with chain for convenient unloading. All kits are readily detachable so that the truck or trailer bodies may be converted for alternate use as regular flatbed bodies with minimum time and effort.

Section 4061(b)(1) of the Code imposes a tax on parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1) sold by the manufacturer, producer, or importer. Among the articles enumerated in section 4061(a)(1) are truck bodies, truck trailer bodies, and semitrailer bodies.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis,

body, or tractor, to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

Section 316.4(c) of Regulations 46, made applicable to the 1954 Code by Treasury Decision 6091, 1954-2 C.B. 47, provides that a manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys, and assembles a taxable article from, such component parts.

The kits in the instant case, as sold by the company, contain components that when assembled are complete articles designed to be attached to truck or trailer bodies to add to their utility by contributing to the load-carrying function of the bodies.

Accordingly, the kits are automotive parts or accessories within the meaning of section 4061(b)(1) of the Code and sales of such kits by the company are sales of taxable articles in knockdown condition within the meaning of section 316.4(c) of the regulations. Therefore, the company is liable for the tax imposed by section 4061(b)(1) on its sale of the kits.

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26 CFR 142.1-1: Imposition of tax; exclusion for light-duty trucks, etc; exemptions for local transit buses and trash containers. (Also Section 4063; 142.1-1.)

Exemption; trash container hoists. Hoists specially designed to be attached to taxable truck chassis for use with exempt roll-off type detachable trash containers do not qualify for exemption from the tax on truck chassis or parts or accessories.

Rev. Rul. 74-263

Advice has been requested whether the lift hoists described below are exempt under the provisions of section 4063(a)(7) of the Internal Revenue Code of 1954 from the manufacturers excise tax imposed by section 4061(a).

A manufacturer of automotive parts and accessories manufactures lift hoists that are specially designed to be attached to taxable truck chassis for use with a variety of roll-off type detachable containers. The hoists in question are suitable for use, and used extensively, with roll-off trash containers of the type exempt under section 4063(a)(7) of the Code from the manufacturers excise tax imposed by section 4061(a).

Section 4061(a) of the Code imposes a tax upon certain enumerated articles sold by the manufacturer, producer, or importer, *including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof.* Among the articles enumerated in section 4061(a) are automobile truck chassis and bodies.

Section 4063(a)(7) of the Code provides that the tax imposed under section 4061(a) shall not apply in the case of any box, container, receptacle, bin or other similar article which is to be used as a trash container and is not designed for the transportation of freight other than trash, and which is not designed to be permanently mounted on or permanently affixed to an automobile truck chassis or body, or in the case of parts or accessories designed primarily for use on, in connection with, or as a component part of any such article.

Section 142.1-1(f) of the Temporary Excise Tax Regulations under the Revenue Act of 1971 provides that a part or accessory is exempt under section 4063(a)(7) of the Code only if it is installed on an exempt trash container at the time of sale or is sold with such container as an integral part of the container system and such system is not designed to be permanently mounted on a vehicle.

Under the regulations, even if a part or accessory is designed primarily for use with exempt trash containers, it is not itself exempt if it is designed to be permanently mounted on a vehicle. Accordingly, since they are specially designed to be attached to the truck chassis the exemption provided by section 4063(a)(7) of the Code is inapplicable to the lift hoists in the instant case. If such hoists are sold on or in connection with truck chassis, they are subject to the tax imposed by section 4061(a). When sold separately, or in combination with sales of any of the containers described, they are subject to the tax imposed on automotive parts or accessories by section 4061(b).

Section 4063.—Exemptions

26 CFR 142.1-1: Imposition of tax; exclusion for light-duty trucks, etc.; exemption for local transit buses and trash containers.

Whether a bus is operated in "mass transportation service in urban areas" for purposes of exemption from the manufacturers tax. See Rev. Proc. 74-1, page 411.

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26 CFR 142.1-1: Imposition of tax; exclusion for light-duty trucks, etc; exemptions for local transit buses and trash containers.

Whether certain lift hoists used with trash containers are exempt under the provisions of section 4063(a)(7) of the Internal Revenue Code of 1954 from the manufacturers excise tax imposed by section 4061(a). See Rev. Rul. 74-263, this page.

Part III.—Petroleum Products
Subpart A.—Gasoline

Section 4081.—Imposition of Tax

26 CFR 48.4081-1: Imposition and rates of tax.
(Also Sections 4082, 4083, 4101; 48.4082-1, 48.4083-1, 48.4101-1.)

Wholesale distributor of gasoline with no storage facilities. A company that maintains no storage facilities but regularly engages in purchasing and reselling gasoline in bulk quantities to producers, retailers, or users, for delivery by its supplier directly into the customers' bulk storage tanks, retains title to the gasoline from the time

of the purchase from its supplier until the gasoline is delivered to its customers' storage tanks, and elects to register under section 4101 of the Code, may make tax-free purchases of gasoline as a wholesale distributor.

Rev. Rul. 74-286

Advice has been requested whether the company described below may be registered as a "wholesale distributor" in order to be treated as a producer of gasoline for purposes of the tax imposed by section 4081 of the Internal Revenue Code of 1954 on sales of gasoline by the producer or importer thereof, or by any producer of gasoline.

The company is engaged in the trade or business of purchasing gasoline and reselling such gasoline regularly in bulk quantities to producers, retailers, or users for delivery into their bulk storage tanks. The company does not maintain its own storage facilities but instructs its supplier to deliver the gasoline directly to its customers. The company takes title to the gasoline at the time of purchase from the supplier and retains title until the gasoline is delivered into the customers' tanks.

Section 4083 of the Code provides that the tax imposed by section 4081 shall not apply in the case of sales of gasoline to a producer of gasoline. Section 4082(a) defines the term "producer" to include, among other persons, a wholesale distributor.

Under the provisions of section 4082(d) of the Code, the term wholesale distributor includes any person who (1) sells gasoline to producers, retailers, or to users who purchase in bulk quantities for delivery into bulk storage tanks, and (2) elects to register, under section 4101, with respect to the tax imposed by section 4081.

Section 48.4082-1(e) 1 of the Manufacturers and Retailers Excise Tax Regulations provides that the term wholesale distributor includes any person who (i) holds himself out to the public as being engaged in the trade or business of selling gasoline to producers of gasoline (including other wholesale distributors), to retailers of gasoline, or to users of gasoline who purchase in bulk quantities for delivery into bulk storage tanks; (ii) actually makes more than casual sales of gasoline to the persons described in (i); and (iii) has elected to be treated as a producer of gasoline.

Section 48.4101(b) of the regulations provides that the application for registry (Form 637) must include a statement setting forth in detail, in the case of a wholesale distributor of gasoline, a description of the storage facilities maintained by the distributor, and the percentage which his bulk sales of gasoline is expected to bear to his total sales of gasoline.

The specific question in the instant case is whether the company, although otherwise meeting the definition of a wholesale distributor under section 4082(d) of the Code and applicable regulations, is precluded from registering under section 4101 as a wholesale distributor because the company maintains no storage facilities for gasoline it purchases.

Although section 48.4101-1(b) of the regulations requires a wholesale distributor to furnish information regarding storage facilities maintained by it, neither this section of the regulations nor section 4082 of the Code requires a person to maintain a storage facility in order to qualify as a wholesale distributor of gasoline. Thus, the lack of storage facilities, in and of itself, does not prevent a person from qualifying as a wholesale distributor of gasoline. However, where a person, who otherwise qualifies as a wholesale distributor, lacks such facilities, it would be necessary to determine that he actually takes title to and resells the products in bulk quantities delivered to his customers in order to be treated as a producer of gasoline within the meaning of section 4082.

Accordingly, the company in the instant case is not precluded from registering even though it lacks storage facilities, inasmuch as it meets the requirements of the Code and regulations in order to qualify and register as a wholesale distributor.

Section 4082.—Definitions

26 CFR 48.4082-1: Definitions.

Whether a company may qualify and register as a wholesale distributor of gasoline for purposes of the manufacturers excise tax on gasoline, even though the company maintains no storage facilities. See Rev. Rul. 74-286, page 311.

Section 4083.—Exemption of Sales to Producer

26 CFR 48.4083-1: Exemptions; sales to producers of gasoline.

Whether, for purposes of the manufacturers excise tax on gasoline, a company may qualify and register as a wholesale distributor of gasoline and elect to be treated as a producer, even though the company maintains no storage facilities. See Rev. Rul. 74-286, page 311.

Subpart B.—Lubricating Oil

Section 4091.—Imposition of Tax

26 CFR 48.4091-6: Sales after December 31, 1965 of oil seldom used as a lubricant.

Lubricating oils; seldom used as lubricant. A controlled blend of petroleum base stocks used for quality control by rubber manufacturers is a lubricating oil seldom used as a lubricant sales of which by the manufacturer for nonlubricating use may be made tax free under section 48.4091-6(a) of the regulations; Rev. Rul. 70-55 amplified.

Rev. Rul. 74-200

Advice has been requested whether the oil product described below is considered to be "lubricating oil" for purposes of the manufacturers excise tax and, if so, whether it may be sold

tax free as a product seldom used as a lubricant.

A company manufactures and sells a controlled blend of petroleum base stocks used almost exclusively for quality control purposes by various manufacturers to determine whether their rubber compounds conform to certain requirements. The composition of the oil is subject to such rigid quality control requirements that the cost of the oil would prohibit its use as a lubricant. The rubber compound is immersed in the product for a period of time after which the compound's physical properties are analyzed, to determine whether the compound meets the manufacturer's quality standards.

Section 4091 of the Internal Revenue Code of 1954 imposes a tax of 6 cents a gallon on lubricating oil (other than cutting oils) sold by the manufacturer or producer.

Section 48.4091-2(a) of the Manufacturers and Retailers Excise Tax Regulations defines the term "lubricating oils" to include all oils, regardless of origin, which: (1) are suitable for use as a lubricant, or (2) are sold for use as a lubricant.

Section 48.4091-6(a) of the regulations provides that if the Commissioner determines that an oil suitable for use as a lubricant is seldom so used, but is used almost exclusively for nonlubricating purposes, the sale by the manufacturer of such oil direct to a purchaser for nonlubricating use by him or for resale by him for nonlubricating use may be made tax free. The manufacturer must obtain from the purchaser and retain in his possession a properly executed exemption certificate.

Rev. Rul. 70-55, 1970-1 C.B. 225, contains a list of lubricating oils under four categories that may be sold free of the manufacturers excise tax imposed by section 4091 of the Code, by reason of being oils "seldom used as lubricants" within the meaning of section 48.4091-6(a) of the regulations. Category 4 in the list describes certain oils, not used as lubricants, that have a primary function of performing physical or mechanical functions other than lubrication.

A chemical analysis of the product described above discloses that it comes within the regulations definition of "lubricating oil" in that it is an oil which is suitable for use as a lubricant. However, since the expense of the product would prohibit lubricating use, and since the product is used almost exclusively for the quality control purposes described above, the sale by the manufacturer of such oil to a purchaser for such nonlubricating use or for resale by him for such nonlubricating use may be made tax free provided he obtains a properly executed exemption certificate from his vendee.

Rev. Rul. 70-55 is hereby amplified to include under category 4 the following: Oils used for quality control purposes.

Subpart C.—Special Provisions Applicable to Petroleum Products

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Section 4101.—Registration

26 CFR 48.4101-1: Registration and bonding.

Whether, for purposes of the manufacturers excise tax on gasoline, a company may register as a wholesale distributor of gasoline, even though the company maintains no storage facilities. See Rev. Rul. 74-286, page 311.

Subchapter D.—Recreational Equipment

Part I.—Sporting Goods

Section 4161.—Imposition of Tax

26 CFR 48.4161-1: Imposition and rate of tax.

Basis for manufacturers excise tax where the cost of tools and dies is charged to a customer by the manufacturer, or tools and dies are sold to the customer by the manufacturer. See Rev. Rul. 74-201, page 314.

Part III.—Firearms

Section 4181.—Imposition of Tax

26 CFR 48.4181-1: Imposition and rates of tax.

Basis for manufacturers excise tax where the cost of tools and dies is charged to a customer by the manufacturer, or tools and dies are sold to the customer by the manufacturer. See Rev. Rul. 74-201, page 314.

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26 CFR 48.4181-2: Meaning of terms.

Replicas of antique firearms. Sales by an importer of articles manufactured, held out, and sold as replicas of antique pistols, revolvers, and rifles, but which are capable of firing or of being readily modified for firing, are subject to tax under section 4181 of the Code.

Rev. Rul. 74-137

Advice has been requested concerning the applicability of the manufacturers excise tax imposed by section 4181 of the Internal Revenue Code of 1954 under the circumstances described below.

A company imports and sells certain articles as replicas of antique pistols, revolvers, and rifles. Since the articles are manufactured primarily for their appeal as replicas, and not for firing, certain components used in their manufacture are of substandard quality. For example, the metal used may not be as hard as that normally used, or parts assisting automatic action may be inadequate, thus requiring manual operation. However, there is no indication in the company's advertising that the replicas are not for firing. In fact the replicas are either capable of firing a shot by means of an explosive, without imminent danger of injury to the person firing the weapon or of being readily modified for such firing. Examples of such modification include drilling out the flash holes and the addition of nuts to hold the parts more securely together. The projectiles for some of the rifles must be specially made since the proper size projectiles for them are not readily available.

The question presented is whether the importer's sales of these articles

are subject to the tax imposed by section 4181 of the Code on sales by the manufacturer, producer, or importer of certain firearms enumerated therein.

Section 4181 of the Code imposes a tax on the sale by the manufacturer, producer, or importer of pistols, revolvers, firearms (other than pistols and revolvers), shells, and cartridges.

Section 48.4181-2 of the Manufacturers and Retailers Excise Tax Regulations defines the term "pistols" to mean small projectile firearms which have a short one-hand stock or butt at an angle to the line of bore and a short barrel or barrels, and which are designed, made, and intended to be aimed and fired from one hand. The term "revolvers" means small projectile firearms of the pistol type, having a breech-loading chambered cylinder so arranged that the cocking of the hammer or movement of the trigger rotates it and brings the next cartridge in line with the barrel for firing. The term "firearms" means any portable weapons from which a shot, bullet, or other projectile may be discharged by an explosive.

Rev. Rul. 57-606, 1957-2 C.B. 733, states that whether a firearm is an antique is immaterial in determining the applicability of the manufacturers excise tax.

Although the articles in question are manufactured, held out, and sold as *replicas* of antique firearms, and certain of the components used in their manufacture are of substandard quality, they are capable of firing or of being readily modified for the firing of a shot, bullet, or other projectile by means of an explosive. Accordingly, these articles are pistols, revolvers, and firearms as defined in section 48.4181-2 of the regulations, and the importer's sales thereof are subject to the tax imposed by section 4181 of the Code.

Subchapter F.—Special Provisions Applicable to Manufacturers Tax

Section 4216.—Definition of Price

(Also Sections 4061, 4161, 4181, 7805; 48.4061(a)-1, 48.4061(b)-1, 48.4161-1, 48.4181-1, 301.7805-1.)

Manufacturers sale price; tools and dies. A separate charge made by a manufacturer for the cost of tools and dies to which he retains title is includible in the sale price on which manufacturers excise tax is computed unless future production is contemplated to which a portion of the cost may be allocated. If the tools and dies become the property of the vendee and their usefulness has been exhausted, the full charge is includible in the manufacturer's sale price; however, if some usefulness remains, then only that part of the charge equal to the depreciation incurred, computed under the "production output" method, is included. Rev. Rul. 54-414 superseded.

Rev. Rul. 74-201

The Internal Revenue Service has reconsidered Rev. Rul. 54-414, 1954-2 C.B. 415, which relates to whether costs of tools and dies may be excluded from the manufacturer's sale price for purposes of computing manufacturers excise tax liability.

Rev. Rul. 54-414 contains two holdings: The first is to the effect that in computing manufacturers excise tax, expenses incurred by a manufacturer for tools and dies are considered merely elements of the cost of manufactured articles and any separate charges made by the manufacturer for such expenses with respect to the sale of the articles must be included in the tax base (sale price). The second holding concludes that the cost to a manufacturer of tools and dies may be excluded from the manufacturer's selling price for the purpose of computing manufacturers excise tax liability if there is a written contract or other written evidence of an agreement between the manufacturer and the customer showing that the tools and dies become the property of the customer either by payment therefor by the customer in a lump sum or by amortization. With respect to the second holding, the Revenue Ruling states that if the charge for the tools and dies is not stated separately on the invoice, the contract or agreement must show the amount of the charge attributable to the tools and dies.

Section 4216(a) of the Internal Revenue Code of 1954 provides that in determining for purposes of the manufacturers excise tax, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of the manufacturers excise tax, whether or not stated as a separate charge. That section further provides that a transportation, delivery, insurance, or any other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Secretary of the Treasury or his delegate in accordance with the regulations.

Section 316.1(f) of Regulations 46, made applicable to the Internal Revenue Code of 1954 by T.D. 6091, 1954-2 C.B. 47, provides that the term "sale" means an agreement whereby the seller transfers the property (that is, the title or the substantial incidents of ownership) in goods to the buyer for a consideration called the price, which may consist of money, services, or other things.

Section 330.1-1(b) of the Regulations on Determination of Price and Price Readjustments provides that any charge which is required to be paid by a manufacturer, producer, or importer as a condition to his sale,

and which is not attributable to an expense falling within one of the exclusions provided in section 3441(a) of the Internal Revenue Code of 1939 [section 4216(a) of the Internal Revenue Code of 1954] is includible in the sale price upon which the tax is based.

In computing manufacturers excise tax liability, all items of consideration flowing from the vendee to the vendor must be included in the tax base. Thus, when parts are furnished to the vendor by the vendee, the Service has required that the vendor include the value of such parts in the tax base when computing manufacturers excise tax liability. See Rev. Rul. 69-437, 1969-2 C.B. 208.

Upon reconsideration of the first holding in Rev. Rul. 54-414, which pertains to situations where title to the tools and dies remains in the manufacturer, the Service has concluded that the factual situation therein should be amplified. Although it is not so stated in the ruling, it was assumed that the contract involved did not provide for future production in which the tools and dies might be used. Where there is no such provision in the contract, the conclusion in Rev. Rul. 54-414 is correct. However, if the contract provides for future production in which the manufacturer will use the tools and dies without further charge to the vendee, then only that portion of the charge for tools and dies that is properly attributable to the articles in the original purchase should be included in the sale price of such articles. In order to allocate a portion of the charge to future purchases, however, the invoice must clearly show that a portion of the charge pertains to future purchases, or the contract or agreement of sale must show that a portion of the charge is for future purchases. If this cannot be done, then the vendor must include the full amount of the charge for tools and dies in the sale price.

With respect to the second holding in Rev. Rul. 54-414, which involves transfer of ownership of the tools and dies to the vendee, the Internal Revenue Service is now of the opinion that a factor representing the value to the manufacturer of the use of the tools and dies must be included in the tax base to properly reflect the total consideration flowing from the vendee to the manufacturer. Rev. Rul. 69-437, *supra*. Accordingly, if the total usefulness of the tools and dies has been exhausted when the vendee takes ownership thereof, then the full charge for tools and dies must be included in the tax base. However, if some usefulness remains in the tools and dies when ownership is transferred, then only that part of the charge for tools and dies equal to the depreciation incurred computed under the "production output" method should be included in the tax base.

For example, if (a) the purchase is for 100 units, (b) the useful life of the tools and dies is estimated to be 500 units, and (c) the charge for the tools and dies is $1,000, then ⅕th $\left(\frac{100}{500}\right)$ of the life of the tools and dies has been expended in connection with the order. Accordingly, ⅕th of the $1,000 charge ($200) would be includible in the tax base of the sale.

Since conclusions with respect to the facts presented in Rev. Rul. 54-414 are incorporated herein, Rev. Rul. 54-414 is hereby superseded.

Under the provisions of section 7805(b) of the Code, the conclusion with respect to the value of the use of tools and dies being includible in the tax base will not be applied to sales of articles by manufacturers prior to May 6, 1974.

Subchapter G. Exemptions, Registrations, etc.

Section 4221.—Certain Tax-Free Sales

(Also Section 4041; 26 CFR 154.1-1.)

Exempt aircraft supplies. Zaire and Afghanistan are added to the list of countries that allow substantially reciprocal privileges for purposes of the exemption for supplies for civil aircraft of foreign registry, but Zaire only with respect to aircraft fuel and lubricants; Rev. Rul. 73-8 modified.

Rev. Rul. 74-48

Rev. Rul. 73-8, 1973-1 C.B. 438, as supplemented by Rev. Rul. 73-208, 1973-1 C.B. 439, and modified by Rev. Rul. 73-400, 1973-2 C.B. 361, sets forth a list of foreign countries that the Secretary of Commerce has found allow substantially reciprocal privileges in respect of aircraft registered in the United States for purposes of the special rule provided by section 4221(e)(1) of the Internal Revenue Code of 1954. That special rule relates to excise tax exemptions with respect to articles sold for use as supplies for civil aircraft registered in a foreign country and employed in foreign trade or trade between the United States and any of its possessions.

The Secretary of the Treasury has been advised by the Secretary of Commerce that he has found the privileges granted by Zaire and Afghanistan to be substantially reciprocal in respect of aircraft registered in the United States for purposes of the provisions of section 4221(e)(1) of the Code. With respect to Zaire, however, such reciprocal privileges are limited to aircraft fuels and lubricants. Therefore, the list of countries that have been found to allow substantially reciprocal privileges should include "Zaire (only aircraft fuel and lubricants)" and "Afghanistan."

Rev. Rul. 73-8 is hereby modified to accord with the conclusion stated herein.

(Also Sections 4055, 4292; 26 CFR 42.4292-1.)

Exemptions; comprehensive health planning organization. A nonprofit organization providing areawide comprehensive health planning for a number of towns with grants received from Federal government and contributions from local communities in its health service area, controlled by an advisory council elected from the organization's general membership and a board of directors elected by the advisory council, does not qualify for the "State and local government exemption" from manufacturers, retailers, or communications taxes.

Rev. Rul. 74-253

Advice has been requested whether articles subject to the manufacturers excise taxes imposed by Chapter 32 of the Internal Revenue Code of 1954 may be sold tax free under the provisions of section 4221(a)(4) to the organization described below.

The organization is incorporated under State law as a non-stock corporation to engage in comprehensive health planning for a number of towns in a health service area. A large portion of the organization's operating funds are provided by grants from the Federal government pursuant to the Comprehensive Health Planning and Public Health Services Amendments of 1966, section 314(b), 42 U.S.C. section 246, which authorized Federal support for comprehensive health planning. The balance of funds is provided by contributions from the local communities. The organization's board of directors which does not exceed thirty members is elected annually by the advisory council. Members of the advisory council are elected from the general membership of the organization. The organization's bylaws require that the membership of the board of directors and the advisory council be such (1) that a majority be persons whose major occupation is neither the provision or administration of any type of health service nor teaching or research in health, and (2) as to insure representation of the interests of local governments, public and voluntary agencies, health organizations and institutions, and consumers of health services in the area.

The organization is engaged in three basic types of activity: areawide health planning; review of programs involving applications for Federal funds; and consulting with towns, local groups, and agencies regarding health planning. The consulting activities are conducted within limitations imposed by guidelines for areawide comprehensive health planning promulgated by the Department of Health, Education, and Welfare. While the organization does not have adequate resources to conduct studies and programs at the request of agencies or community groups, it does design, supervise, and assist with studies and programs appropriate to the areawide plan.

Section 4221(a)(4) of the Code provides that under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under Chapter 32 on the sale by the manufacturer of an article to a State or local government for the exclusive use of a State or local government.

In determining whether sales to an organization are sales for the exclusive use of a State or local government, it must be established that the organization is either (a) controlled, directly or indirectly, by an agency of a State or local government, or (b) is performing a traditional governmental function on a nonprofit basis. See Rev. Rul. 70-214, 1970-1 C.B. 230, which discusses the excise tax exemption with respect to a nonprofit corporation organized to carry out community action programs.

The organization in question is not controlled directly or indirectly by an agency of a State or local government since it is operated by a board that is independent of State and local authority, and it does not depend on a State or local government for financial support. In addition, the comprehensive health planning and consulting activities of the organization under the circumstances are not traditional governmental functions ordinarily associated with State or local governments.

Therefore, sales of taxable articles by manufacturers to the organization may not be made tax-free under the provisions of section 4221(a)(4) of the Code since such sales are not for the exclusive use of a State or local government within the meaning of that section.

The rationale of this Revenue Ruling is equally applicable to the exemption from retailers excise taxes provided by section 4055 of the Code, and the exemption from facilities and services taxes provided by section 4292. Accordingly, the exemptions from excise taxes provided by sections 4055 and 4292 are not applicable in the case of the described organization.

Whether fuel used in noncommercial aircraft operated between the United States and Puerto Rico for the purpose of transporting clothing material and finished garments between affiliated companies constitutes "supplies for vessels" as that term is defined in section 4221(d)(3) of the Code. See Rev. Rul. 74-112, page 302.

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26 CFR 145.3-1: Tax-free sales of school buses.

Whether the exemption from manufactures excise tax for the sale of school buses is applicable to the sale of a bus to a church for certain uses. See Rev. Rul. 74-234, below.

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26 CFR 148.1-4: Tax-free sales or services to certain nonprofit educational organizations.

(Also 145.3-1.)

(Also Section 4061; 48.4061(a)-1.)

Exemptions; school bus; Sunday school and noneducational transportation. The sale to a church of a bus for use in transporting pupils to and from its Sunday school and for extensive use in transporting young people to and from various church youth functions and activities not directly related to the Sunday school's educational activities does not qualify for exemption from tax under either section 4221(a)(5) or (e)(5) of the Code.

Rev. Rul. 74-234

Advice has been requested whether, in the situation set forth below, the sale of a bus is exempt from the manufacturers excise tax on motor vehicle articles imposed by section 4061(a) of the Internal Revenue Code of 1954.

A certain church operates a Sunday school activity that qualifies as a nonprofit educational organization within the meaning of section 4221(d)(5) of the Code. The church purchased a bus from the manufacturer for use in transporting pupils to and from its Sunday school. However, the bus was also to be used extensively throughout the year to transport young people participating in the church's Boy Scout, Girl Scout, and Youth Fellowship programs at and away from the church, and for transporting children to and from a center for camp retreats at a church farm located about 20 miles from the church.

The specific question presented is whether the sale of the bus to the church is exempt under either the exemption for sales of articles to nonprofit educational organizations provided by section 4221(a)(5) of the Code, or the exemption provided for sales of school buses by section 4221(e)(5).

Section 4061(a)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated motor vehicle articles, including automobile bus chassis and bodies.

Section 4221(a)(5) of the Code provides that no manufacturers excise tax shall be imposed on the sale by the manufacturer of an article to a nonprofit educational organization for its exclusive use.

As defined in section 4221(d)(5) of the Code, the term "nonprofit educational organization" means an educational organization described in section 170(b)(1)(A)(ii) which is exempt from income tax under section 501(a). The term also includes a school operated as an activity of an organization described in section 501(c)(3) which is exempt from income tax under section 501(a), if such school normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Section 4221(e)(5) of the Code provides that the tax imposed by section 4061(a) shall not apply to a bus sold to any person for use exclusively in transporting students and employees of schools operated by State or local governments or by nonprofit educational organizations. For purposes of section 4221(e)(5), incidental use of a bus in providing transportation for a State or local government or a nonprofit organization described in section 501(c) which is exempt from tax under section 501(a) shall be disregarded.

Although the bus in the instant case was to be used to provide transportation for students who attended the church's Sunday school, it was also to be used extensively to transport persons in connection with various church youth functions and activities that are not directly related to the school's educational activities. Accordingly, the bus was not purchased "for the exclusive use of" the educational activity within the meaning of section 4221(a)(5) of the Code, and, therefore, the exemption provided by that section does not apply to the described sale.

Moreover, the exemption provided by section 4221(e)(5) of the Code does not apply to the described sale. Although that section refers to the sale of a bus to "any person," to construe that provision as including a sale to a nonprofit educational organization for its use would in effect vitiate the requirement of section 4221(a)(5) that the bus be sold for the exclusive use of the educational activity. The legislative history of that section indicates that the phrase "any person" as set forth in section 4221(e)(5) refers to independent operators who use buses to transport students under contract arrangements with schools. See *S. Rep. No. 324*, 89th Cong., 1st Sess. 554 (1965), 1965-2 C.B. 676, 712. See also Rev. Rul. 68-203, 1968-1 C.B. 484, indicating that a parents' committee of an inner-city church which purchases a bus for use exclusively in transporting students to a suburban school may be independent operators for purposes of section 4221(e)(5) of the Code.

In addition, even if section 4221(e)(5) of the Code applied to sales to a nonprofit educational organization, the transportation activities that are unrelated to the conveyance of students to and from school were so extensive that they cannot be considered merely "incidental" to the transportation of students. Therefore, the bus would not have been sold "for use exclusively" in transporting students within the meaning of section 4221(e)(5).

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26 CFR 148.1-4: Tax-free sales or services to certain nonprofit educational organizations.

Whether the exemption from the manufacturers excise taxes for sales of taxable articles to a "nonprofit educational organization" applies to an organization engaged in conducting an activity known as "involvement drama" or "participation theater." See Rev. Rul. 74-46, page 304.

Chapter 33.—Facilities and Services
Subchapter B.—Communications

Section 4251.—Imposition of Tax

26 CFR 49.4251-1: Imposition of tax. (Also Section 4252.)

Maintenance or repair of owned or leased communications equipment. Amounts paid by a telephone service subscriber for maintenance or repair of leased communications equipment interconnected with a taxable local telephone service are subject to the communications tax imposed by section 4251 of the Code. However, the tax is not applicable if the equipment is owned by the subscriber.

Rev. Rul. 74-49

Advice has been requested concerning application of the tax on communications service imposed by section 4251 of the Internal Revenue Code of 1954 to amounts paid for maintenance or repair of communications equipment in the situations described below.

Situation 1. A company subscribes to a telephone service that is subject to the communications tax imposed on amounts paid for telephone service by section 4251 of the Code. The subscriber also leases certain communication equipment from a source other than the company furnishing the telephone service. The leased equipment is used in connection with the telephone service. The subscriber entered into a contract with the lessor company for maintenance and repair of the leased equipment.

Situation 2. The facts are the same as in *Situation 1*, except that the subscriber purchases the communication equipment and has it maintained and repaired by various companies.

Rev. Rul. 73-401, 1973-2 C.B. 363, holds that the leased equipment in *Situation 1* is subject to the communications tax imposed by section 4251 of the Code, but the equipment in *Situation 2* is not subject to such tax.

The question asked is whether amounts paid for maintenance and repair of such equipment used in connection with the taxable telephone services are subject to the tax imposed by section 4251 of the Code.

Section 4251(a) of the Code imposes a tax on amounts paid for local telephone service, toll telephone service, and teletypewriter exchange service.

Section 4252(a) of the Code provides that the term "local telephone service" means (1) the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system, and (2) any facility or service provided in connection with a service described in (1). The term local telephone service does not include any service which is a "toll telephone service" or a "private communication service."

Section 49.4253-7(b) of the Facilities and Services Excise Tax Regulations provides with respect to the communications tax that amounts paid for the repair or replacement of instruments, wires, poles, switchboards, apparatus, or equipment, incidental to ordinary maintenance, are subject to tax.

The applicable law and regulations make no distinction between amounts paid to a company furnishing a basic taxable communications service and a company providing collateral equipment used in connection with the basic service. Likewise, there is no distinction for amounts paid for maintenance or repair of equipment used in a taxable communication service, when such equipment is owned by the company furnishing the communications service or some other company, as the charge for use of the equipment is subject to the communications tax. However, if the equipment used in a taxable communications service is owned by the subscriber there is no charge for use of the equipment that is subject to the communications tax and, therefore, any charge for maintenance or repair of the equipment is not subject to the communications tax.

Accordingly, in *Situation 1* amounts paid for maintenance and repair of the leased equipment are subject to the communications tax imposed by section 4251 of the Code.

However, in *Situation 2*, since the equipment is *owned* by the subscriber rather than *leased* by him, amounts paid for maintenance and repair of such equipment are not subject to the communications tax.

Section 4252.—Definitions

Whether the communications tax applies to amounts paid for the maintenance or repair of certain communications equipment sold or leased under described situations. See Rev. Rul. 74-49, above.

Subchapter C. Transportation by Air
Part I.—Persons

Section 4261.—Imposition of Tax

26 CFR 49.4261-1: Imposition of tax; in general.

Transportation of persons on Government-owned aircraft. An aviation company operating under a contract with a Government agency to provide domestic air transportation for the agency's personnel using both government-owned "public aircraft" and company planes is liable for tax on the "amount paid" for transportation on the Government's aircraft as well as its own. The computation of the tax may be based either on the cash received plus the value of the aircraft use and other agency contributions, or a comparable amount for similar services using a company plane.

Rev. Rul. 74-123

Advice has been requested concerning the application of the excise tax on the transportation of persons by air imposed by section 4261(a) of the Internal Revenue Code of 1954 under the circumstances described below.

Under the terms of a contract between a Federal agency and an aviation company, the company provides domestic air transportation for agency personnel on official business. In carrying out its contract the company uses both its own aircraft and aircraft owned by the Federal agency. All the aircraft used under the contract have maximum certificated takeoff weights in excess of 6,000 pounds. The agency pays the company for the service at a specified rate per hour which varies according to ownership and type of aircraft used and the number of crew members required.

The company is obligated to operate the aircraft on scheduled flights between definite points in the United States as provided in the contract. The company provides pilots and crews having the qualifications required by the contract and pays the salaries and other costs connected with their employment. All other personnel required to carry out the contract are provided by the company, and the company's personnel are under its own exclusive control, management and supervision. The Government-owned aircraft are "public aircraft" as defined in the Federal Aviation Administration regulations and, as such, they must be operated and maintained in compliance with the regulations pertaining to such aircraft.

Under the contract the company is responsible for the operating expenses of the Government-owned aircraft, such as fuel and oil. It performs the day-to-day maintenance, inspections, repairs, painting, tie down, storage, and protection of such aircraft. These services are performed on Government-owned aircraft at company expense, except that the agency furnishes at no cost to the company such spare parts and built-up engines as may be required for such aircraft. The agency is responsible for major repair and modifications of its own planes and the company maintains insurance on government-owned aircraft as prescribed by the agency at agency expense. The company has the sole responsibility for the safe operation of Government-owned aircraft and holds the agency harmless from all claims resulting from the performance of its services. Under certain circumstances, however, the agency will assume responsibility for damages resulting from use of Government-owned aircraft in excess of insurance coverage.

Section 4261(a) of the Code imposes a tax on amounts paid for taxable transportation of persons by air. For purposes of the tax imposed by section 4261(a), section 4262 defines "taxable transportation" as including (with exceptions not applicable here) transportation by air that begins and ends in the United States.

When the company uses its own aircraft under the circumstances of this case, amounts paid for the service rendered are clearly subject to the tax on transportation of persons by air imposed by section 4261 of the Code. The question presented is whether the amounts paid for service when the company uses Government-owned aircraft are subject to the tax imposed by section 4261.

The transportation service provided by the company when it operates Government-owned planes is essentially the same service provided by the company when it uses its own aircraft. Under the circumstances of the case, the mere fact that the company uses Government-owned aircraft rather than its own in carrying out the contract is not sufficient to change the nature of the service as "taxable transportation," for purposes of the tax imposed by section 4261 of the Code. Accordingly, amounts paid for the transportation services rendered in Government-owned aircraft are subject to the tax imposed by section 4261.

In computing the transportation tax due on the part of the service that involves use of Government-owned aircraft, the "amounts paid" for the service include not only the amount of money actually paid, but also the value of any contribution made by the agency toward providing the service; for example, the value of the use of Government-owned aircraft, insurance expense, etc. See Rev. Rul. 60-311, 1960-2 C.B. 341. However, in lieu of computing the tax on the foregoing basis, the Internal Revenue Service will accept a tax computed on the amount the company would charge the agency for the particular service if a comparable company-owned rather than Government-owned aircraft were used.

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26 CFR 49.4261-1: Imposition of tax; in general.

Rev. Rul. 74-181

Rev. Rul. 72-538, 1972-2 C.B. 577, concerns the applicability of the tax on the transportation of persons by air imposed by section 4261 of the Internal Revenue Code of 1954 to two situations involving a resident of Canada purchasing tickets in Canada for air transportation to points in the United States.

Held, the conclusions in Rev. Rul. 72-538 are applicable not only to residents of Canada but to any person purchasing such transportation.

Rev. Rul 72-538 is hereby modified to indicate such application.

Subchapter E. Special Provisions Applicable To Services and Facilities Taxes

Section 4292.—State and Local Governmental Exemption

26 CFR 42.4292-1: State and local government exemptions.

Whether a certain comprehensive health planning organization qualifies for exemption from the services and facilities excise taxes. See Rev. Rul. 74-253, page 316.

Section 4294.—Exemption for Nonprofit Educational Organizations

26 CFR 148.1-4: Tax-free sales or services to certain nonprofit educational organizations.

Whether the exemption from the communications taxes for services furnished to a "nonprofit educational organization" applies to an organization engaged in conducting an activity known as "involvement drama" or "participation theater." See Rev. Rul. 74-46, page 304.

Chapter 36.—Certain Other Excise Taxes

Subchapter B.—Occupational Tax on Coin-Operated Devices

Section 4461.—Imposition of Tax

26 CFR 45.4461-1: Imposition of tax.

Coin-operated gaming devices; personal or business use. An individual who uses an otherwise taxable coin-operated gaming device in his residence only for personal pleasure or for exhibition as a collector's item is not liable for the occupational tax; however, should his operation of the device take on the characteristics of a trade or business he would be liable for the tax.

Rev. Rul. 74-124

Advice has been requested concerning liability for the special tax imposed by section 4461 of the Internal Revenue Code of 1954, with respect to the use of a certain coin-operated gaming device.

The coin-operated gaming device in question has tumblers, accepts nickels, and makes payoffs depending on the combination of objects on the tumblers. The device is sold to individuals who use it for personal pleasure or for exhibition as a collector's item.

Section 4461(a) of the Code imposes a special annual tax to be paid by every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated gaming device as defined in section 4462.

Since section 4461(a) of the Code refers to "any place or premises," the fact that a coin-operated gaming device is used in a private residence rather than a commercial place would not exclude it from the tax. However, the general implication in that section of the term "maintains for use or permits the use of" is that someone other than the person who maintains the device will be the user and the operation of the device takes on the characteristics of a trade or business.

Therefore, where an individual uses the device only for his own pleasure or for exhibition as a collector's item, he is not maintaining for use or permitting the use of a coin-operated gaming device within the scope of section 4461 (a) of the Code. Accordingly, he is not liable for the special tax imposed by that section.

On the other hand, should his operation of the device take on the characteristics of a trade or business, he would be maintaining for use or permitting the use of a coin-operated gaming device and, therefore, liable for the tax imposed by section 4461(a) of the Code.

Subchapter D. Tax on Use of Certain Vehicles

Section 4482.—Definitions

26 CFR 41.4482(b)-1: Definition of taxable gross weight.

Highway use tax; public utility trucks. The weight of tool compartments bolted to the side of a public utility truck body and a platform assembly attached directly to the truck chassis to accommodate an earth boring machine is to be included in computing the actual unloaded weight of the truck for purposes of the highway use tax. However, the weight of outrigger-stabilizing jacks, front winch and mountings, and earth boring machine components is excluded.

Rev. Rul. 74-182

Advice has been requested whether the weight of the articles described below should be included in computing the "actual unloaded weight" of certain trucks for purposes of the highway motor vehicle use tax imposed by section 4481 of the Internal Revenue Code of 1954.

An electric power company owns and operates utility trucks equipped with the following articles:

(1) Outrigger—stabilizing jacks that provide jobsite support and leveling of the body or chassis on which specialized equipment, such as derricks, booms, diggers, towers, and ladders, are mounted. The jacks are built-in retractable legs and are hydraulically operated.

(2) Front winch and mountings that are attached to the bumper of the vehicle and are used for a variety of purposes in connection with the erection of transmission and distribution lines.

(3) A platform assembly which is attached directly to a truck chassis to accommodate an earth boring machine (hole diggers) which consists of a pivot-base assembly, sliding base assembly, operator's platform, hydraulic and drive parts, and wiring for marker lights and reflectors.

(4) Tool compartments that are bolted onto the side of the body of the truck and serve to store and carry the tools.

Section 4481 of the Code imposes a tax on the use of any highway motor vehicle which (together with the semitrailers and trailers customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle) has a taxable gross weight of more than 26,000 pounds.

Under the provisions of section 4482(b) of the Code, one of the factors to be taken into consideration in determining the taxable gross weight

of a highway motor vehicle is the actual unloaded weight of the vehicle fully equipped for service.

In the case of trucks and truck-tractors, section 41.4482(b)-1(b)(2)(i) of the Highway Motor Vehicle Use Tax Regulations defines the term "fully equipped for service" as including the body (whether or not designed and adapted primarily for transporting cargo); all accessories; all equipment attached to or carried on the truck or truck-tractor for use in connection with the movement of the vehicle by means of its own motor or for use in the maintenance of the vehicle; and a full complement of lubricants, fuel, and water. The regulation also provides that the term does not include driver, any equipment (not including body) attached to or carried on the vehicle for use in handling, protecting, or preserving cargo; or any special equipment (such as an air compressor, crane, specialized oilfield machinery, etc.) mounted on the vehicle for use on construction jobs, in oilfield operations, etc.

Rev. Rul. 67-416, 1967-2 C.B. 384, holds that the weight of a platform attached to a tank truck chassis to accommodate dispensing equipment must be included in computing the actual unloaded weight of the vehicle for purposes of the highway use tax.

The outrigger-stabilizing jacks, front winch and mountings described in (1) and (2), and the earth boring machine components in (3), serve no function in the transportation and maintenance of the trucks. Therefore, the weight of such articles is not to be included in computing the actual unloaded weight of the trucks for purposes of the highway use tax.

The tool compartments described in (4) are a part of the body used in storing and transporting the tools. The platform assembly in (3) serves a transportation function in providing a base on the chassis for accommodating the earth boring machine components. Therefore, the weights of both the tool compartments and the platform assembly in (3) and (4) are to be included in computing the actual unloaded weight of the vehicles for purposes of the highway use tax.

Chapter 41.—Interest Equalization Tax
Subchapter A. Acquisition of Foreign Stock and Debt Obligations

Section 4911.—Imposition of Tax

E.O. 11754

MODIFYING RATES OF INTEREST EQUALIZATION TAX

WHEREAS, I have determined that the rates of tax prescribed under section 1 of Executive Order No. 11464, [1969-1 C.B. 292] dated April 3, 1969, with respect to acquisitions of stocks of foreign issuers and debt obligations of foreign obligors made after April 4, 1969, are higher than the rates of tax necessary to limit the acquisitions by United States persons of stocks of foreign issuers and debt obligations of foreign obligors within a range consistent with the balance-of-payments objectives of the United States;

NOW, THEREFORE, by virtue of the authority vested in me by section 4911(b)(2) of the Internal Revenue Code of 1954, and as President of the United States, it is hereby ordered as follows:

SECTION 1. Section 1 of Executive Order No. 11464, [1969-1 C.B. 292] dated April 3, 1969, is hereby amended to read as follows:

"SECTION 1. *Rates of Tax.*

"(a) *Rates applicable to acquisitions of stock.* The tax imposed by section 4911 of the Internal Revenue Code of 1954 on the acquisition of stock shall be equal to 3.75 percent of the actual value of the stock.

"(b) *Rates applicable to acquisitions of debt obligations.* The tax imposed by section 4911 of the Internal Revenue Code of 1954 on the acquisition of a debt obligation shall be equal to a percentage of the actual value of the debt obligation measured by the period remaining to its maturity and determined in accordance with the following table:

If the period remaining to maturity is:	*The tax as a percentage of actual value is:*
At least 1 year, but less than 1¼ years	0.26 percent
At least 1¼ years, but less than 1½ years	0.33 percent
At least 1½ years, but less than 1¾ years	0.38 percent
At least 1¾ years, but less than 2¼ years	0.46 percent
At least 2¼ years, but less than 2¾ years	0.58 percent
At least 2¾ years, but less than 3½ years	0.69 percent
At least 3½ years, but less than 4½ years	0.89 percent
At least 4½ years, but less than 5½ years	1.09 percent
At least 5½ years, but less than 6½ years	1.28 percent
At least 6½ years, but less than 7½ years	1.45 percent
At least 7½ years, but less than 8½ years	1.63 percent
At least 8½ years, but less than 9½ years	1.78 percent
At least 9½ years, but less than 10½ years	1.93 percent
At least 10½ years, but less than 11½ years	2.08 percent
At least 11½ years, but less than 13½ years	2.28 percent
At least 13½ years, but less than 16½ years	2.58 percent
At least 16½ years, but less than 18½ years	2.84 percent
At least 18½ years, but less than 21½ years	3.06 percent
At least 21½ years, but less than 23½ years	3.26 percent
At least 23½ years, but less than 26½ years	3.44 percent
At least 26½ years, but less than 28½ years	3.59 percent
28½ years or more	3.75 percent"

SEC. 2. With respect to acquisitions of stock of foreign issuers and debt obligations of foreign obligors made under the rules of a national securities exchange registered with the Securities and Exchange Commission or under the rules of the National Association of Securities Dealers, Inc., this order shall be effective for acquisitions made after December 31, 1973, but only if the trade date was after December 31, 1973. In the case of other acquisitions of stock of foreign issuers and debt obligations of foreign obligors, this order shall be effective for acquisitions made after December 31, 1973.

RICHARD NIXON.

THE WHITE HOUSE,
December 26, 1973.

(Filed by the Office of the Federal Register on December 27, 1973, 11:06 a.m., and published in the issue of the Federal Register for December 28, 1973, 38 F.R. 35423)

E.O. 11766

Modifying Rates of
Interest Equalization Tax

WHEREAS I have determined that the rates of tax prescribed under section 1 of Executive Order No. 11754 of December 26, 1973, [page 321] with respect to acquisitions of stocks of foreign issuers and debt obligations of foreign obligors made after December 31, 1973, are higher than the rates of tax necessary to limit the acquisitions by United States persons of stocks of foreign issuers, and debt obligations of foreign obligors within a range consistent with the balance-of-payments objectives of the United States:

NOW, THEREFORE, by virtue of the authority vested in me by section 4911(b)(2) of the Internal Revenue Code of 1954, and as President of the United States, it is hereby ordered as follows:

Section 1. Section 1 of Executive Order No. 11464 of April 3, 1969, [1969-1 C.B. 292] as amended, is hereby amended to read as follows:

"Section 1. *Rates of Tax.*

"(a) *Rates applicable to acquisitions of stock.* The tax imposed by section 4911 of the Internal Revenue Code of 1954 on the acquisition of stock shall be equal to zero percent of the actual value of the stock.

"(b) *Rates applicable to acquisitions of debt obligations.* The tax imposed by section 4911 of the Internal Revenue Code of 1954 on the acquisition of a debt obligation shall be equal to zero percent of the actual value of the debt obligation measured by the period remaining to its maturity."

Sec. 2. With respect to acquisitions of stock of foreign issuers and debt obligations of foreign obligors made under the rules of a national securities exchange registered with the Securities and Exchange Commission or under the rules of the National Association of Securities Dealers, Inc., this Order shall be effective for acquisitions made after January 29, 1974, but only if the trade date was after January 29, 1974. In the case of other acquisitions of stock of foreign issuers and debt obligations of foreign obligors, this Order shall be effective for acquisitions made after January 29, 1974.

Richard Nixon.

THE WHITE HOUSE,
January 29, 1974.

(Filed by the Office of the Federal Register on January 29, 1974, 10:12 a.m., and published in the issue of the Federal Register for January 30, 1974, 39 F.R. 3807)

(Also Section 4914.)

Interest equalization; foreign minerals refined and converted in U.S. The commercially usable substance produced when a natural mineral substance mined in a foreign country is refined and converted in the U.S. satisfies the "substantial transformation of property" test, and constitutes property manufactured or produced in the U.S., for purposes of the exclusion from IET under section 4914(c)(1)(B)(i) of the Code applicable to the acquisition of a foreign debt obligation arising out of the export credit sale of a product.

Rev. Rul. 74-193

Advice has been requested whether, in the situation described below, a refined and converted mineral substance constitutes property manufactured in the United States for purposes of section 4914(c)(1)(B)(i) of the Internal Revenue Code of 1954.

In its operations, the taxpayer, a domestic corporation, purchases a natural mineral product which is mined in foreign countries and refines and converts such mineral product in the United States into a substance which is commercially usable. It sells the final product to unrelated foreign companies which, in payment therefor, issue debt obligations to the taxpayer that have periods remaining to maturity of one year or more.

Section 4911 of the Code, in part, imposes an interest equalization tax (IET) on each acquisition by a United States person (as defined in section 4920(a)(4)) of a debt obligation of a foreign obligor (if such obligation has a period remaining to maturity of 1 year or more).

Section 4914(c) of the Code provides an exemption from the IET for certain credit export transactions. Among the specific requirements for this exemption is the provision of section 4914(c)(1)(B)(i) that not less than 85 percent of the amount of the loan or the amount paid or other consideration given to acquire such debt obligation is attributable to the sale of personal property manufactured, produced, grown, or extracted in the United States.

Although there are no regulations under section 4914(c)(1)(B)(i) of

the Code, there are regulations under section 954(d)(1)(A) which contain specific tests for determining what constitutes manufacture, production, or construction of property. The effect of both cited sections is to provide that a particular incidence of Federal taxation depends in part upon where property which is purchased and thereafter sold is manufactured, produced, grown, or extracted. Both sections employ similar language in accomplishing their purposes. It is, therefore, appropriate to refer to the regulations under section 954(d)(1)(A) to determine whether property is manufactured, produced, grown, or extracted in the United States for purposes of section 4914(c)(1)(B)(i).

Section 1.954-3(a)(4) of the Income Tax Regulations provides two alternative tests for determining whether a foreign corporation will be considered to have manufactured, produced, or constructed personal property which it purchases and thereafter sells. The two tests are (1) the "substantial transformation of property" test and (2) the "purchased components" test. The foreign corporation must satisfy one of these two tests to establish that the property which it sells is in effect not the property which it purchased. The "substantial transformation of property" test provides, in part, that if purchased personal property is substantially transformed prior to sale, the property sold will be treated as having been manufactured, produced, or constructed by the selling corporation. The examples of transformed property given in the subparagraph are: a change in wood pulp to paper; steel to screws and bolts; and tuna fish to canned tuna fish.

In the instant case, the refining and converting process which changes the natural mineral substance into a commercially usable substance would satisfy the "substantial transformation of property" test prescribed in section 1.954-3(a)(4) of the regulations. Accordingly, the refined and converted mineral substance constitutes property manufactured or produced within the United States for purposes of section 4914(c)(1)(B)(i) of the Code.

It should be noted that the rate of IET specified in section 4911(b) of the Code has been reduced to zero by Executive Order 11766, dated January 29, 1974, effective for acquisition of foreign stock and debt obligations made after January 29, 1974.

Section 4914.—Exclusion for Certain Acquisitions

Whether a mineral which is mined in a foreign country, but refined and converted in the United States, constitutes property manufactured in the United States for purposes of section 4914(c)(1)(B)(i) of the Internal Revenue Code of 1954. See Rev. Rul. 74-193, page 322.

Section 4917.—Exclusion for Original or New Issues Where Required for International Monetary Stability

26 CFR 147.4-1: Exclusion for original or new issues where required for international monetary stability.
(Also Section 4920; 147.7-2.)

Interest equalization; Canadian corporation acquiring stock treated as domestic. A Canadian corporation's acquisition of a foreign stock issue treated as a domestic issue under section 4920 of the Code, following a U.S. person's acquisition of the original issue of the Canadian corporation's stock, will not of itself cause the Canadian corporation to be deemed "formed or availed of" for the purposes set forth in section 2(b) of Executive Order 11304, and will not cause the U.S. person's stock acquisition to be subject to the interest equalization tax.

Rev. Rul. 74-11

Advice has been requested whether, under the circumstances described below, the acquisition of stock in a Canadian corporation is excluded from interest equalization tax (IET) under section 4917 of the Internal Revenue Code of 1954.

A, a United States person, acquired the original issue of the stock of *X*, a Canadian corporation. *X* then acquired a foreign stock issue which is treated as a domestic issue under section 4920(b) of the Code.

Section 4917 of the Code provides, in relevant part, that if the President of the United States shall at any time determine that the application of the IET imposed by section 4911 will have such consequences for a foreign country as to imperil or threaten to imperil the stability of the international monetary system, he may, by Executive Order, specify that the IET shall not apply to the acquisition by a United States person of stock or a debt obligation of a corporation of such foreign country to the extent that such stock or debt obligation is acquired as all or part of an original or new issue.

Section 1 of Executive Order 11304, dated September 12, 1966, 1966-2 C.B. 482, provides, in part, that the tax imposed by section 4911 of the Code shall not apply to the acquisition by a United States person of stock of any corporation, partnership, or trust organized under the law of Canada or a political subdivision thereof, or any individual resident in Canada, if such stock is acquired as all or part of an original or new issue.

However, section 2 of Executive Order 11304 provides, in part, that the exclusion from tax provided in section 1 shall not apply to the following:

(a) Any acquisition of stock of a company registered under the Investment Company Act of 1940 (54 Stat. 847; 15 U.S.C. 80a-1 to 80a-52); and

(b) Any acquisition of stock of a Canadian corporation, partnership, or trust formed or availed of for the principal purpose of acquiring stock of a Canadian or other foreign issuer

other than stock described in section 4916(a) of the Code.

Section 4920(b) of the Code provides, in part, that a foreign corporation shall not be considered a foreign issuer with respect to any class of its stock provided certain conditions enumerated in section 4920(b) are met.

It is held in the instant case that the acquisition by *X* of the foreign stock issue which is treated as a domestic issue under section 4920(b) of the Code will not, of itself, cause such Canadian corporation to be "formed or availed of" for the prescribed purposes set forth in section 2(b) of Executive Order 11304.

Therefore, the acquisition by *A* of the stock of *X* is excluded from the IET under section 4917 of the Code provided all other requirements of that section have been met.

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26 CFR 147.4-1: Exclusion for original or new issues where required for international monetary stability.

Interest equalization; Canadian bonds; interest accrual date different than interest computation date. For purposes of the exclusion from interest equalization tax provided by section 4917 of the Code and Executive Order 11304 for new issues of Canadian bonds, the 90-day interest accrual period within which such bonds must be acquired runs from the date of issuance when a debtor-creditor relationship is in existence, not from an earlier date from which interest is computed.

Rev. Rul. 74-202

Advice has been requested concerning the date on which the interest begins to accrue for purposes of section 4917(c)(2) of the Internal Revenue Code of 1954 under the circumstances described below.

In 1970, an agency of a Canadian province issued a series of sinking funds bonds in the principal amount of 30*x* dollars (U.S.). The bonds are dated July 1, 1970, and will mature July 1, 1980. One-third of the principal amount of the bonds was issued on July 9, 1970 ("First Closing"), and two-thirds of the principal amount were issued on October 9, 1970 ("Second Closing") to United States underwriters. Interest on the bonds, whether such bonds were delivered at the first or second closing, ran from July 1, 1970. Payment for the bonds was made by United States underwriters at the respective closings against delivery of the bonds. The price of the bonds included interest from July 1, 1970.

Section 4911 of the Code imposes the interest equalization tax on the acquisition by a United States person (as defined in section 4920(a)(4)) of a debt obligation of a foreign obligor that has a period remaining to maturity of one year or more.

Section 4917 of the Code and Executive Order 11304, 1966-2 C.B. 482, provide an exclusion from the interest equalization tax for an acquisition by a United States person of original or new issues of foreign debt obligations, if the foreign obligor is an agency or a subdivision of the Canadian Government, and if notice of the acquisition is filed as prescribed by the Secretary of the Treasury or his delegate. Section 4917(c)(2) and section 147.4-1(b)(2) of the Temporary Regulations under the Interest Equalization Tax Act provide that for purposes of section 4917, a debt obligation, whether or not acquired from the obligor, shall be treated as part of an original or new issue only if acquired not later than 90 days after the date on which interest begins to accrue on such debt obligation. In addition, a notice of acquisition on Form 3779 (Notice of Acquisition of Original or New Canadian Stock or Debt Obligation) setting forth the information required by such form shall be timely filed in the manner prescribed under section 147.4-1(c) of the Temporary regulations.

Interest on indebtedness begins to accrue at the time the liability giving rise to the interest is in existence. Interest, when computed from a date prior to the issue date of an obligation, does not accrue until the obligation is in existence. The obligation first exists when by reason of a transaction between the issuer and the acquirer there has developed a relationship of debtor and creditor. See *Commissioner v. Philadelphia Transportation Company*, 174 F. 2d 255 (3rd Cir. 1949), *aff'd per curiam*, 338 U.S. 883 (1949).

Accordingly, for purposes of section 4917 of the Code, although the interest on the bonds issued in both closings was computed from July 1, 1970, the interest on the bonds in the first closing began to accrue on July 9, 1970, and the interest on the bonds issued in the second closing began to accrue on October 9, 1970. Therefore, the bonds issued to underwriters in both closings were acquired not later than 90 days after the date on which the interest began to accrue. If separate notices of acquisition, Form 3779, were timely filed for each closing for which the exclusion was claimed, the requirements of section 4917 and Executive Order 11304 were satisfied with respect to each closing and the acquisitions of the debt obligations are not subject to the interest equalization tax imposed by section 4911.

Section 4920.—Definitions and Special Rules

26 CFR 147.7-2: Foreign stock issues treated as domestic stock issues.

Whether the acquisition of stock in a Canadian corporation, under the circumstances described, is excluded from the interest equalization tax under section 4917 of the Internal Revenue Code of 1954. See Rev. Rul. 74-11, page 323.

Chapter 42. Private Foundations

Section 4941.—Taxes on Self-Dealing

26 CFR 53.4941(a)-1: Imposition of initial taxes.
(Also Sections 4944, 4945; 53.4944-1, 53.4945-1.)

T.D. 7299

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 53.—FOUNDATION EXCISE TAXES

Definition of "knowing" with respect to foundation excise taxes on foundation managers and government officials

DEPARTMENT OF THE TREASURY,
OFFICE OF THE COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

By a notice of proposed rule making appearing in the Federal Register for Tuesday, April 17, 1973 (38 F.R. 9512), amendments to the Foundation Excise Tax Regulations (26 CFR Part 53) under sections 4941, 4944, and 4945 of the Internal Revenue Code of 1954 were published.

These proposed regulations, which proposed revised rules relating to the definition of the term "knowing" as it applies to the excise taxes imposed on foundation managers and government officials, are adopted in this document with certain changes made in response to comments made by members of the general public and persons within the Treasury Department.

Section 4941(a)(2) imposes a tax on the participation of a foundation manager in an act of self-dealing, "knowing it is such an act, . . . unless such participation is not willful and is due to reasonable cause." Similarly, sections 4944 and 4945, respectively, impose taxes on a foundation manager who participates in the making of a jeopardizing investment or agrees to a taxable expenditure, "knowing" it is such a participation or agreement, unless it is "not willful and is due to reasonable cause." In addition, section 4941(a)(1) imposes a self-dealing tax on any government official who participates in an act of self-dealing "knowing that it is such an act".

The present regulations under sections 4944 and 4945 state that a foundation manager has acted "knowing" that an act is a jeopardizing investment or a taxable expenditure if he has actual knowledge of sufficient facts to make the act taxable under these sections and he is "generally aware that such an expenditure under these circumstances might be inconsistent with the law governing foundations."

Generally, the revised regulations retain the first component of the "knowing" test, make minor modifications to the second component, and add a third component—that the foundation manager (or government official) must have been negligent in not making reasonable attempts to ascertain whether the act would result in the imposition of tax under section 4941, 4944, or 4945, as the case may be.

Adoption of amendments to the regulations

In view of the foregoing and after consideration of all relevant matter as was presented by interested persons regarding the notice of proposed rule making dated April 17, 1973, the Foundation Excise Tax Regulations (26 CFR Part 53) under sections 4941, 4944, and 4945, relating to taxes on self-dealing, investments which jeopardize charitable purpose, and taxable expenditures, are amended as follows:

Paragraph 1. Paragraph (b)(3) of § 53.4941(a)-1 is amended to read as follows:

§ 53.4941(a)-1 Imposition of initial taxes.

* * * * *

(b) *Tax on foundation manager* * * *

(3) *Knowing.* For purposes of section 4941, a person shall be considered to have participated in a transaction "knowing" that it is an act of self-dealing only if—

(1) He has actual knowledge of sufficient facts so that, based solely upon such facts, such transaction would be an act of self-dealing,

(ii) He is aware that such an act under these circumstances may violate the provisions of federal tax law governing self-dealing, and

(iii) He negligently fails to make reasonable attempts to ascertain whether the transaction is an act of self-dealing, or he is in fact aware that it is such an act.

For purposes of this part and chapter 42, the term "knowing" does not mean "having reason to know". However, evidence tending to show that a person has reason to know of a particular fact or particular rule is relevant in determining whether he had actual knowledge of such fact or rule. Thus, for example, evidence tending to show that a person has reason to know of sufficient facts so that, based solely upon such facts, a transaction would be an act of self-dealing is relevant in determining whether he has actual knowledge of such facts.

* * * * *

Par. 2. Paragraph (b)(2)(i) of § 53.4944-1 is amended to read as follows:

§ 53.4944-1 Initial taxes.

* * * * *

(b) *On the management* * * *

(2) *Definitions and special rules*—

(i) *Knowing.* For purposes of section 4944, a foundation manager shall be considered to have participated in the making of an investment "knowing" that it is jeopardizing the carry-

ing out of any of the foundation's exempt purposes only if—

(*a*) He has actual knowledge of sufficient facts so that, based solely upon such facts, such investment would be a jeopardizing investment under paragraph (a)(2) of this section,

(*b*) He is aware that such an investment under these circumstances may violate the provisions of federal tax law governing jeopardizing investments, and

(*c*) He negligently fails to make reasonable attempts to ascertain whether the investment is a jeopardizing investment, or he is in fact aware that it is such an investment.

For purposes of this part and chapter 42, the term "knowing" does not mean "having reason to know". However, evidence tending to show that a foundation manager has reason to know of a particular fact or particular rule is relevant in determining whether he had actual knowledge of such fact or rule. Thus, for example, evidence tending to show that a foundation manager has reason to know of sufficient facts so that, based solely upon such facts, an investment would be a jeopardizing investment is relevant in determining whether he has actual knowledge of such facts.

* * * * *

Par. 3. Section 53.4945-1 is amended by revising paragraph (a)(2)(iii) and example (1) of paragraph (c)(3). These amended and added provisions read as follows:

§ 53.4945-1 Taxes on taxable expenditures.

(a) *Imposition of initial taxes* * * *

(2) *Tax on foundation manager* * * *

(iii) *Knowing.* For purposes of section 4945, a foundation manager shall be considered to have agreed to an expenditure "knowing" that it is a taxable expenditure only if—

(*a*) He has actual knowledge of sufficient facts so that, based solely upon such facts, such expenditure would be a taxable expenditure,

(*b*) He is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing taxable expenditures, and

(*c*) He negligently fails to make reasonable attempts to ascertain whether the expenditure is a taxable expenditure, or he is in fact aware that it is such an expenditure.

For purposes of this part and chapter 42, the term "knowing" does not mean "having reason to know". However, evidence tending to show that a foundation manager has reason to know of a particular fact or particular rule is relevant in determining whether he had actual knowledge of such fact or rule. Thus, for example, evidence tending to show that a foundation manager has reason to know of sufficient facts so that, based solely upon such facts, an expenditure would be a taxable expenditure is relevant in determining whether he has actual knowledge of such facts.

* * * * *

(c) *Special rules* * * *

(3) *Examples.* * * *

Example (1). A, B, and C comprise the board of directors of Foundation M. They vote unanimously in favor of a grant of $100,000 to D, a business associate of each of the directors. The grant is to be used by D for travel and educational purposes and is not made in accordance with the requirements of section 4945(g). Each director knows that D was selected as the recipient of the grant solely because of his friendship with the directors and is aware that some grants made for travel, study, or other similar purposes may be taxable expenditures. Also, none of the directors makes any attempt to consult counsel, or to otherwise determine, whether this grant is a taxable expenditure. Initial taxes are imposed under paragraphs (1) and (2) of section 4945(a). The tax to be paid by the foundation is $10,000 (10 percent of $100,000). The tax to be paid by the board of directors is $2,500 (2½ percent of $100,000). A, B, and C are jointly and severally liable for this $2,500 and this sum may be collected by the Service from any one of them.

* * * * *

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 19, 1973.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 21, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 27, 1973, 38 F.R. 35304)

Section 4942.—Taxes on Failure to Distribute Income

26 CFR 53.4942(a)-2(c)(5): Computation of undistributed income; applicable percentage.

Rev. Rul. 74-238[1]

Pursuant to section 4942(e)(3) of the Internal Revenue Code of 1954, it has been determined that the applicable percentage to be used by a private foundation in determining its minimum investment return with respect to a taxable year beginning in calendar year 1974 has been changed, in the case of a private foundation organized after May 26, 1969, from 5.25 percent to 6.0 percent and, in the case of a private foundation organized before May 27, 1969, from 4.375 percent to 5.5 percent.

[1] Also released as Technical Information Release 1288, dated April 24, 1974.

Section 4944.—Taxes on Investments which Jeopardize Charitable Purposes

26 CFR 53.4944-1: Foundation excise taxes.

Definition of "knowing" in connection with a foundation manager who makes an investment jeopardizing the foundation's tax-exempt purposes. See T.D. 7299, page 325.

Section 4945.—Taxes on Taxable Expenditures

26 CFR 53.4945-1: Foundation excise taxes.

Definition of "knowing" in connection with a foundation manager who makes a taxable expenditure jeopardizing the foundation's tax-exempt purposes. See T.D. 7299, page 325.

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26 CFR 53.4945-4: Grants to individuals.

Private foundations; fees to consultants. Payments to consultants by a private foundation for personal services performed in the development of model curricula and design of educational materials to aid the foundation in its program activity of assisting educators to employ improved educational methods are not grants within the meaning of section 4945(d)(3) of the Code.

Rev. Rul. 74-125

Advice has been requested whether payments made to individuals by a private foundation under the circumstances described below constitute grants within the meaning of section 4945(d)(3) of the Internal Revenue Code of 1954.

The foundation's activities include disseminating publications and developing and conducting training programs to assist educators in employing improved educational methods. In the course of carrying out its activities, the foundation obtains the services of consultants. The services include the development of model curricula in a particular educational area and the design of materials to assist educators in the performance of their educational functions.

Section 4945(d)(3) of the Code provides in pertinent part that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual.

Section 53.4945-4(a)(2) of the Foundation Excise Tax Regulations provides that "grants" do not ordinarily include payments (including salaries, consultants' fees, and reimbursement for travel expenses such as transportation, board, and lodging) to persons (regardless of whether such persons are individuals) for personal services in assisting a foundation in planning, evaluating, or developing projects or areas of program activity by consulting, advising, or participating in conferences organized by the foundation.

The development of model curricula and design of educational materials by the consultants for the foundation constitute personal services. These services assist the foundation in planning and developing its program activity of assisting educators to employ improved educational methods.

Accordingly, the payments made to the individuals under the circumstances described do not constitute grants within the meaning of the applicable regulations and therefore are not taxable expenditures within the meaning of section 4945(d)(3) of the Code.

Section 4946.—Definitions and Special Rules

26 CFR 53.4946-1: Definitions and special rules.

Private foundations; administration; disqualified persons. Employees of a bank designated as the trustee of a private foundation, who have been delegated fiduciary responsibility for the day-to-day administration and distribution of the trust funds, are foundation managers within the meaning of section 4946(b)(1) of the Code and are disqualified persons as defined in section 4946(a)(1)(B) even though they are ultimately responsible to the bank directors and officers for their actions with respect to the trust.

Rev. Rul. 74-287

Advice has been requested whether the persons described below are disqualified persons within the meaning of section 4946 of the Internal Revenue Code of 1954 with respect to a private foundation described in section 509(a).

The private foundation is a trust that conducts a loan scholarship program which meets the requirements of section 4945(g) of the Code. The designated trustee is a bank. However, fiduciary responsibility for the day-to-day administration of the trust, including distribution of the trust funds, is delegated to certain bank employees who are ultimately responsible to bank directors and officers for their actions. Under the terms of the trust agreement, it is conceivable that the children of these employees might be recipients of scholarship aid, resulting in an act of self-dealing under section 4941 should the employees be disqualified persons.

Section 4946(a)(1)(B) of the Code provides that the term "disqualified person" includes a person who is a foundation manager.

Sections 4946(b)(1) of the Code and 53.4946-1(f)(1) of the Foundation Excise Tax Regulations define a foundation manager as being an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation).

Although the employees of the bank delegated fiduciary responsibility for administering the trust are ultimately responsible to the board and executive officers of the bank for actions taken

with respect to the trust, they are free, on a day-to-day basis, to administer the trust and distribute the funds according to their best judgment and therefore have powers or responsibilities similar to those of trustees of the foundation.

Accordingly, the employees described above are foundation managers within the meaning of section 4946(b)(1) of the Code and, consequently, are disqualified persons with respect to the trust.

Section 4948.—Application of Taxes and Denial of Exemption With Respect To Certain Foreign Organizations

26 CFR 53.4948-1: Application of taxes and denial of exemption with respect to certain foreign organizations.

Canadian private foundation; investment income. A Canadian private foundation, exempt from the Canadian income tax and exempt from U.S. income tax under section 501(c)(3) of the Code, is also exempt from the tax imposed on gross investment income by section 4948 (a) by virtue of Article X of the U.S.-Canada Income Tax Convention.

Rev. Rul. 74-183

Advice has been requested whether a private foundation that is a resident of Canada and exempt from Canadian income tax under Canadian law and from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 is subject to the tax imposed by section 4948(a).

Article X of the Income Tax Convention between the United States and Canada provides that income derived from sources within one of the contracting States by a religious, scientific, literary, educational, or charitable organization of the other contracting State shall be exempt from taxation in the State from which the income is derived if, within the meaning of the laws of both contracting States, such organization would have been exempt from income tax.

Section 4940(a) of the Code imposes on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 4 percent of the net investment income of such foundation for the taxable year.

Section 4948(a) of the Code provides that in lieu of the tax imposed by section 4940 there is imposed for each taxable year on the gross investment income (within the meaning of section 4940(c)(2)) derived from sources within the United States (within the meaning of section 861) by every foreign organization which is a private foundation for the taxable year a tax equal to 4 percent of such income.

Section 53.4948-1(a)(3) of the Foundation Excise Tax Regulations provides that whenever there exists a tax treaty between the United States and a foreign country, and a foreign private foundation subject to section 4948(a) of the Code is a resident of such country or is otherwise entitled to the benefits of such treaty (whether or not such benefits are available to all residents), if the treaty provides that any item or items (or all items with respect to an organization exempt from income taxation) of gross investment income (within the meaning of section 4940(c)(2)) shall be exempt from income tax, such item or items shall not be taken into account by such foundation in computing the tax to be imposed under section 4948 (a) for any taxable year for which the treaty is effective.

The application of the treaty results in the exemption from income tax of all items of gross income. Therefore, a private foundation, under the circumstances described, is not subject to the tax imposed by section 4948(a) of the Code.

Subtitle F.—Procedure and Administration
Chapter 61.—Information and Returns
Subchapter A. Returns and Records
Part II.—Tax Returns or Statements
Subpart A.—General Requirement

Section 6011.—General Requirement of Return, Statement or List

26 CFR 1.6011-1: General requirement of return, statement or list.

Requirements and conditions under which magnetic tape records may be submitted in lieu of Form 1042S. See Rev. Proc. 74-12, page 423.

Subpart B.—Income Tax Returns

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013-1: Joint returns.

Whether a Form 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment; Form 1902-E, Report of Individual Income Tax Changes; and Form 4549, Income Tax Audit Changes, properly executed by the taxpayer and her husband is considered a return under section 6020 (a) of the Internal Revenue Code of 1954 and a valid election to file a joint return under section 6013. See Rev. Rul. 74-203, page 330.

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26 CFR 1.6013-1: Joint returns.

Whether the nondiscrimination clause of Paragraph 11 of the Protocol to the United States-Canada Income Tax Convention prevents the United States from denying a Canadian citizen who is both a resident and a nonresident of the United States during the taxable year the benefit of using a joint return. See Rev. Rul. 74-239, page 372.

Section 6014.—Income Tax Return —Tax Not Computed by Taxpayer

26 CFR 1.6014-2: Tax not computed by taxpayer for taxable years beginning after December 31, 1969.

T.D. 7298

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

301.—PROCEDURE AND ADMINISTRATION

Computation of tax by the Service

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) in order to provide rules for the Service to compute the tax for taxable years beginning after December 31, 1972.

The regulations currently set out the rules under which the Service will compute the tax for individuals. The regulations are being amended to provide that the rules under which the Service will compute the tax shall be contained in the instructions to Forms 1040 and 1040A.

Adoption of Amendments to the Regulations

The Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) are amended as follows:

Paragraph 1. Paragraphs (a), (b), (c)(2), (c)(3), (d)(1) and (e) of § 1.6014-2 are amended to read as follows:

§ 1.6014-2 Tax not computed by taxpayer for taxable years beginning after December 31, 1969.

(a) *In general.* An individual subject to the tax imposed by section 1 of the Code may, in accordance with the instructions applicable to the income tax return to be filed, elect, for any taxable year beginning after December 31, 1969, not to show on his income tax return for such year the amount of tax due in connection with such return.

(b) *Restriction on making an election.* The election pursuant to this section shall not be made by an individual who does not file his return (or amended return) making such election on or before the date prescribed in section 6072(a) for the filing of the original return (determined without regard to any extension of time).

* * * * *

(c) *Effect of election.* * * *

(2) Where the election provided for in this section is made by a taxpayer who takes the standard deduction and who has adjusted gross income of less than $10,000, such election constitutes an election to pay the tax imposed by section 3.

(3) A taxpayer who makes an election under section 6014 shall not be precluded from claiming—

(i) Status as a head of household or a surviving spouse;

(ii) The credit under section 31 (relating to tax withheld on wages);

(iii) The credit under section 37 (relating to retirement income);

(iv) The credit under section 38 (relating to investment in certain depreciable property);

(v) The credit under section 39 (relating to certain uses of gasoline and lubricating oil);

(vi) The credit under section 41 (relating to contributions to candidates for public office); or

(vii) The credit under section 42 (relating to overpayments of tax).

(d) *Joint returns.* (1) A husband and wife who file a joint return may elect not to show the tax on such return in accordance with the rules prescribed in paragraphs (a) and (b) of this section.

* * * * *

(e) *Married individuals filing separate returns.* This section shall apply to married individuals filing separate returns unless otherwise provided in the instructions accompanying a return. The instructions may require the taxpayer to attach to his return a statement to the effect that his tax and the tax of his spouse were determined in accordance with the rules of sections 141(d) and 142(a).

* * * * *

Par. 2. Paragraph (a)(2) of § 301.6402-3 is amended to read as follows:

§ 301.6402-3 Special rules applicable to income tax.

(a) * * *

(2) In the case of an overpayment for a taxable year of an individual for which a Form 1040 or Form 1040A has been filed, claim for refund may be made on Form 1040X ("Amended U.S. Individual Income Tax Return"). In cases to which this subparagraph applies, the taxpayer is encouraged to use Form 1040X.

* * * * *

Because this Treasury decision amends existing regulations by providing rules relating to administrative practice and procedure, it is found unnecessary to issue this Treasury decision with notice and public procedure thereon under 5 U.S.C. 553(b) or subject to the effective date limitation of 5 U.S.C. 553(d).

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 17, 1973.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 31, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 26, 1973, 38 F.R. 35234)

Section 6015.—Declaration of Estimated Income Tax by Individuals

26 CFR 1.605(a)-1: Declaration of estimated income tax by individuals.

Whether income received by a gravedigger from the operator of a funeral establishment should be considered in determining if a declaration of estimated income tax is required. See Rev. Rul. 74-219, page 295.

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26 CFR 1.6015(a)-1: Declaration of estimated income tax by individuals.

Whether income received by a distributor performing services for a delivery-service corporation should be considered in determining if a declaration of estimated income tax is required. See Rev. Rul. 74-220, page 296.

Section 6017.—Self-Employment Tax Returns

26 CFR 1.6017-1: Self-employment tax returns.

Whether income received by a gravedigger from the operator of a funeral establishment should be considered in determining if a self-employment tax return is required. See Rev. Rul. 74-219, page 295.

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26 CFR 1.6017-1: Self-employment tax returns.

Whether income received by a distributor performing services for a delivery-service corporation should be considered in determining if self-employment tax return is required. See Rev. Rul. 74-220, page 296.

Subpart C.—Estate and Gift Tax Return

Section 6018.—Estate Tax Returns

26 CFR 20.6018: Statutory provisions; estate tax returns.

Estate tax return requirements for estates of nonresidents not citizens of the United States. See T.D. 7296, page 255.

Subpart D.—Miscellaneous Provisions

Section 6020.—Return Prepared for or Executed by Secretary

26 CFR 301.6020-1: Return prepared or executed by district directors or other internal revenue officers.
(Also Section 6013; 1.6013-1).

Forms constituting election to file joint return. An executed Form 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, Form 1902E, Report of Individual Income Tax Audit Changes, or Form 4549, Income Tax Audit Changes, is a return as described in section 6020(a) of the Code and, when signed by a husband and wife, is a valid election to file a joint return under section 6013.

Rev. Rul. 74-203

Advice has been requested whether, under the following circumstances, a return has been executed under section 6020(a) of the Internal Revenue Code of 1954 pursuant to a valid election to file a joint return under section 6013.

The taxpayers, husband and wife, did not file Federal income tax returns for the taxable year 1970. After an examination in 1972 of the taxpayers' books and records that were voluntarily made available, the revenue agent determined the income and deductions of both taxpayers and computed the 1970 tax using the rate applicable to married persons filing jointly. This determination was set forth on schedules accompanying Form 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, furnished the taxpayers. The taxpayers agreed to the tax liability and signed Form 870.

Most of the income upon which the tax liability was determined had been earned by the husband, while assets capable of attachment are owned by the wife. Upon action by the Internal Revenue Service to collect the liability, the wife contends that an election to file a joint return was not made by the execution of Form 870.

Section 6020(a) of the Code provides that if any person shall fail to make a required return but consents to disclose information necessary for its preparation, the Secretary or his delegate may prepare such return which, being signed by such person, may be received by the Secretary or his delegate as the return of such person.

Section 1.6013-1(a)(1) of the Income Tax Regulations provides that a husband and wife may elect to make a joint return, and for any taxable year with respect to which a joint return has been filed, separate returns shall not be made by the spouses after the time for filing the return of either has expired.

Even though a document is not in the form prescribed for use as the appropriate return, it may constitute a return if it discloses the data from which the tax can be computed, is executed by the taxpayer, and is lodged with the Internal Revenue Service (see *Germantown Trust Co. v. Commissioner*, 309 U.S. 304 (1940), 1940-1 C.B. 178.

In *United States v. Olgeirson*, 284 F. Supp. 655 (D. N. D. 1968), the District Court held that the signing of a Form 870 by a husband and wife, under circumstances similar to those described in this Revenue Ruling, made them jointly and severally liable.

The Form 870, although not containing the data from which the tax is computed, is accompanied by certain schedules, made available to the taxpayer, which contain the required data.

Accordingly, the executed Form 870 with accompanying schedules is a return under section 6020(a) of the Code and a valid election to file a joint return under section 6013.

The above conclusion applies equally to a Form 1902-E, Report of Individual Income Tax Audit Changes, or Form 4549, Income Tax Audit Changes, when signed by a husband and wife.

Subpart B.—Information Concerning Transactions with Other Persons

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Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049-1: Returns of information as to interest paid in calendar years after

1962 and original issue discount includible in gross income for calendar years after 1970.

Requirements for reporting original issue discount on face-amount certificates issued after December 31, 1974. See T.D. 7311, page 234.

Subpart C.—Information Regarding Wages Paid Employees

Section 6051.—Receipts for Employees

26 CFR 31.6051-1: Statements for employees.

Additional time for employers to furnish copies of the 1974 Form W-2, Wage and Tax Statement, to employees whose employment is terminated during 1974. See Rev. Proc. 74-15, page 437.

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26 CFR 31.6051-1: Statements for employees.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

Part VII.—Place for Filing Returns or Other Documents

Section 6091.—Place for Filing Returns or Other Documents

26 CFR 20.6091-1: Place for filing returns or other documents.
(Also Section 6325; 20.6325-1.)

T.D. 7302

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 20.—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954; PART 25.—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Place for filing estate and gift tax returns with respect to certain nonresidents and issuance of transfer certificates

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

This document contains amendments to the Estate Tax Regulations (26 CFR Part 20) under section 6091 of the Internal Revenue Code of 1954 and to the Gift Tax Regulations (26 CFR Part 25) under section 6091 of such Code in order to provide revised rules relating to the place for filing estate and gift tax returns with respect to certain nonresidents. Further, an amendment to the Estate Tax Regulations (26 CFR Part 20) under section 6325 of the Internal Revenue Code of 1954 provides authorization for the service center director to issue transfer certificates in nonresident estates in certain cases.

Under § 20.6091-1(b) of the existing regulations, an estate tax return required to be filed under section 6018 of the Code must be filed with the Director of International Operations, Washington, D.C., if the decedent was not domiciled in the United States at the time of his death. However, the instructions for the estate tax return required to be filed with respect to a nonresident citizen or a nonresident alien (Forms 706 and 706NA, respectively) presently provide that the return is to be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania. The amendments made by this document would conform the regulations to the instructions issued with respect to the estate tax returns.

Because the amendments merely direct the taxpayer to file at the place designated by the instructions for the applicable forms, no effective date is provided with respect to the revised rules. Accordingly, estate tax returns heretofore or hereafter filed with the service center in accordance with the instructions to the form are considered to be filed at the proper place. Further, estate tax returns heretofore filed with the Director of International Operations in accordance with the regulations are considered to have been filed at the proper place.

The amendments also provide authorization for the service center director, in addition to the district director, to issue transfer certificates in the case of nonresidents where the tax imposed upon the estate is fully discharged or provided for. The amendments do not extend the authorization to issue such transfer certificates to the service center director in cases where the tax has not been fully discharged.

Under § 25.6091-1(c) of the existing regulations, a gift tax return required to be filed under section 6019 of the Code must be filed with the Director of International Operations, or in accordance with the applicable instructions to the form, if the donor is a nonresident who does not have a principal place of business which is located in an internal revenue district. The instructions for the gift tax return (Form 709) presently provide that the returns for such nonresidents are to be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania. The regulations are amended by this document to specifically refer to the service center as the proper place for filing gift tax returns for such nonresident donors.

Adoption of amendments to the regulations

In order to revise the rules relating to the place for filing estate and gift tax returns of nonresidents and the issuance of transfer certificates, the Estate Tax Regulations (26 CFR Part 20) under sections 6091 and 6325 of the Internal Revenue Code of 1954 and the Gift Tax Regulations (26 CFR Part 25) under section 6091 of such Code are hereby amended as follows:

ESTATE TAX REGULATIONS
(26 CFR Part 20)

Paragraph 1. Paragraph (b) of

§ 20.6091-1 is amended to read as follows:

§ 20.6091-1 Place for filing returns or other documents.

* * * * *

(b) *Non U.S. domiciliaries.* If the decedent was not domiciled in the United States at the time of his death, the preliminary notice required by § 20.6036-1 in the case of the estate of a decedent dying before January 1, 1971, and the estate tax return required by § 20.6018-1 shall be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania or the Director of International Operations, Washington, D.C., depending upon the place designated on the return form or in the instructions issued with respect to such form. This paragraph applies whether or not the decedent was a citizen of the United States and whether or not the return is made by hand-carrying.

Par. 2. Paragraph (c) of § 20.6325-1 is amended to read as follows:

§ 20.6325-1 Release of lien or partial discharge of property; transfer certificates in nonresident estates.

* * * * *

(c) A transfer certificate will be issued by the service center director or the district director when he is satisfied that the tax imposed upon the estate, if any, has been fully discharged or provided for. The tax will be considered fully discharged for purposes of the issuance of a transfer certificate only when investigation has been completed and payment of the tax, including any deficiency finally determined, has been made. If the tax liability has not been fully discharged, transfer certificates may be issued permitting the transfer of particular items of property without liability upon the filing with the district director of such security as he may require. No transfer certificate is required in an estate of a resident decedent. Further, in the case of an estate of a nonresident decedent (regardless of citizenship) a transfer certificate is not required with respect to property which is being administered by an executor or administrator appointed, qualified, and acting within the United States. For additional regulations under section 6325, see § 301.6325-1 of this chapter (Regulations on Procedure and Administration).

GIFT TAX REGULATIONS
(26 CFR Part 25)

Par. 3. Paragraph (c) of § 25.6091-1 is amended to read as follows:

§ 25.6091-1 Place for filing returns and other documents.

* * * * *

(c) *Returns of certain nonresidents.* If the donor is a nonresident (whether or not a citizen), and he does not have a principal place of business which is located in an internal revenue district, the gift tax return required by section 6019, whether or not such return is made by hand-carrying, shall be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania, or the Director of International Operations, Washington, D.C., depending upon the place designated on the return form or in the instructions issued with respect to such form.

* * * * *

Because of the immediate need to conform provisions contained in this Treasury decision with the instructions applicable to estate and gift tax forms required to be filed with respect to nonresidents, it is found impracticable and unnecessary to issue it with notice and public procedure thereon under subsection (b) of section 553 of title 5 of the United States Code.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 31, 1973.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 2, 1974, 8:45 a.m., and published in the issue of the Federal Register for January 3, 1974, 39 F.R. 796)

Part VIII.—Designation of Income Tax Payments to Presidential Election Campaign Fund

Section 6096.—Designation by Individuals

26 CFR 301.6096: Statutory provisions; designation by individuals.

T.D. 7304

TITLE 26. — INTERNAL REVENUE. — CHAPTER I, SUBCHAPTER A, PART 12. — TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1971; SUBCHAPTER F, PART 301. — PROCEDURE AND ADMINISTRATION

Designation by individuals to Presidential Election Campaign Fund

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

By a notice of proposed rule making appearing in the Federal Register for Wednesday, November 28, 1973 (38 F.R. 32812), amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 6096 of the Internal Revenue Code of 1954 were proposed in order to provide rules for the administration of the Presidential Election Campaign Fund. The proposed regulations provided that designations

to the Presidential Election Campaign Fund, if made at the time of filing the tax return, shall be made on either the first page of the return or on the page bearing the taxpayer's signature, in accordance with the applicable instructions. Further, the proposed regulations provided that if a designation was not made at the time of filing the tax return, a designation may be made on the form furnished by the Internal Revenue Service for such purpose, filed within 20 and one half months after the due date for the original return for such taxable year.

The proposed regulations reflected the legislative changes in section 6096, made by section 802(a) of the Revenue Act of 1971 (85 Stat. 573) [Pub. L. 92-178, 1972-1 C.B. 443] and by section 6(a) of the Act of July 1, 1973 (87 Stat. 135) [Pub L. 93-53, 1973-2 C.B. 438].

After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments of the regulations as proposed are adopted by this document without change.

Adoption of amendments to the regulations

On Wednesday, November 28, 1973, notice of proposed rule making with respect to the amendments of the Regulations on Procedure and Administration (26 CFR Part 301) under section 6096 of the Internal Revenue Code of 1954, regarding the Presidential Election Campaign Fund, was published in the Federal Register. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendments of the regulations as proposed are hereby adopted, effective for taxable years ending on or after December 31, 1972.

Section 12.6 of the temporary Income Tax Regulations under the Revenue Act of 1971 (26 CFR Part 12) is superseded.

Paragraph 1. The following new sections are added immediately after § 301.6091-1:

§ 301.6096 Statutory provisions; designation by individuals

Sec. 6096. *Designation by individuals*—(a) *In General.* Every individual (other than a nonresident alien) whose income tax liability for any taxable year is $1 or more may designate that $1 shall be paid over to the Presidential Election Campaign Fund in accordance with the provisions of section 9006(a). In the case of a joint return of husband and wife having an income tax liability of $2 or more, each spouse may designate that $1 shall be paid to the fund.

(b) *Income tax liability.* For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown on his return) allowable under sections 33, 37, 38, 40 and 41.

(c) *Manner and time of designation.* A designation under subsection (a) may be made with respect to any taxable year,—

(1) at the time of filing the return of the tax imposed by chapter 1 for such taxable year, or

(a) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary or his delegate.

Such designation shall be made in such manner as the Secretary or his delegate prescribes by regulations except that, if such designation is made at the time of filing the return of the tax imposed by chapter 1 for such taxable year such designation shall be made either on the first page of the return or on the page bearing the taxpayer's signature.

[Sec. 6096 added by sec. 302, Foreign Investors Tax Act 1966 (80 Stat. 1587) [Pub. L. 89-809, 1966-2 C.B. 656]; Amended by sec. 802(a) and (b)(2), Rev. Act 1971 (85 Stat. 573) and by sec. 6(a) of the Act of July 1, 1973. (87 Stat. 135)]

§ 301.6096-1 Designation by individuals for taxable years beginning after December 31, 1972.

(a) *In general.* Every individual (other than a nonresident alien) whose income tax liability, as defined in paragraph (b) of this section, is one dollar or more may, at his option, designate that one dollar shall be paid over to the Presidential Election Campaign Fund, in accordance with the provisions of section 9006. In the case of a joint return of a husband and wife, each spouse may designate that one dollar be paid to the fund as provided in this paragraph only if the joint income tax liability of the husband and wife is two dollars or more.

(b) *Income tax liability.* For purposes of paragraph (a) of this section, the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown on his return) allowable under sections 33, 37, 38, 40 and 41.

(c) *Manner and time of designation.* (1) A designation under paragraph (a) of this section may be made with respect to any taxable year at the time of the filing of the return of the tax imposed by chapter 1 for such taxable year, and shall be made either on the first page of the return or on the page bearing the taxpayer's signature, in accordance with the instructions applicable thereto.

(2) With respect to any taxable year beginning after December 31, 1972 for which no designation was made under subparagraph (1) of this paragraph, a designation may be made on the form furnished by the Internal Revenue Service for such purpose, filed within 20 and one half months after the due date for the original return for such taxable year.

In the case of a joint return where neither spouse made a designation or where only one spouse made a designation, a designation may be made, as provided in this subparagraph, by the spouse or spouses who had not previously made a designation.

(3) A designation once made, whether by an original return or otherwise, may not be revoked.

(d) *Effective date.* This section shall apply to taxable years beginning after December 31, 1972.

§ 301.6096-2 Designation by individuals for taxable years ending on or after December 31, 1972 and beginning before January 1, 1973

(a) *In general.* (1) For taxable years ending on or after December 31, 1972 and beginning before January 1, 1973, every individual (other than a nonresident alien) whose income tax liability, as defined in paragraph (b) of this section, is one dollar or more, may, at his option, designate that one dollar shall be paid over to the Presidential Election Campaign Fund, referred to in § 301.6096-1 (a). Where in accordance with prior law, such a designation was made for the account of any candidate of any specified political party, or for a general account for all candidates for election to the offices of President and Vice President of the United States, such a designation shall be treated solely as a designation to such fund.

(2) In the case of a joint return of a husband and wife, each spouse may designate that one dollar be paid to the fund as provided in subparagraph (1) of this paragraph only if the joint income tax liability of the husband and wife is two dollars or more.

(b) *Income tax liability.* For purposes of paragraph (a) of this section, the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown on his return).

(c) *Manner and time of designation.* (1) A designation under paragraph (a) of this section may be made with respect to any such taxable year at the time of the filing of the return of the tax imposed by chapter 1 for such taxable year. If such designation is made at the time of filing the original return for such year, it shall be made by the individual on the form furnished by the Internal Revenue Service for such purpose in accordance with the instructions applicable thereto.

(2) With respect to any taxable year ending on or after December 31, 1972 and beginning before January 1, 1973, for which no designation was made under subparagraph (1) of this paragraph, a designation may be made on the form furnished by the Internal Revenue Service for such purpose, filed within 20 and one half months after the due date for the original return for such taxable year. In the case of a joint return where neither spouse made a designation or where only one spouse made a designation, a designation may be made, as provided in this subparagraph, by the spouse or spouses who had not previously made a designation.

(3) A designation once made, whether by an original return or otherwise, may not be revoked.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved January 25, 1974.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 1, 1974, 8:45 a.m., and published in the issue of the Federal Register for February 4, 1974, 39 F.R. 4476)

Subchapter B. Miscellaneous Provisions

Section 6103.—Publicity of Returns and Disclosure of Information as to Persons Filing Income Tax Returns

26 CFR 301.6103(a)-108: Inspection by Department of Agriculture of income tax returns made under the Internal Revenue Code of 1954 of persons having farm operations.

Revoking the Authority of the Department of Agriculture To Inspect Income Tax Returns

E.O. 11773

By virtue of the authority vested in me as President of the United States of America, Executive Order No. 11697 of January 17, 1973 [1973-1 C.B. 592] and Executive Order No. 11709 of March 27, 1973 [1973-1 C.B. 595], are hereby revoked and the authority conferred upon the Department of Agriculture by those Orders to inspect income tax returns is hereby revoked.

RICHARD NIXON

THE WHITE HOUSE
March 21, 1974.

(Filed in the Office of the Federal Register on March 21, 1974, 12:02 p.m., and published in the issue of the Federal Register for March 22, 1974, 39 F.R. 10881.)

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26 CFR 301.6103(a)-108: Inspection by Department of Agriculture of income tax returns made under the Internal Revenue Code of 1954 of persons having farm operations.

T.D. 7313

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Inspection by Department of Agriculture of income tax returns made under the Internal Revenue Code of 1954 of persons having farm operations

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

Inspection by the Department of Agriculture of certain income tax returns was authorized by Executive Order 11697 (38 F.R. 1723) [1973-1 C.B. 592], signed by the President on January 17, 1973, as modified by Executive Order 11709 (38 F.R. 8131) [1973-1 C.B. 595], signed by the President on March 27, 1973. Executive Orders 11697 and 11709 in effect provided that such inspection shall be in accordance and upon compliance with § 301.6103 (a)-108 of the Regulations on Procedure and Administration (26 CFR Part 301) prescribed by the Secretary of the Treasury in Treasury Decision 7255 (38 F.R. 2332) [1973-1 C.B. 595], as amended by Treasury Decision 7267 (38 F.R. 8152) [1973-1 C.B. 596], and approved by the President on January 17, 1973, and March 27, 1973.

Executive Order 11773 (39 F.R. 10881) [1974-16 I.R.B. 13], signed by the President on March 21, 1974, revoked Executive Orders 11697 and 11709 and the authority conferred upon the Department of Agriculture by those Orders to inspect income tax returns. Accordingly, since § 301.6103 (a)-108 no longer has any force or effect, this document deletes that section from the Regulations on Procedure and Administration.

Deletion of regulations

Section 301.6103(a)-108 of the Regulations on Procedure and Administration (26 CFR Part 301) is hereby deleted.

Because this Treasury decision relates to a general statement of policy and merely deletes a section which no longer has force or effect, it is found that it is unnecessary to issue this Treasury decision with notice and public procedure thereon under 5 U.S.C. 553(b), or subject to the effective date limitation of 5 U.S.C. 553 (d).

GEORGE P. SHULTZ,
Secretary of the Treasury.

April 30, 1974.

(Filed by the Office of the Federal Register on May 3, 1974, 8:45 a.m., and published in the issue of the Federal Register for May 6, 1974, 39 F.R. 15754)

Section 6109.—Identifying Numbers

26 CFR 301.6109-1: Identifying numbers.

T.D. 7306[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Taxpayer identifying numbers

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

By a notice of proposed rule making appearing in the Federal Register for Wednesday, December 5, 1973 (38 F.R. 33490), amendments to the Income Tax Regulations (26 CFR Part 1), the Employment Tax Regulations (26 CFR Part 31), and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 6109, 6676, and 7701 of the Internal Revenue Code of 1954 were proposed in order to revise the rules relating to taxpayer identifying numbers.

The most precise and concise method for identifying taxpayers in the automated recordkeeping system of the Internal Revenue Service is through the use of taxpayer identifying numbers. The existing regulations under section 6109 set forth detailed requirements with respect to taxpayer identifying numbers. The proposed regulations described the two types of taxpayer identifying numbers, told taxpayers where to apply for them, and informed taxpayers that they must give all taxpayer identifying numbers required by the forms and related instructions.

This Treasury decision contains two minor changes from the notice of proposed rule making. One is the addition of a sentence to draw attention to the fact that requirements relating to information to be furnished to the Bureau of Alcohol, Tobacco and Firearms are unchanged by this Treasury decision. Pursuant to paragraph 4(a) of Treasury Order 221, published in the Federal Register for June 10, 1972 (37 F.R. 11696), certain regulations of the Internal Revenue Service, including pertinent sections of 26 CFR Part 301, continue in effect as regulations of the Bureau of Alcohol, Tobacco and Firearms until superseded or revised. The Director, Bureau of Alcohol, Tobacco and Firearms has, therefore, joined as a signatory to this Treasury decision.

The other change is the updating of cross references to parts of the Code of Federal Regulations by replacing the references to the January 1, 1972 revision with references to the April 1, 1973 revision. The two revisions are identical with respect to the regulations under section 6109.

[1] The publication of this Treasury Decision in 39 F.R. 9946, dated March 15, 1974 contains (1) instructions for modifying the notice of proposed rulemaking published in 38 F.R. 33490, dated December 5, 1973, and (2) the full text of the regulations with such modifications. As here published, the Treasury Decision reflects the full text of such regulations with modifications. The individual instructions have been omitted.

Adoption of amendments to the regulations.

After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted.

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. Section 1.6109-1 is amended to read as follows:

§ 1.6109-1 Identifying numbers.

(a) *Information to be furnished after April 15, 1974.* For provisions concerning the requesting and furnishing of identifying numbers with respect to returns, statements, and other documents which must be filed after April 15, 1974, see § 301.6109-1 of this chapter (Regulations on Procedures and Administration).

(b) *Information to be furnished before April 16, 1974.* For provisions concerning the requesting and furnishing of identifying numbers with respect to returns, statements, and other documents which must be filed before April 16, 1974, see 26 CFR § 1.6109-1 (revised as of April 1, 1973).

EMPLOYMENT TAX
REGULATIONS
(26 CFR Part 31)

Par. 2. Section 31.6109-1 is amended to read as follows:

§ 31.6109-1 Supplying of identifying numbers.

(a) *In general.* The returns, statements, and other documents required to be filed under this subchapter shall reflect such identifying numbers as are required by each return, statement, or document and its related instructions. See § 301.6109-1 of this chapter (Regulations on Procedure and Administration).

(b) *Effective date.* The provisions of this section are effective for information which must be furnished after April 15, 1974. See 26 CFR § 31.6109-1 (revised as of April 1, 1973) for provisions with respect to information which must be furnished before April 16, 1974.

Part 301—PROCEDURE AND ADMINISTRATION

Par. 3. Section 301.6109-1 is amended to read as follows:

§ 301.6109-1 Identifying numbers.

(a) *In general.* There are two types of taxpayer identifying numbers: social security numbers and employer identification numbers. Social security numbers take the form 000-00-0000, while employer identification numbers take the form 00-0000000. Social security numbers identify individual persons and estates of decedents, while employer identification numbers identify corporations, partnerships, nonprofit associations, trusts, and similar nonindividual persons. Both types of taxpayer identifying numbers are used by individuals who are employers or who are engaged in trade or business as sole proprietors, as required by returns, statements or other documents and their related instructions. Such documents often require an individual's own social security number in connection with his individual taxes, and his employer identification number in connection with his business taxes.

(b) *Use of one's own number.* Every person who files under this title a return, statement, or other document shall furnish his taxpayer identifying number as required by the forms and the instructions relating thereto. A person whose number must be included on a document filed by another person shall give the taxpayer identifying number so required to the other person on request. For provisions dealing specifically with the duty of employees with respect to their social security numbers, see paragraphs (a) and (b) of § 31.6011(b)-2 of this chapter (Employment Tax Regulations). For provisions dealing specifically with the duty of employers with respect to employer identification numbers, see § 31.6011(b)-1 of this chapter (Employment Tax Regulations).

(c) *Use of another's number.* Every person required under this title to file a return, statement, or other document shall furnish such taxpayer identifying numbers of other persons as required by the forms and the instructions relating thereto. If he does not know the taxpayer identifying number of the other person, he shall request such number of the other person. A request should state that the identifying number is required to be furnished under authority of law. When the person filing the return, statement, or other document does not know the number of the other person, and has complied with the request provision of this paragraph, he shall sign an affidavit on the transmittal document forwarding such returns, statements, or other documents to the Internal Revenue Service, so stating. A person required to file a taxpayer identifying number shall correct any errors in such filing when his attention has been drawn to them.

(d) *Obtaining a taxpayer identifying number*—(1) *Social security number.* Any individual required to furnish a social security number pursuant to paragraph (b) of this section shall apply for one, if he has not done so previously, on Form SS-5, which may be obtained from any Social Security Administration or Internal Revenue Service office. He shall make such application far enough in advance of the first required use of such number to permit issuance of the number in time for compliance with such requirement. The form, together with any supplementary statement, shall be prepared and filed in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for. Individuals who are ineligible for or do not wish to participate in the benefits of the social security program shall nevertheless obtain a social security number if they are required to furnish

such a number pursuant to paragraph (b) of this section.

(2) *Employer identification number.* Any person required to furnish an employer identification number pursuant to paragraph (b) of this section shall apply for one, if he has not done so previously, on Form SS-4, which may be obtained from any office of the Internal Revenue Service. He shall make such application far enough in advance of the first required use of such number to permit issuance of the number in time for compliance with such requirement. The form, together with any supplementary statement, shall be prepared and filed in accordance with the form, instructions, and regulations applicable thereto, and shall set forth fully and clearly the data therein called for.

(e) *Banks, and brokers and dealers in securities.* For additional requirements relating to deposits, share accounts, and brokerage accounts, see 31 CFR 103.34 and 103.35.

(f) *Penalty.* For penalty for failure to supply identifying numbers, see section 6676 and § 301.6676-1.

(g) *Nonresident alien exclusion.* This section shall not apply to nonresident aliens, foreign corporations, foreign partnerships, or foreign private foundations that do not have income effectively connected with the conduct of a trade or business within the United States and do not have an office or place of business or a fiscal or paying agent in the United States.

(h) *Effective date.* The provisions of this section are effective for information which must be furnished after April 15, 1974. See the parts of 26 CFR (revised as of April 1, 1973) which relate to the particular tax for provisions with respect to information which must be furnished before April 16, 1974, and for information which must be furnished to the Bureau of Alcohol, Tobacco and Firearms prior to the effective date of comparable procedural regulations promulgated by the Bureau in 27 CFR Part 70. Nothing contained in the regulations under section 6109 shall limit the authority of the Internal Revenue Service to obtain taxpayer identifying numbers required before or after the effective date of this paragraph after notice is served upon the taxpayer pursuant to section 6001.

Par. 4. Paragraph (a) of § 301.6676-1 is amended by replacing the phrase "Under § 1.6109-1(b)(2)" with "Under § 301.6109-1(c)." It reads as follows:

§ 301.6676-1 Penalty for failure to supply identifying number.

(a) *In general.* Except as provided in paragraph (c) of this section, if any person who is required by the regulations under section 6109—

(1) To include his identifying number in any return, statement, or other document,

(2) To furnish his identifying number to another person, or

(3) To include in any return, statement, or other document made with respect to another person the identifying number of such other person,

fails to comply with such requirement at the time prescribed by such regulations, such person shall pay a penalty of $5 for each such failure. Such penalty shall be paid in the same manner as tax upon the issuance of a notice and demand therefor. Under § 301.6109-1(c) a payer is required to request the identifying number of the payee. If, after such a request has been made, the payee does not furnish the payer with his identifying number, the penalty will not be assessed against the payer.

* * * * *

Par. 5. Section 301.7701-11 is amended to read as set forth below:

§ 301.7701-11 Social security number.

For purposes of this chapter, the term "social security number" means the taxpayer identifying number of an individual or estate which is assigned pursuant to section 6011(b) or corresponding provisions of prior law, or pursuant to section 6109, and in which nine digits are separated by hyphens as follows: 000-00-0000. Such term does not include a number with a letter as a suffix which is used to identify an auxiliary beneficiary under the social security program. The terms "account number" and "social security number" refer to the same number.

Par. 6. Section 301.7701-12 is amended to read as set forth below:

§ 301.7701-12 Employer identification number.

For purposes of this chapter, the term "employer identification number" means the taxpayer identifying number of an individual or other person (whether or not an employer) which is assigned pursuant to section 6011(b) or corresponding provisions of prior law, or pursuant to section 6109, and in which nine digits are separated by a hyphen, as follows: 00-0000000. The terms "employer identification number" and "identification number" (defined in § 31.0-2(a)(11) of this chapter (Employment Tax Regulations)) refer to the same number.

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

REX D. DAVIS,
Director, Bureau of Alcohol, Tobacco and Firearms.
DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved March 11, 1974.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 14, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 15, 1974, 39 F.R. 9946.)

Chapter 64.—Collection
Subchapter A.—General Provisions

Section 6302.—Mode or Time of Collection

26 CFR 31.6302(c)-1: Use of Government

depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

Deposit requirements. An employer whose employees are paid on July 13 for the semi-monthly pay period ended July 6 and whose undeposited income and FICA taxes withheld from wages for this period amount to over $2000 must deposit such taxes within three banking days after the quarter-monthly period ending July 15.

Rev. Rul. 74-126

Advice has been requested concerning the proper deposit date under section 6302 of the Internal Revenue Code of 1954 for withheld income tax and Federal Insurance Contributions Act taxes under the circumstances described below.

An employer's semi-monthly pay period ended on July 6th. The employees were paid on July 13th. The employer's undeposited taxes for this period were over $2000. The employer raises the question of whether he should deposit the withheld taxes amounting to over $2000 within three banking days after July 6, the last day of the payroll period; three banking days after the quarter-monthly period ending on July 7; or three banking days after the quarter-monthly period ending on July 15.

Section 3402(a) of the Code states that every employer making payment of wages is subject to the income tax withholding requirements.

Section 3102(a) of the Code requires employers to deduct taxes from wages as and when paid.

Section 6302(c) of the Code provides that the Secretary or his delegate may authorize Federal Reserve banks, and incorporated banks or trust companies which are depositaries or financial agents of the United States, to receive any tax imposed under the Internal Revenue laws, in such manner, at such times, and under such conditions as he may prescribe.

Section 31.6302(c)-1(a)(1)(i)(b) of the Employment Tax Regulations states that an employer must deposit withheld taxes within three banking days after the close of any quarter-monthly period, if at the close of that period, the aggregate amount of undeposited taxes required to be withheld is $2000 or more.

The regulation defines the term "quarter-monthly period" to mean the first 7 days of a calendar month, the 8th day through the 15th day, the 16th day through the 22nd day, and any portion of the calendar month following the 22nd day. Thus, if on the 7th, 15th, 22nd, or last day of the month, the cumulative liability is $2000 or more, a deposit must be made within the next three banking days.

Since under sections 3402(a) and 3102(a) of the Code withholding is not required until payment of wages is made, the deposit requirements cannot take effect prior to this date. As the employees were paid on July 13, this date is controlling for purposes of determining the date the deposit of taxes must be made.

Accordingly, in the instant case, the deposit of taxes under section 6302 of the Code must be made within three banking days of the quarter-monthly period ending on July 15.

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26 CFR 31.6302(c)-1(a): Requirement.

Deposit requirements; religious order; vow-of-poverty members. A religious order that has elected social security coverage for its vow-of-poverty members, whose wages subject to the FICA are in the form of non-cash support, is considered to have adopted an assumed payroll accounting period and an assumed payday of monthly or less for the purpose of meeting the deposit requirements of section 6302 of the Code.

Rev. Rul. 74-85

Advice has been requested as to the deposit requirements under section 6302 of the Internal Revenue Code of 1954 for religious orders that have elected under section 3121(r) to have social security coverage extended to their members who have taken a vow of poverty.

The question of the deposit requirements for the taxes due with respect to a vow-of-poverty member results from the fact that such member is generally not paid any monetary remuneration on a regular pay-period basis, but derives his "wages" subject to FICA tax in the form of non-cash support, including the fair market value of any board, lodging, clothing, and other perquisites furnished to him by the religious order. Many of the religious orders also employ lay personnel who are paid actual wages upon which the religious order properly withholds and deposits the taxes as required by law.

Under section 3121(i)(4) of the Code and section 31.3121(i)-4 of the Employment Tax Regulations the value of the perquisites furnished by a religious order to its vow-of-poverty members, for the purpose of computing the FICA tax, is never less than $100 per month.

Under section 31.6302(c)-1(a) of the Employment Tax Regulations, the time for making deposits is determined by reference to the payment of wages within the fixed depositing dates set forth in the regulations.

The adoption of payroll accounting periods and payment dates is generally a matter left to the discretion of the employer. In the case of a vow-of-poverty member of a religious order described above, there is no fixed pay period or pay date.

For purposes of determining whether a religious order has met the deposit requirements of section 6302 of the Code with respect to the FICA taxes for its vow-of-poverty members, the order may consider that such members are "paid" on a monthly basis. If the only employees of the

religious order are its vow-of-poverty members, the order shall, for purposes of determining the amount required to be deposited and the proper deposit due date, adopt an assumed payroll accounting period and an assumed payday of monthly or less. However, if the order has adopted a payroll accounting system in which its lay members are paid more frequently than monthly, the same payroll accounting period and payday may be used with respect to its vow-of-poverty members also.

Accordingly, the deposit requirements under section 6302 of the Code are met by a religious order electing social security coverage for its members under section 3121(r) if its members, who have taken a vow of poverty, are considered to have been paid on a basis of monthly or less and the order deposits the proper amounts computed on such a basis.

Subchapter C.—Lien for Taxes

Section 6325.—Release of Lien or Discharge of Property

26 CFR 20.6325-1: Release of lien or partial discharge of property; transfer certificates in nonresident estates.

Transfer certificate requirements. See T.D. 7296, page 255.

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26 CFR 20.6325-1: Release of lien or partial discharge of property; transfer certificates in nonresident estates.

Authorization for service center directors to issue transfer certificates for nonresidents where the tax imposed on the estate is fully discharged or provided for. See T.D. 7302, page 331.

Chapter 65.—Abatements, Credits, and Refunds
Subchapter B.—Rules of Special Application

Section 6411.—Tentative Carryback Adjustments

26 CFR 1.6411: Statutory provisions; tentative carryback adjustments.

Applications for tentative carryback adjustments in connection with investment credit, capital loss, or WIN carrybacks. See T.D. 7301, page 203.

Section 6413.—Special Rules Applicable to Certain Employment Taxes

26 CFR 31.6413(c)-1: Special refunds.

Unpaid employment taxes attributable to the subsidiary in a parent-subsidiary relationship. See Rev. Proc. 74-16, page 437.

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26 CFR 31.6413(c)-1: Special refunds.

Payment by an employer of the tax on employees under section 3101 of the Federal Insurance Contributions Act without deducting it from "wages." See Rev. Rul. 74-75, page 19.

Chapter 66.—Limitations
Subchapter A. Limitations on Assessment and Collection

Section 6501.—Limitations on Assessment and Collection

26 CFR 301.6501(a)-1: Period of limitations upon assessment and collection.

Whether taxable income for a base period year, that is barred by the statute of limitations, may be adjusted to determine average base period income for income averaging purposes. See Rev. Rul. 74-61, page 239.

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26 CFR 301.6501(h): Statutory provisions; limitations on assessment and collection; net operating loss or capital loss carrybacks.

Limitations on assessment and collection in the case of deficiencies attributable to capital loss carrybacks. See T.D. 7301, page 203.

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26 CFR 301.6501(j): Statutory provisions; limitations on assessment and collection; investment credit carrybacks.

Limitations on assessment and collection in the case of deficiencies attributable to investment credit carrybacks from a taxable year derived from a net operating loss or capital loss carryback from a subsequent taxable year. See T.D. 7301, page 203.

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26 CFR 301.6501(m): Statutory provisions; limitations on assessment and collection; tentative carryback adjustment assessment period.

Limitation period after tentative carryback adjustment where an amount has been applied, credited, or refunded for a net operating loss, capital loss, investment credit, or WIN carryback. See T.D. 7301, page 203.

26 CFR 301.6501(o): Statutory provisions; limitations on assessment and collection; work incentive program credit carrybacks.

Limitations on assessment and collection in the case of deficiencies attributable to the application of a work incentive program credit carryback. See T.D. 7301, page 203.

Section 6502.—Collection After Assessment

26 CFR 301.6502-1: Collection after assessment.
(Also Sections 6532, 7403, 7424, 7426; 301.6532-3, 301.7403-1, 301.7424-2 301.7426-1.)

T.D. 7305 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 301.—PROCEDURE AND ADMINSTRATION

Federal tax liens

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

By a notice of proposed rule making appearing in the Federal Register for Saturday, August 28, 1971 (36 F.R. 17355), amendments to the Regulations on Procedure and Administration (26 CFR Part 301) were proposed in order to conform such regulations to changes in the Internal Revenue Code of 1954 made by sections 107, 108, 110, 111, 112, and 113 of the Federal Tax Lien Act of 1966 (80 Stat. 1140, 1142, 1145, 1146) [Pub. L. 89-719, 1966-2 C.B. 623]. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, certain changes were made,

[1] The publication of this Treasury Decision in 39 F.R. 9949, dated March 15, 1974, contains (1) instructions for modifying the notice of proposed rulemaking published in 36 F.R. 17355, dated August 28, 1971, and (2) the full text of the regulations with such modifications. As here published, the Treasury Decision reflects the full text of such regulations with modifications. The individual instructions have been omitted.

and the proposed amendments of the regulations, subject to the change indicated below, are adopted by this document.

This document contains amendments to the regulations relating to Federal tax liens, proceedings by taxpayers and third parties, and the sale of personal property and administration of real estate acquired by the United States in payment of debts arising under the internal revenue laws.

Under § 301.7426-1(a)(1), any person, other than the taxpayer against whom is assessed the tax out of which a levy arises, may bring a civil action against the United States in a district court of the United States based upon such person's claim that he has an interest in, or a lien on, property which is senior to the interest or lien of the United States and that the property was wrongfully levied upon. With respect to a wrongful levy, the forms of relief which may be granted by a district court are set forth under § 301.7426-1(b)(1). Relief may be granted under these provisions only if the property levied upon belongs to a person other than the taxpayer or if the levy or sale pursuant to levy will irreparably injure or destroy an interest or lien which is senior to the interest or lien of the United States. Section 301.7426-1(b), as changed, sets forth an example of a wrongful levy under subparagraph (2). Accordingly, subparagraphs (2) and (3) of proposed § 301.7426-1(b) are redesignated as subparagraphs (3) and (4) of § 301.7426-1(b) as adopted by this document.

Example (1) of proposed § 301.-6532-3(c) is revised by this document to clarify the calculation of the period of limitations illustrated therein. Further, references to the Alcohol, Tobacco, and Firearms Division and the Division of Loans and Currency in §§ 301.7403-1(a) and 301.7505-1(a)(1), respectively, are revised to reflect reorganizational changes.

Pursuant to paragraph 4(a) of Treasury order 221, published in the Federal Register for June 10, 1972 (37 F.R. 11696), certain regulations of the Internal Revenue Service continue in effect as regulations of the Bureau of Alcohol, Tobacco and Firearms until superseded or revised. The regulations amended by this Treasury decision are among those that continue to apply for purposes of the laws administered by the Bureau in addition to applying for purposes of the laws administered by the Internal Revenue Service. The Director, Bureau of Alcohol, Tobacco and Firearms has, for this reason, joined as a signatory to this Treasury decision.

Adoption of amendments to the regulations

On August 28, 1971, notice of proposed rule making to conform the Regulations on Procedure and Administration (26 CFR Part 301) to changes in the Internal Revenue Code of 1954 made by sections 107, 108, 110, 111, 112, and 113 of the Federal Tax Lien Act of 1966 (80 Stat. 1140, 1142, 1145, 1146) [Pub. L. 89-719, 1966-2 C.B. 623] was published in the Federal Register (36 F.R. 17355). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following amendment of the regulations is hereby adopted.

Paragraph 1. Section 301.6322 is amended by revising section 6322 and by adding a historical note to read as follows:

§ 301.6322 Statutory provisions; period of lien.

Sec. 6322. *Period of lien.* Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time.

[Sec. 6322 as amended by sec. 113(a) Federal Tax Lien Act 1966 (80 Stat. 1146)]

Par. 2. Section 301.6502 is amended by revising subsection (a) of section 6502 and by adding a historical note to read as follows:

§ 301.6502 Statutory provisions; collection after assessment.

Sec. 6502. *Collection after assessment*—(a) *Length of period.* Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—

(1) Within 6 years after the assessment of the tax, or

(2) Prior to the expiration of any period for collection agreed upon in writing by the Secretary or his delegate and the taxpayer before the expiration of such 6-year period (or, if there is a release of levy under section 6343 after such 6-year period, then before such release).

The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. The period provided by this subsection during which a tax may be collected by levy shall not be extended or curtailed by reason of a judgment against the taxpayer.

* * * * *

[Sec. 6502 as amended by sec. 113(b) Federal Tax Lien Act 1966 (80 Stat. 1146)]

Par. 3. Section 301.6502-1 is amended by adding a new subparagraph (3) to paragraph (a) to read as follows:

§ 301.6502-1 Collection after assessment.

(a) *Length of period.* * * *

(3) The period provided by section 6502(a) and this section shall not be extended or curtailed by reason of a judgment against a taxpayer. There-

fore, a personal judgment rendered against a taxpayer arising out of an unpaid assessed tax liability will not extend the period during which the liability may be collected by levy. Similarly, the period during which the liability may be collected by levy is not curtailed by the fact that the United States secures such a judgment. For example, if the United States secures a personal judgment arising out of a tax liability assessed 4 years earlier, the liability may be collected in any manner provided by section 7403 or in any manner provided for the enforcement of a judgment or, during the remaining 2 years of the 6 year statutory period, by levy as if such judgment had not been secured.

* * * * *

Par. 4. Section 301.6532 is amended by adding a new subsection (c) to section 6532 and by amending the historical note to read as follows:

§ 301.6532 Statutory provisions; periods of limitation on suits.

* * * * *

(c) *Suits by persons other than taxpayers*—(1) *General rule.* Except as provided by paragraph (2), no suit or proceeding under section 7426 shall be begun after the expiration of 9 months from the date of the levy or agreement giving rise to such action.

(2) *Period when claim is filed.* If a request is made for the return of property described in section 6343(b), the 9-month period prescribed in paragraph (1) shall be extended for a period of 12 months from the date of filing of such request or for a period of 6 months from the date of mailing by registered or certified mail by the Secretary or his delegate to the person making such request of a notice of disallowance of the part of the request to which the action relates, whichever is shorter.

[Sec. 6532 as amended by sec. 89(b), Technical Amendments Act 1958 (72 Stat. 1665) [Pub. L. 85-866, 1958-3 C.B. 254] and sec. 110(b) Federal Tax Lien Act 1966 (80 Stat. 1144) [Pub. L. 89-719, 1966-2 C.B. 623]]

Par. 5. Immediately after § 301.6532-2 there is added the following new section:

§ 301.6532-3 Periods of limitation on suits by persons other than taxpayers.

(a) *General rule.* No suit or proceeding, except as otherwise provided in section 6532(c)(2) and paragraph (b) of this section, under section 7426 and § 301.7426-1 relating to civil actions by persons other than taxpayers, shall be begun after the expiration of 9 months from the date of levy or agreement under section 6325(b)(3) giving rise to such action.

(b) *Period when claim is filed.* The 9-month period prescribed in section 6532(c)(1) and paragraph (a) of this section shall be extended to the shorter of,

(1) 12 months from the date of filing by a third party of a written request under § 301.6343-1(b)(2) for the return of property wrongfully levied upon, or

(2) 6 months from the date of mailing by registered or certified mail by the district director to the party claimant of a notice of disallowance of the part of the request to which the action relates.

A request which, under § 301.6343-1(b)(3), is not considered adequate does not extend the 9-month period described in paragraph (a) of this section.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). On June 1, 1970, a tax is assessed against A with respect to his delinquent tax liability. On July 19, 1970, a levy is wrongfully made upon certain tangible personal property of B's which is in A's possession at that time. On July 20, 1970, notice of seizure is given to A. Thus, under section 6502(b), July 20, 1970, is the date on which the levy is considered to be made. Unless a request for the return of property is sooner made to extend the 9-month period, no suit or proceeding under section 7426 may be begun by B after April 20, 1971, which is 9 months from the date of levy.

Example (2). Assume the same facts as in the preceding example except that, on August 3, 1970, B properly files a request for the return of his property wrongfully levied upon. Assume further that the district director mails, on March 1, 1971, a notice of disallowance of B's request for the return of the property. No suit or proceeding under section 7426 may be begun by B after August 3, 1971, which is 12 months from the date of filing a request for the return of property wrongfully levied upon.

Example (3). Assume the same facts as in the preceding example except that the notice of disallowance of B's request for the return of property wrongfully levied upon is mailed to B on November 12, 1970. Since the 6-month period from the mailing of the notice of disallowance expires before the 12-month period from the date of filing the request for the return of property which ends on August 3, 1971, no suit or proceeding under section 7426 may be begun by B after May 12, 1971, which is 6 months from the date of mailing the notice of disallowance.

Par. 6. Section 301.7402 is amended by redesignating subsection (e) of section 7402 as subsection (f), by adding a new subsection (e) to section 7402, and by adding a historical note to read as follows:

§ 301.7402 Statutory provisions; jurisdiction of district courts.

Sec. 7402. *Jurisdiction of district courts.*

* * * * *

(e) *To quiet title.* The United States district courts shall have jurisdiction of any action brought by the United States to quiet title to property if the title claimed by the United

States to such property was derived from enforcement of a lien under this title.

(f) *General jurisdiction.* * * *

[Sec. 7402 as amended by sec. 107(a) Federal Tax Lien Act 1966 (80 Stat. 1140) [Pub. L. 89-719, 1966-2 C.B. 623]; sec. 230(d), Act of June 6, 1972 (Pub. Law 92-310, 86 Stat. 209) [1972-2 C.B. 670]]

Par. 7. Section 301.7403 is amended by adding a new sentence at the end of subsection (c) of section 7403 and by adding a historical note to read as follows:

§ 301.7403 Statutory provisions; action to enforce lien or to subject property to payment of tax.

Sec. 7403. *Action to enforce lien or to subject property to payment of tax.*

* * * * *

(c) *Adjudication and decree.* The court shall, after the parties have been duly notified of the action, proceed to adjudicate all matters involved therein and finally determine the merits of all claims to and liens upon the property, and, in all cases where a claim or interest of the United States therein is established, may decree a sale of such property, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and of the United States. If the property is sold to satisfy a first lien held by the United States, the United States may bid at the sale such sum, not exceeding the amount of such lien with expenses of sale, as the Secretary or his delegate directs.

* * * * *

[Sec. 7403 as amended by sec. 107(b) Federal Tax Lien Act 1966 (80 Stat. 1140)]

Par. 8. Section 301.7403-1 is amended by adding paragraph (b) and by providing a heading for paragraph (a) to read as follows:

§ 301.7403-1 Action to enforce lien or to subject property to payment of tax.

(a) *Civil actions.* In any case where there has been a refusal or neglect to pay any tax, or to discharge any liability in respect thereof, whether or not levy has been made, the Attorney General or his delegate, at the request of the Commissioner (or the Director, Bureau of Alcohol, Tobacco, and Firearms, or the Chief Counsel for the Bureau, with respect to the provisions of subtitle E of the Code), or the Chief Counsel for the Internal Revenue Service or his delegate, may direct a civil action to be filed in a district court of the United States to enforce the lien of the United States under the Code with respect to such tax or liability or to subject any property, of whatever nature, of the delinquent, or in which he has any right, title or interest, to the payment of such tax or liability. In any such proceeding, at the instance of the United States, the court may appoint a receiver to enforce the lien, or, upon certification by the Commissioner or the Chief Counsel for the Internal Revenue Service during the pendency of such proceedings that it is in the public interest, may appoint a receiver with all the powers of a receiver in equity.

(b) *Bid by the United States.* If property is sold to satisfy a first lien held by the United States, the United States may bid at the sale a sum which does not exceed the amount of its lien and the expenses of the sale. See also 31 U.S.C. 195.

Par. 9. The center heading immediately preceding section 301.7421 is revised to read as follows:

PROCEEDINGS BY TAXPAYERS AND THIRD PARTIES

Par. 10. Section 301.7421 is amended by revising subsection (a) of section 7421 and by adding a historical note to read as follows:

§ 301.7421 Statutory provisions; prohibition of suits to restrain assessment or collection.

Sec. 7421. *Prohibition of suits to restrain assessment or collection*—(a) *Tax.* Except as provided in sections 6212(a) and (c), 6213(a), and 7426 (a) and (b)(1), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

* * * * *

[Sec. 7421 as amended by sec. 110(c) Federal Tax Lien Act 1966 (80 Stat. 1144)]

Par. 11. Section 301.7424 is amended to read as follows:

§ 301.7424 Statutory provisions; intervention.

Sec. 7424. *Intervention.* If the United States is not a party to a civil action or suit, the United States may intervene in such action or suit to assert any lien arising under this title on the property which is the subject of such action or suit. The provisions of section 2410 of title 28 of the United States Code (except subsection (b)) and of section 1444 of title 28 of the United States Code shall apply in any case in which the United States intervenes as if the United States had originally been named a defendant in such action or suit. In any case in which the application of the United States to intervene is denied, the adjudication in such civil action or suit shall have no effect upon such lien.

[Sec. 7424 as amended by sec. 108 Federal Tax Lien Act 1966 (80 Stat. 1140)]

Par. 12. Section 301.7424-1 is amended by redesignating paragraphs (a) and (b) as paragraphs (b) and (c), respectively, and by adding a new paragraph (a). These redesignated and added paragraphs read as follows:

§ 301.7424-1 Civil action to clear title to property.

(a) The provisions of this section shall apply only to civil actions to clear title commenced on or before November 2, 1966. For provisions permitting the United States to be made a party defendant in a proceeding for the fore-

closure of a lien upon property where the United States may have claim upon the property involved, see section 2410 of title 28 of the United States Code.

(b) Any person having a lien upon or any interest in the property referred to in section 7403, notice of which has been duly filed of record in the jurisdiction in which the property is located, prior to the filing of the notice of the lien of the United States as provided in section 6323, or any person purchasing the property at a sale to satisfy such prior lien or interest, may make a written request to the Commissioner to authorize the filing of a civil action as provided in section 7403.

(c) If the Commissioner fails to authorize the filing of such civil action within 6 months after receipt of such written request, such person or purchaser may, after giving notice to the Commissioner, file a petition in the district court of the United States for the district in which the property is located, praying leave to file a civil action for a final determination of all claims to or liens upon the property in question.

Par. 13. There is inserted immediately after section 301.7424-1 the following new section:

§ 301.7424-2 Intervention.

If the United States is not a party to a civil action or suit, the United States may intervene in such action or suit to assert any lien arising under title 26 of the United States Code on the property which is the subject of such action or suit. The provisions of section 2410 of title 28 of the United States Code (except subsection (b)) and of section 1444 of title 28 of the United States Code shall apply in any case in which the United States intervenes as if the United States had originally been named a defendant in such action or suit. If the application of the United States to intervene is denied, the adjudication in such civil action or suit shall have no effect upon such lien.

Par. 14. Immediately after section 301.7425 there are added new section 301.7426 and a historical note and new section 301.7426-1 to read as follows:

§ 301.7426 Statutory provisions; civil actions by persons other than taxpayers.

Sec. 7426. *Civil actions by persons other than taxpayers*—(a) *Actions permitted*—(1) *Wrongful levy.* If a levy has been made on property or property has been sold pursuant to a levy, any person (other than the person against whom is assessed the tax out of which such levy arose) who claims an interest in or lien on such property and that such property was wrongfully levied upon may bring a civil action against the United States in a district court of the United States. Such action may be brought without regard to whether such property has been surrendered to or sold by the Secretary or his delegate.

(2) *Surplus proceeds.* If property has been sold pursuant to a levy, any person (other than the person against whom is assessed the tax out of which such levy arose) who claims an interest in or lien on such property junior to that of the United States and to be legally entitled to the surplus proceeds of such sale may bring a civil action against the United States in a district court of the United States.

(3) *Substituted sale proceeds.* If property has been sold pursuant to an agreement described in section 6325 (b)(3) (relating to substitution of proceeds of sale), any person who claims to be legally entitled to all or any part of the amount held as a fund pursuant to such agreement may bring a civil action against the United States in a district court of the United States.

(b) *Adjudication.* The district court shall have jurisdiction to grant only such of the following forms of relief as may be appropriate in the circumstances:

(1) *Injunction.* If a levy or sale would irreparably injure rights in property which the court determines to be superior to rights of the United States in such property, the court may grant an injunction to prohibit the enforcement of such levy or to prohibit such sale.

(2) *Recovery of property.* If the court determines that such property has been wrongfully levied upon, the court may—

(A) Order the return of specific property if the United States is in possession of such property;

(B) Grant a judgment for the amount of money levied upon; or

(C) Grant a judgment for an amount not exceeding the amount received by the United States from the sale of such property.

For the purposes of subparagraph (C), if the property was declared purchased by the United States at a sale pursuant to section 6335(e) (relating to manner and conditions of sale), the United States shall be treated as having received an amount equal to the minimum price determined pursuant to such section or (if larger) the amount received by the United States from the resale of such property.

(3) *Surplus proceeds.* If the court determines that the interest or lien of any party to an action under this section was transferred to the proceds of a sale of such property, the court may grant a judgment in an amount equal to all or any part of the amount of the surplus proceeds of such sale.

(4) *Substituted sale proceeds.* If the court determines that a party has an interest in or lien on the amount held as a fund pursuant to an agreement described in section 6325(b)(3) (relating to substitution of proceeds of sale), the court may grant a judgment in an amount equal to all or any part of the amount of such fund.

(c) *Validity of assessment.* For purposes of an adjudication under this section, the assessment of tax upon which the interest or lien of the United

States is based shall be conclusively presumed to be valid.

(d) *Limitation on rights of action.* No action may be maintained against any officer or employee of the United States (or former officer or employee) or his personal representative with respect to any acts for which an action could be maintained under this section.

(e) *Substitution of United States as party.* If an action, which could be brought against the United States under this section, is improperly brought against any officer or employee of the United States (or former officer or employee) or his personal representative, the court shall order, upon such terms as are just, that the pleadings be amended to substitute the United States as a party for such officer or employee as of the time such action was commenced upon proper service of process on the United States.

(f) *Provision inapplicable.* The provisions of section 7422(a) (relating to prohibition of suit prior to filing claim for refund) shall not apply to actions under this section.

(g) *Interest.* Interest shall be allowed at the rate of 6 percent per annum—

(1) In the case of a judgment pursuant to subsection (b)(2)(B), from the date the Secretary or his delegate receives the money wrongfully levied upon to the date of payment of such judgment; and

(2) In the case of a judgment pursuant to subsection (b)(2)(C), from the date of the sale of the property wrongfully levied upon to the date of payment of such judgment.

(h) *Cross reference.* For period of limitation, see section 6532(c).

[Sec. 7426 as added by sec. 110(a) Federal Tax Lien Act 1966 (80 Stat. 1142) [Pub. L. 89-719, 1966-2 C.B. 623]]

§ 301.7426-1 Civil actions by persons other than taxpayers.

(a) *Actions permitted*—(1) *Wrongful levy.* If a levy has been made on property or property has been sold pursuant to a levy, any person (other than the person against whom is assessed the tax out of which such levy arose) may bring a civil action against the United States in a district court of the United States based on such person's claim—

(i) That he has an interest in, or a lien on, such property which is senior to the interest of the United States; and

(ii) That such property was wrongfully levied upon.

No action is permitted under section 7426(a)(1) unless there has been a levy upon the property claimed. For example, no cause of action arises under this section where the United States sets-off an amount due to the taxpayer against taxes owed by him since no levy has been made.

(2) *Surplus proceeds.* If property has been sold pursuant to levy, any person (other than the person against whom is assessed the tax out of which such levy arose) may bring a civil action against the United States in a district court of the United States based upon such person's claim that he—

(i) Has an interest in or lien on such property junior to that of the United States; and

(ii) Is entitled to the surplus proceeds of such sale.

(3) *Substituted sale proceeds.* Any person, who claims to be legally entitled to all or any part of the amount which is held as a fund from the sale of property pursuant to an agreement described in section 6325(b)(3), may bring a civil action against the United States in a district court of the United States to obtain the relief provided by section 7426(b)(4). It is not necessary that the claimant be a party to the agreement which provides for the substitution of the sale proceeds for the property subject to the lien.

(b) *Adjudication*—(1) *Wrongful levy.* If the court determines that property has been wrongfully levied upon, the court may—

(i) Grant an injunction to prohibit the enforcement of such levy or to prohibit a sale of such property if such sale would irreparably injure rights in the property which are superior to the rights of the United States in such property; or

(ii) Order the return of specific property if the United States is in possession of such property; or

(iii) Grant a judgment for the amount of money levied upon; or

(iv) Grant a judgment for an amount not exceeding the amount received by the United States from the sale of such property (which, in the case of property declared purchased by the United States at a sale, shall be the greater of the minimum amount determined pursuant to section 6335(e) or the amount received by the United States from the resale of such property).

For purposes of this paragraph, a levy is wrongful against a person (other than the taxpayer against whom the assessment giving rise to the levy is made) if (*a*) the levy is upon property exempt from levy under section 6334, or (*b*) the levy is upon property in which the taxpayer had no interest at the time the lien arose or thereafter, or (*c*) the levy is upon property with respect to which such person is a purchaser against whom the lien is invalid under section 6323 or 6324(a)(2) or (b), or (*d*) the levy or sale pursuant to levy will or does effectively destroy or otherwise irreparably injure such person's interest in the property which is senior to the Federal tax lien. A levy may be wrongful against a holder of a senior lien upon the taxpayer's property under certain circumstances although legal rights to enforce his interest survive the levy procedure. For example, the levy may be wrongful against such a person if the property is an obligation which is collected pursuant to the levy rather than sold and nothing thereafter remains for the senior lienholder, or the property levied upon is of such a na-

ture that when it is sold at a public sale the property subject to the senior lien is not available for the senior lienholder as a realistic source for the enforcement of his interest. Some of the factors which should be taken into account in determining whether property remains or will remain a realistic source from which the senior lienholder may realize collection are: (*1*) the nature of the property, (*2*) the number of purchasers, (*3*) the value of each unit sold or to be sold, (*4*) whether, as a direct result of the distraint sale, the costs of realizing collection from the security have or will be so substantially increased as to render the security substantially valueless as a source of collection, and (*5*) whether the property subject to the distraint sale constitutes substantially all of the property available as security for the payment of the indebtedness to the senior lienholder.

(2) *Example.* The provisions of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. On April 10, 1972, A makes a $10,000 loan to B which is partially secured by a $5,000 obligation owed to B by C. Under local law, A's security interest in the obligation owed to B by C is protected against a subsequent judgment lien arising out of an unsecured obligation. Thus, under section 6323(h)(1), A's security interest exists as of April 10, 1972, for purposes of determining priorities against a tax lien under section 6323. On April 17, 1972, an assessment of $6,000 is made against B with respect to his delinquent Federal tax liability. Thereafter, notice of lien is filed pursuant to section 6323(f) with respect to B's delinquent tax liability. On July 10, 1972, a notice of levy is served upon C to reach the amount owed by him to B. C pays over the $5,000 obligation in satisfaction of the levy and, under local law, the obligation is discharged as to A. Because the levy effectively destroyed A's senior security interest in the obligation owed to B by C, the levy is wrongful as to A for purposes of section 7426. Under these circumstances, the levy is wrongful with respect to A even if, under local law, A may have a cause of action in contract against B for the $10,000 loan or may have a cause of action in tort against C for the amount of the $5,000 payment which defeated A's security interest in the obligation owed by C to B.

(3) *Surplus proceeds.* If the court determines that the interest or lien of any party to an action under section 7426 was transferred to the proceeds of a sale of the property, the court may grant a judgment in an amount equal to all or any part of the amount of the surplus proceeds of such sale. The term "surplus proceeds" means those proceeds realized on a sale of property remaining after application of the provisions of section 6342(a).

(4) *Substituted sale proceeds.* If the court determines that a party has an interest in or lien on the amount held as a fund pursuant to an agreement described in section 6325(b)(3), the court may grant a judgment in an amount equal to all or any part of the amount of such fund.

Par. 15. Section 301.7505 is amended to read as follows:

§ 301.7505 Statutory provisions; sale of personal property acquired by the United States.

Sec. 7505. *Sale of personal property acquired by the United States*—(a) *Sale.* Any personal property acquired by the United States in payment of or as security for debts arising under the internal revenue laws may be sold by the Secretary or his delegate in accordance with such regulations as may be prescribed by the Secretary or his delegate.

(b) *Accounting.* In case of the resale of such property, the proceeds of the sale shall be paid into the Treasury as internal revenue collections, and there shall be rendered a distinct account of all charges incurred in such sales.

[Sec. 7505 as amended by secs. 111(a) and (c) Federal Tax Lien Act 1966 (80 Stat. 1145 [Pub. L. 89-719, 1966-2 C.B. 623]]

Par. 16. Section 301.7505-1 is amended by revising the heading thereof, by revising subparagraph (1) of paragraph (a), and by revising so much of subparagraph (2) of paragraph (a) as precedes subdivision (ii) thereof. These revised provisions read as follows:

§ 301.7505-1 Sale of personal property acquired by the United States.

(a) *Sale*—(1) *In general.* Any personal property (except bonds, notes, checks, and other securities) acquired by the United States in payment of or as security for debts arising under the internal revenue laws may be sold by the district director who acquired such property for the United States. United States savings bonds shall not be sold by the district director but shall be transferred to the appropriate office of the Treasury Department for redemption. Other bonds, notes, checks, and other securities shall be disposed of in accordance with instructions issued by the Commissioner.

(2) *Time, place, manner, and terms of sale.* The time, place, manner, and terms of sale of personal property acquired for the United States shall be as follows:

(i) *Time, notice, and place of sale.* The property may be sold at any time after it has been acquired by the United States. A public notice of sale shall be posted at the post office nearest the place of sale and in at least two other public places. The notice shall specify the property to be sold and the time, place, manner, and conditions of sale. In addition, the district director may use such other methods of advertising as he believes will result in obtaining the highest price for the property. The place of sale shall be within the internal revenue district

where the property was originally acquired by the United States. However, if the district director believes that a substantially higher price may be obtained, the sale may be held outside his district.

* * * * *

Par. 17. Section 301.7506 is amended by revising subsection (a) of section 7506 and by adding a historical note to read as follows:

§ 301.7506 Statutory provisions; administration of real estate acquired by the United States.

Sec. 7506. *Administration of real estate acquired by the United States*—(a) *Person charged with.* The Secretary or his delegate shall have charge of all real estate which is or shall become the property of the United States by judgment of forfeiture under the internal revenue laws, or which has been or shall be assigned, set off, or conveyed by purchase or otherwise to the United States in payment of debts or penalties arising under the laws relating to internal revenue, or which has been or shall be vested in the United States by mortgage or other security for the payment of such debts, or which has been redeemed by the United States, and of all trusts created for the use of the United States in payment of such debts due them.

* * * * *

[Sec. 7506 as amended by section 111(b) Federal Tax Lien Act 1966 (80 Stat. 1145) [Pub. L. 89-719, 1966-2 C.B. 623]]

Par. 18. Section 301.7506-1 is amended by revising paragraph (a) to read as follows:

§ 301.7506-1 Administration of real estate acquired by the United States.

(a) *Persons charged with.* The district director for the internal revenue district in which the property is situated shall have charge of all real estate which is or shall become the property of the United States by judgment of forfeiture under the internal revenue laws, or which has been or shall be assigned, set off, or conveyed by purchase or otherwise to the United States in payment of debts or penalties arising under the laws relating to internal revenue, or which has been or shall be vested in the United States by mortgage, or other security for payment of such debts, or which has been redeemed by the United States, or which has been or shall be acquired by the United States in payment of or as security for debts arising under the internal revenue laws, and of all trusts created for the use of the United States in payment of such debts due the United States.

* * * * *

Par. 19. Section 301.7809 is amended by revising subsections (a) and (b) of section 7809, and by revising the historical note. These amended and revised provisions read as follows:

§ 301.7809 Statutory provisions; deposit of collections.

Sec. 7809. *Deposit of collections*—(a) *General rule.* Except as provided in subsections (b) and (c) and in sections 4735, 4762, 7651, 7652, 7654, and 7810, the gross amount of all taxes and revenues received under the provisions of this title, and collections of whatever nature received or collected by authority of any internal revenue law, shall be paid daily into the Treasury of the United States under instructions of the Secretary or his delegate as internal revenue collections, by the officer or employee receiving or collecting the same, without any abatement or deduction on account of salary, compensation, fees, costs, charges, expenses, or claims of any description. A certificate of such payment, stating the name of the depositor and the specific account on which the deposit was made, signed by the Treasurer of the United States, designated depository, or proper officer of a deposit bank, shall be transmitted to the Secretary or his delegate.

(b) *Deposit funds.* * * *

(2) *Sums offered for purchase of real estate.* Sums offered for the purchase of real estate under the provisions of section 7506;

(3) *Surplus proceeds in sales under levy.* Surplus proceeds in any sale under levy, after making allowance for the amount of the tax, interest, penalties, and additions thereto, and for costs and charges of the levy and sale; and

(4) *Surplus proceeds in sales of redeemed property.* Surplus proceeds in any sale under section 7506 of real property redeemed by the United States, after making allowance for the amount of the tax, interest, penalties, and additions thereto, and for the costs of sale.

Upon the acceptance of such offer in compromise or offer for the purchase of such real estate, the amount so accepted shall be withdrawn from such deposit fund account and deposited in the Treasury of the United States as internal revenue collections. Upon the rejection of any such offer, the Secretary or his delegate shall refund to the maker of such offer the amount thereof.

* * * * *

[Sec. 7809 as amended by sec. 3(b), Act of Oct. 23, 1962 (Pub. Law 87-870, 76 Stat. 1161) [1962-3 C.B. 213] and sec. 112(b) Federal Tax Lien Act 1966 (80 Stat. 1146) [Pub. L. 89-719, 1966-2 C.B. 623]]

Par. 20. Section 301.7810 is added and reads as follows:

§ 301.7810 Statutory provisions, revolving fund for redemption of real property.

Sec. 7810. *Revolving fund for redemption of real property*—(a) *Establishment of fund.* There is established a revolving fund, under the control of the Secretary or his delegate, which shall be available without fiscal year limitation for all expenses necessary for the redemption (by the Secretary or his delegate) of real property as provided in section 7425(d) and section 2410 of title 28 of the United States

Code. There are authorized to be appropriated from time to time such sums (not to exceed $1,000,000 in the aggregate) as may be necessary to carry out the purposes of this section.

(b) *Reimbursement of fund.* The fund shall be reimbursed from the proceeds of a subsequent sale of real property redeemed by the United States in an amount equal to the amount expended out of such fund for such redemption.

(c) *System of accounts.* The Secretary or his delegate shall maintain an adequate system of accounts for such fund and prepare annual reports on the basis of such accounts.

[Sec. 7810 as added by sec. 112(a) Federal Tax Lien Act 1966 (80 Stat. 1145)]

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

REX D. DAVIS,
Director, Bureau of Alcohol, Tobacco and Firearms.

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved March 11, 1974.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 14, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 15, 1974, 39 F.R. 9949)

Subchapter B.—Limitations on Credit or Refund

Section 6511.—Limitations on Credit or Refund

26 CFR 301.6511(d): Statutory provisions; limitations on credit or refund; special rules applicable to income tax.

Limitation on credit or refund attributable to a capital loss carryback. See T.D. 7301, page 203.

Subchapter D.—Periods of Limitation in Judicial Proceedings

Section 6532.—Periods of Limitation on Suits

26 CFR 301.6532-3: Periods of limitation on suits.

Limitation period for filing suits for the return of property wrongfully levied upon. See T. D. 7305, page 339.

Chapter 67.—Interest
Subchapter A.—Interest on Underpayments

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment, of Tax

26 CFR 301.6601: Statutory provisions; interest on underpayment, nonpayment, or extensions of time for payment, of tax.

Interest on underpayments of tax reduced by capital loss, investment credit, or WIN credit carryback. See T.D. 7301, page 203.

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26 CFR 301.6601-1: Interest on underpayments.
(Also Sections 6651, 7503; 301.6651-1(a)(2), 301.7503-1.)

Additions to tax; filing date on Saturday, Sunday, or holiday. Interest and a late payment penalty assessed against a taxpayer who timely filed his return on Monday, April 16, 1973, but did not pay the balance of tax due with his return, must be computed from Sunday, April 15, the prescribed date for filing.

Rev. Rul. 74-235

Advice has been requested concerning the computation of interest under section 6601(a) and the addition to the tax for failure to pay under section 6651(a)(2) of the Internal Revenue Code of 1954 under the circumstances described below.

The taxpayer timely filed his individual income tax return for 1972 on Monday, April 16, 1973, because April 15, 1973, the due date of the return under section 6072 of the Internal Revenue Code of 1954, fell on a Sunday. The return showed a balance of tax due, but it was not paid with the return when filed. The taxpayer was sent a statement of notice and demand for payment of the tax, which included interest and a late payment penalty that had been computed from April 15, 1973.

The specific question is whether the interest and penalty should be computed from April 15 or from April 16, 1973.

Section 6601(a) of the Code provides that if tax is not paid when due, interest shall be paid for the period from the date required to be paid until the date paid, computed at an annual rate of 6 percent.

Section 6651(a)(2) of the Code provides that if tax shown on a return is not paid on or before the date prescribed for payment, an addition to the tax of 0.5 percent a month, (not exceeding 25 percent in the aggregate) will be imposed, until paid, unless the taxpayer shows reasonable cause for failure to pay the tax timely.

Section 6151 of the Code provides that tax shall be paid at the time and place fixed for filing the return (determined without regard to any extension of time for filing). Section 6072 provides that a calendar year individual income tax return shall be filed on or before April 15 following the close of the year.

Section 7503 of the Code provides that when a date prescribed under authority of any internal revenue law for performing any act falls on a Saturday, Sunday, or legal holiday, such act will be considered to have been performed timely if done on the next succeeding day which is not a Saturday, Sunday, or legal holiday.

Section 7503 of the Code only applies if the act is actually performed on such next succeeding day. It only provides that if an act is performed on the next succeeding day, such act will be considered as performed timely for purposes of waiving any additions to the tax or interest which might otherwise be due if it were not for the provisions of section 7503.

Accordingly, because payment of the tax was not made on the next succeeding day which was not a Saturday, Sunday, or legal holiday, interest and additions to the tax will be computed from the actual due date of the return, April 15, 1973, notwithstanding that such due date falls on a Saturday, Sunday, or legal holiday and notwithstanding that the return was timely filed on April 16, 1973.

Subchapter B.—Interest on Overpayments

Section 6611.—Interest on Overpayments

26 CFR 301.6611: Statutory provisions; interest on overpayments.

Interest on overpayments resulting from the carryback of a net capital loss, an investment credit, or a WIN credit. See T.D. 7301, page 203.

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26 CFR 301.6611-1: Refund within 45 days.
(Also Section 7502; 301.7502-1.)

45-day period during which no interest is allowable on return showing overpayment. For a return showing an overpayment and filed by registered mail during a filing extension period, the 45-day period during which no interest is allowable begins on the registration date rather than the date the return is received by the Revenue Service.

Rev. Rul. 74-236

Advice has been requested whether, under the circumstances described below, the 45-day period within which no interest is allowable on an overpayment of tax under section 6611(e) of the Internal Revenue Code of 1954 is computed from the date the return is timely mailed under the terms of an extension of time to file or from the date the return is actually received by the Internal Revenue Service.

The taxpayer's return for the taxable year 1970 was due on March 15, 1971. An extension of time to file was granted to September 15, 1971. On September 15, 1971, the taxpayer mailed its return, showing an overpayment, to the Service by registered mail. The return was received by the Service on September 17, 1971.

Section 6611(e) of the Code provides that no interest will be paid if a refund is made within 45 days after the last date prescribed for filing the return (determined without regard to an extension of time for filing) or, if the return is filed after such last date, the refund is made within 45 days after the return is filed.

Section 7502(a)(1) of the Code provides that if any return required to be filed within a prescribed period or on or before a prescribed date is, after such period or date, delivered by United States mail to the place at which the return is required to be filed, the date of the United States postmark stamped on the cover in which the return is mailed shall be deemed to be the date of delivery of the return.

Section 7502(a)(2) of the Code provides that subsection (a) shall apply only if the postmark date falls within the prescribed period or on or before the prescribed date for filing the return (including any extension granted for such filing), deposited in the mail in the United States, postage pre-paid and properly addressed.

Section 7502(c)(1) of the Code provides that if the return is sent by registered mail, such registration shall be prima facie evidence that the return was delivered to the addressee and the date of registration shall be deemed the postmark date.

The taxpayer's return was sent by United States registered mail on September 15, 1971, which was the prescribed date for filing, including the extension granted. Under section 7502(c)(1)(B) of the Code, the registration date is deemed the postmark date. There is no provision excepting section 6611(e) from the provisions of section 7502. Therefore, the taxpayer's return is considered filed on September 15, 1971, and not on September 17, 1971, when the return was received by the Service.

Accordingly, since the taxpayer timely mailed its return on September 15, 1971, under the terms of an extension to file on or before that date, the date the return was mailed is to be used in computing the 45-day period within which no interest is allowable on an overpayment under section 6611(e) of the Code.

Chapter 68.—Additions to the Tax, Additional Amounts, and Assessable Penalties
Subchapter A. Additions to the Tax and Additional Amounts

Section 6651.—Failure to File Tax Return or to Pay Tax

26 CFR 301.6651-1(a)(2): Failure to pay tax shown on return.

Computation of the addition to the tax for failure to pay the tax shown on the return when the date for payment falls on a Saturday, Sunday, or legal holiday and payment is not made on the next succeeding day which is not a Saturday, Sunday, or legal holiday. See Rev. Rul. 74-235, page 347.

Chapter 75.—Crimes, Other Offenses, and Forfeitures
Subchapter A. Crimes
Part I.—General Provisions

Section 7216.—Disclosure or Use of Information by Preparers of Returns

26 CFR 301.7216: Statutory provisions; disclosure or use of information by preparers of returns.

T.D. 7310 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

[1] The publication of this Treasury Decision in 39 F.R. 11537, dated March 29, 1974, contains (1) instructions for modifying the notice of proposed rulemaking published in 37 F.R. 28070, dated December 20, 1972, and (2) the full text of the regulations with such modifications. As here published, the Treasury Decision reflects the full text of such regulations, with modifications. The individual instructions have been omitted.

Disclosure or use of information by preparers of returns.

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

By a notice of proposed rule making appearing in the Federal Register for December 20, 1972 (37 F.R. 28070), amendments to the Regulations on Procedure and Administration (26 CFR Part 301) were proposed in order to conform the regulations to section 7216 of the Internal Revenue Code of 1954, relating to the disclosure or use of information by preparers of returns, as added by section 316 of the Revenue Act of 1971 (85 Stat. 529) [Pub. L. 92-178, 1972-1 C.B. 443]. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the proposed amendments of the regulations, subject to the changes indicated below, are adopted by this document.

Section 7216(a) of the Code provides that any person who is engaged in the business of preparing, or providing services in connection with the preparation of, income tax returns or declarations of estimated tax and who discloses any tax return information or uses such information for any purpose other than to prepare, or assist in preparing, a return shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $1,000, or imprisoned not more than 1 year, or both. Section 7216(a) also applies to any person who for compensation prepares any such return or declaration, whether or not such person is in the tax return preparer business.

Section 7216(b) provides certain exceptions to the new penalty rule. A tax return preparer may without penalty disclose tax return information if such disclosure is made pursuant to any other provision of the Internal Revenue Code or pursuant to an order of a court. The penalty does not apply to the use of information in the preparation of State and local tax returns. Furthermore, the Secretary or his delegate is authorized to prescribe regulations under which other disclosures or uses will not be subject to the penalty.

As published with the notice of proposed rule making, § 301.7216-1 contained in paragraph (a) the general rule for the application of section 7216 and in paragraph (b) detailed definitions of the terms "tax return", "tax return preparer", "tax return processor", and "tax return information". This document makes a technical change in paragraph (a) to make clear that the tax return referred to therein is the return of the taxpayer in respect of whom the information was furnished. Paragraph (b) is revised substantially by this document. The distinction between a tax return preparer and a tax return processor is eliminated. Persons who under the notice of proposed rule making were defined as tax return processors are included within the new definition of tax return preparers. As a result of this revision, all of the disclosures or uses permitted without formal written consent under § 301.7216-2, and with formal written consent under § 301.7216-3, are applicable to all persons classified as tax return preparers.

Pursuant to the authority granted to the Secretary or his delegate, § 301.7216-2, as set forth in the notice of proposed rule making, provided that certain disclosures or uses of tax return information were permitted without the formal written consent of the taxpayer. The taxpayer's attorney was permitted to disclose or use tax return information in connection with the rendering of legal services, such as estate planning, preparation of trial briefs, etc., to the taxpayer. Accountants were permitted to disclose or use tax return information in the preparation of books of account, working papers, and accounting statements or reports, or in the performance of other services for a taxpayer. In addition, other disclosures without the formal written consent of the taxpayer were permitted, such as a disclosure by a tax return preparer to a tax return processor, or a disclosure by one employee to another employee of a tax return preparer or a tax return processor.

A number of changes have been made by this document in proposed § 301.7216-2. Thus, a new paragraph (b) has been added to authorize in appropriate circumstances the disclosure or use, in the preparation of a tax return of one taxpayer, of tax return information furnished by another taxpayer. These situations are limited to those involving related taxpayers having no adverse interest. The rules governing attorneys and accountants have been combined and revised, and specifically extended to corporate fiduciaries, such as trust companies and bank trust departments, with the objective of permitting, without formal written consent of the taxpayer, the disclosure or use of tax return information in the customary and ordinary course of performing the professional or fiduciary services to or for the taxpayer. Another new rule makes clear that a tax return preparer may, without penalty, make tax return information available to the fiduciary of a taxpayer who, after furnishing the information, has become incompetent, insolvent, or bankrupt, or to the fiduciary of the estate of a deceased taxpayer. The rule on disclosure by one employee to another employee of a tax return preparer has been clarified and made applicable to officers and partners. The rule relating to use of information in the preparation of State returns has been expanded to apply to disclosure or use in the prep-

aration or audit of State returns. In addition, the rules on retention of records and compiling of taxpayer lists have been made less restrictive.

Under the notice of proposed rule making, and pursuant to the authority granted to the Secretary or his delegate, certain disclosures or uses were permitted under § 301.7216-3 only with the formal written consent of the taxpayer. These consents were required to permit tax return preparers to use tax return information in connection with the solicitation of certain additional current business, to allow lawyers and accountants to disclose to third parties, and to permit tax return preparers to use the tax return information of one taxpayer in preparing the tax return of another taxpayer entering into a tax-related transaction with the first. These rules were intended to cover situations where tax returns information could not be disclosed or used pursuant to § 301.7216-2.

Section 301.7216-3 has been revised in this document. The rule on solicitation of current business has been revised so that it applies only to matters not related to the Internal Revenue Service. Existing rules in Treasury Department Circular No. 230 (31 CFR 10.30) and Rev. Proc. 68-20, 1968-1 C.B. 812, govern the solicitation of employment in matters related to the Internal Revenue Service. The rule on disclosure to third parties has been expanded to apply to all tax return preparers; it will not apply where disclosure without formal written consent is permitted under § 301.7216-2 in the performance of professional or fiduciary services. The rule on use of tax return information in connection with another person's return has been revised to apply to disclosures or uses where the new § 301.7216-2(b) added by this document does not permit disclosure or use without formal written consent. A revised rule permits the formal consent to be signed by the taxpayer or his duly authorized agent or fiduciary. Two examples affecting certified public accountants have been eliminated from proposed § 301.7216-3(c) since the situations involved will be covered by revised § 301.7216-2(e).

In view of the foregoing, the following amendments of the regulations are hereby adopted:

Paragraph 1. The following new sections are added immediately after § 301.7215:

§ 301.7216 Statutory provisions; disclosure or use of information by preparers of returns.

Sec. 7216. *Disclosure or use of information by preparers of returns*—(a) *General rule.* Any person who is engaged in the business of preparing, or providing services in connection with the preparation of, returns of the tax imposed by chapter 1, or declarations or amended declarations of estimated tax under section 6015, or any person who for compensation prepares any such return or declaration for any other person, and who—

(1) Discloses any information furnished to him for, or in connection with, the preparation of any such return or declaration, or

(2) Uses any such information for any purpose other than to prepare, or assist in preparing, any such return or declaration,

shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than $1,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution.

(b) *Exceptions* — (1) *Disclosure.* Subsection (a) shall not apply to a disclosure of information if such disclosure is made—

(A) Pursuant to any other provision of this title, or

(B) Pursuant to an order of a court.

(2) *Use.* Subsection (a) shall not apply to the use of information in the preparation of, or in connection with the preparation of, State and local tax returns and declarations of estimated tax of the person to whom the information relates.

(3) *Regulations.* Subsection (a) shall not apply to a disclosure or use of information which is permitted by regulations prescribed by the Secretary or his delegate under this section.

[Sec. 7216 as added by sec. 316, Rev. Act 1971 (85 Stat. 529) [Pub. L. 92-178, 1972-1 C.B. 443]

§ 301.7216-1 Penalty for disclosure or use of tax return information.

(a) *In general.* Section 7216(a) provides in effect that, except as provided in section 7216(b), any tax return preparer (as described in paragraph (b)(2) of this section) who on or after January 1, 1972, discloses or uses any tax return information (as described in paragraph (b)(3) of this section) other than for the specific purpose of preparing, assisting in preparing, or obtaining or providing services in connection with the preparation of, any tax return of the taxpayer by or for whom the information was made available to a tax return preparer, shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than $1,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution. Pursuant to section 7216(b), the provisions of section 7216(a) and this paragraph do not apply to any disclosure or use permitted under § 301.7216-2 or § 301.7216-3.

(b) *Definitions.* For purposes only of section 7216 and §§ 301.7216-1 through 301.7216-3—

(1) *Tax return.* The term "tax return" means any return (or amended return) of the income tax imposed by chapter 1 or 2 of the Code, or any declaration (or amended declaration) of estimated tax made under section 6015.

(2) *Tax return preparer.* (i) The term tax return preparer means any person—

(A) Who is engaged in the business of preparing tax returns,

(B) Who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns,

(C) Who is remunerated for preparing, or assisting in preparing, a tax return for any other person, or

(D) Any individual who, as part of his duties or employment with any person described in (A), (B), or (C) of this subdivision, performs services which assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.

For example, assume that a bank is a tax return preparer within the meaning of (A) of this subdivision and it employs one individual to solicit the necessary tax return information for the preparation of a tax return and another individual to prepare the return on the basis of the information that is furnished. Under these circumstances, both employees are tax return preparers. Also, for example, a secretary to a tax return preparer who types or otherwise works on returns prepared by the preparer is a tax return preparer.

(ii) A person is engaged in the business of preparing tax returns as described in subdivision (i)(A) of this subparagraph if, in the course of his business, he holds himself out to taxpayers as a person who prepares tax returns, whether or not tax return preparation is his sole business activity and whether or not he charges a fee for such services.

(iii) A person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns as described in subdivision (i)(B) of this subparagraph if, in the course of his business, he holds himself out to tax return preparers or to taxpayers as a person who performs such auxiliary services, whether or not providing such auxiliary services is his sole business activity and whether or not he charges a fee for such services. For example, a person part or all of whose business is to provide a computerized tax return processing service based on tax return information furnished by another person is a tax return preparer.

(iv) A tax return preparer described in subdivision (i)(C) of this subparagraph includes any person who—

(A) For remuneration but not in the course of a business prepares a tax return for another person, or

(B) For remuneration and on a casual basis helps a relative, friend, or other acquaintance to prepare the latter's tax return.

(v) A person is not a tax return preparer merely because he leases office space to a tax return preparer, furnishes credit to a taxpayer whose tax return is prepared by a tax return preparer, or otherwise performs some service which only incidentally relates to the preparation of tax returns. For example, assume that a tax return preparer contracts with a department store for the rental of space in the store, and that the store advertises that taxpayers who use the tax return preparation service may charge the cost of having their tax return perpared to their charge account with the department store. Under such circumstances, the department store is not a tax return preparer.

(3) *Tax return information.* The term "tax return information" means any information, including but not limited to a taxpayer's name, address, or identifying number, which is furnished in any form or manner by a taxpayer for, or in connection with, the preparation of a tax return of such taxpayer. Information furnished by a taxpayer includes information which is furnished on behalf of the taxpayer by any person; for example, any person required under section 6012 to make a return for such taxpayer, such as a guardian for a minor, by a duly authorized agent for his principal, by a fiduciary for an estate or trust, or by a receiver, trustee in bankruptcy, or assignee for a corporation.

§ 301.7216-2 Disclosure or use without formal consent of taxpayer.

(a) *Disclosure pursuant to other provisions of Internal Revenue Code.* The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure of tax return information if such disclosure is made pursuant to any other provision of the Code or the regulations thereunder. Thus, for example, the provisions of such sections do not apply to a disclosure pursuant to section 7269 to an officer or employee of the Internal Revenue Service of information concerning the estate of a decedent or a disclosure pursuant to section 7602 to an officer or employee of the Internal Revenue Service of books, papers, records, or other data which may be relevant to the liability of any person for the income tax.

(b) *Disclosure or use of information in the case of related taxpayers.* (1) A tax return preparer may use, in preparing a tax return of a second taxpayer, and may disclose to such second taxpayer in the form in which it appears on such return, any tax return information which the preparer obtained from a first taxpayer if—

(A) The second taxpayer is related to the first taxpayer within the meaning of subparagraph (2) of this paragraph,

(B) The first taxpayer's tax interest in such information is not adverse to the second taxpayer's tax interest in such information, and

(C) The first taxpayer has not expressly prohibited such disclosure or use.

(2) For purposes of subparagraph (1)(A) of this paragraph, one taxpayer is related to another taxpayer

if they have any one of the following relationships: husband and wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations as defined in section 1563.

(3) See § 301.7216-3(a)(3) for disclosure or use of tax return information of the taxpayer in preparing the tax return of a second taxpayer where the requirements of this paragraph are not satisfied.

(c) *Disclosure pursuant to court order.* The provisions of section 7216 (a) and § 301.7216-1 shall not apply to any disclosure of tax return information if such disclosure is made pursuant to the order of any court of record, Federal, State, or local, clearly identifying the information to be disclosed.

(d) *Disclosure for use in revenue investigations or court proceedings.* A tax return preparer may disclose tax return information (1) to his attorney, or to an employee of the Internal Revenue Service, for use in connection with an investigation of such tax return preparer conducted by the Internal Revenue Service or (2) to his attorney, or to any officer of a court, for use in connection with proceedings involving such tax return preparer before the court.

(e) *Attorneys and accountants.* A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer to or for whom it renders legal or accounting services may disclose or use the tax return information of such taxpayer in the ordinary course of rendering such legal or accounting services to or for such taxpayer. Thus, for example, a lawyer who prepares a tax return for a taxpayer to or for whom he renders legal services may disclose or use the tax return information of the taxpayer for, or in connection with, the rendering of legal services, such as estate planning or administration, or preparation of trial briefs or trust instruments, to the taxpayer or his estate. In further illustration, an accountant who prepares a tax return for a taxpayer to or for whom he renders accounting services may disclose or use the tax return information of the taxpayer for, or in connection with, the preparation of books of account, working papers, or accounting statements or reports of the taxpayer and, in the normal course of rendering such accounting services to or for the taxpayer, may, with the express or implied consent of the taxpayer, make such tax return information available to stockholders, management, suppliers, lenders, or other third parties.

(f) *Corporate fiduciaries.* A trust company, trust department of a bank, or other corporate fiduciary which prepares a tax return for a taxpayer to or for whom it renders fiduciary, investment, or other custodial or management services may (1) disclose or use the tax return information of such taxpayer in the ordinary course of rendering such services to or for the taxpayer or (2), with the express or implied consent of the taxpayer, make such information available to the taxpayer's attorney, accountant, or investment advisor.

(g) *Disclosure to taxpayer's fiduciary.* If after furnishing tax return information to a tax return preparer the taxpayer dies or becomes incompetent, insolvent, or bankrupt, or his assets are placed in conservatorship or receivership, the tax return preparer may disclose such information to the duly appointed fiduciary of the taxpayer or his estate, or to the duly authorized agent of such fiduciary.

(h) *Disclosure by tax return preparer to obtain tax return processing service.* A tax return preparer may disclose tax return information of a taxpayer to another tax return preparer described in § 301.7216-1(b)(2)(i)(B) for the purpose of having the second tax return preparer transfer that information to, and compute the tax liability on, a tax return of such taxpayer by means of electronic, mechanical, or other form of tax return processing service.

(i) *Disclosure by one officer, employee, or member to another officer, employee, or member.* An officer, employee, or member of a tax return preparer may transfer any tax return information to another officer, employee, or member of the same tax return preparer for the purpose of performing services which assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the tax return of a taxpayer by or for whom the information was furnished.

(j) *Identical information obtained from other sources.* The provisions of section 7216(a) and § 301.7216-1 shall not apply to the disclosure or use by a tax return preparer of information which is identical to any tax return information which has been furnished to him if such identical information was obtained otherwise than in connection with the preparation of, or providing auxiliary services in connection with the preparation of, a tax return.

(k) *Disclosure or use of information in preparation or audit of State returns.* The provisions of section 7216 (a) and § 301.7216-1 shall not apply to the disclosure or use by any tax return preparer of any tax return information in the preparation or audit of, or in connection with the preparation or audit of, any tax return or declaration of estimated tax required of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, or of any possession of the United States.

(l) *Retention of records.* A tax return preparer may retain tax return information of a taxpayer, including copies of tax returns or data processing tapes prepared on the basis

of such tax return information, and may use such information in connection with the preparation of other tax returns of the taxpayer or in connection with an audit by the Internal Revenue Service of any tax return. The provisions of paragraph (m) of this section respecting the transfer of a taxpayer list apply also to the transfer of any records and related workpapers to which this paragraph applies.

(m) *Lists for solicitation of tax return business.* Any tax return preparer may compile and maintain a separate list containing the names and addresses of taxpayers whose tax returns he has prepared or processed. This list may be used by the compiler solely to contact the taxpayers on the list for the purpose of offering tax information or additional tax return preparation services to such taxpayers. The compiler of the list may not transfer the taxpayer list, or any part thereof, to any other person unless such transfer takes place in conjunction with the sale or other disposition of the tax return preparation business of such compiler. A person who acquires a taxpayer list, or a part thereof, in conjunction with such a sale or other disposition shall be subject to the provisions of this paragraph with respect to such list as if he had been the compiler of such list. The term "list", as used in this paragraph, includes any record or system whereby the names and addresses of taxpayers are retained.

§ 301.7216-3 Disclosure or use only with formal consent of taxpayer.

(a) *Written consent to use or disclosure*—(1) *Solicitation of other business.* (i) If a tax return preparer has obtained from the taxpayer a consent described in paragraph (b) of this section, he may use the tax return information of such taxpayer to solicit from the taxpayer any additional current business, in matters not related to the Internal Revenue Service, which the tax return preparer provides and offers to the public. The request for such consent may not be made later than the time the taxpayer receives his completed tax return from the tax return preparer. If the request is not granted, no follow up request may be made. This authorization to use the tax return information of the taxpayer does not apply, however, for purposes of facilitating the solicitation of the taxpayer's use of any services or facilities furnished by a person other than the tax return preparer, unless such other person and the tax return preparer are members of the same affiliated group within the meaning of section 1504. Thus, for example, the authorization would not apply if the other person is a corporation which is owned or controlled directly or indirectly by the same interests which own or control the tax return preparer but which is not affiliated with the tax return preparer within the meaning of section 1504(a). Moreover, this authorization does not apply for purposes of facilitating the solicitation of additional business to be furnished at some indefinite time in the future, as, for example, the future sale of mutual fund shares or life insurance, or the furnishing of future credit card services. It is not necessary, however, that the additional business be furnished in the same locality in which the tax return information is furnished.

(ii) For prohibition against solicitation of employment in matters related to the Internal Revenue Service, see 31 CFR 10.30 (Treasury Department Circular No. 230) and § 7 of Rev. Proc. 68-20, 1968-1 C.B. 812.

(2) *Permissible disclosures to third parties.* If a tax return preparer has obtained from a taxpayer a consent described in paragraph (b) of this section, he may disclose the tax return information of such taxpayer to such third persons as the taxpayer may direct. However, see § 301.7216-2 for certain permissible disclosures without formal written consent.

(3) *Disclosure or use of information in connection with another person's return.* A tax return preparer may disclose or use any tax return information, which was obtained from a first taxpayer, in preparing a tax return of a second taxpayer if the tax return preparer has obtained from the first taxpayer a written consent described in paragraph (b) of this section. See § 301.7216-2(b) for disclosure or use in certain cases without formal consent.

(b) *Form of consent.* A separate written consent, signed by the taxpayer or his duly authorized agent or fiduciary, must be obtained for each separate use or disclosure authorized in paragraph (a)(1), (2), or (3) of this section and shall contain—

(1) The name of the tax return preparer,

(2) The name of the taxpayer,

(3) The purpose for which the consent is being furnished,

(4) The date on which such consent is signed,

(5) A statement that the tax return information may not be disclosed or used by the tax return preparer for any purpose (not otherwise permitted under § 301.7216-2) other than that stated in the consent, and

(6) A statement by the taxpayer, or his agent or fiduciary, that he consents to the disclosure or use of such information for the purpose described in subparagraph (3) of this paragraph.

(c) *Illustrations.* The application of this section may be illustrated by the following examples:

Example (1). In order to stimulate the making of loans, a bank advertises that it is in the business of preparing tax returns. A taxpayer goes to the bank to have his tax return prepared. After the return has been completed by the bank, the employee of the bank who obtained the tax return information from the taxpayer explains that the taxpayer owes an addi-

tional $400 in taxes and that the bank's loan department may be able to offer the taxpayer a loan to pay the tax due. If the taxpayer decides to accept the opportunity offered to apply for a loan, the bank must first have the taxpayer execute a written consent described in paragraph (b) of this section for the bank to use any of such information which is required in determining whether to make the tax loan.

Example (2). An individual who sells life insurance and shares in a mutual fund is also in the business of preparing tax returns. A taxpayer who has gone to the individual to have his tax return prepared is requested, at the time he picks up his completed tax return, to give his consent to the individual's use of his tax return information in connection with such individual's solicitation of the taxpayer's purchasing a life insurance policy and shares in the mutual fund. Before the individual may use such tax return information as a basis for soliciting such additional business from the taxpayer, the taxpayer must execute separate written consents under paragraph (b) of this section, one authorizing the use of such information as a basis for soliciting the sale of the mutual fund shares and a second authorizing the use of such information as a basis for soliciting the sale of the life insurance.

Example (3). The facts are the same as in example (2) except that the individual does not sell life insurance but does sell shares in several mutual funds. If the request is for the purpose of using the tax return information as a basis for soliciting the sale at one time of shares in mutual funds A and B, only one written consent under paragraph (b) of this section is required of the taxpayer. If, however, the request is for the purpose of using the tax return information as a basis for soliciting the sale of shares in fund A at one time, and the sale of shares in fund B at a later time, two written consents under such paragraph are required of the taxpayer.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved March 25, 1974.

FREDERICK W. HICKMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 27, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 29, 1974, 39 F.R. 11537)

Chapter 76.—Judicial Proceedings

Subchapter A.—Civil Actions by the United States

Section 7403.—Action to Enforce Lien or to Subject Property to Payment of Tax

26 CFR 301.7403-1: Action to enforce lien or to subject property to payment of tax.

Amount the United States may bid at a judicial sale of property to satisfy a first lien on the property held by the United States. See T.D. 7305, page 339.

Subchapter B.—Proceedings by Taxpayers and Third Parties

Section 7421.—Prohibition of Suits to Restrain Assessment or Collection

Ct. D. 1962

SUPREME COURT OF THE UNITED STATES
No. 72-1470

Bob Jones University, Petitioner, v. William E. Simon, Secretary of Treasury, et al.

[416 U.S.]

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

[May 15, 1974]

Syllabus

Petitioner, a private university, was notified by the Internal Revenue Service (IRS), pursuant to a newly announced policy of denying tax-exempt status for private schools with racially discriminatory admissions policies, that it was going to revoke a ruling letter declaring that petitioner qualified for tax-exempt status under § 501(c)(3) of the Internal Revenue Code of 1954 (Code). Petitioner sued for injunctive relief to prevent revocation, alleging irreparable injury in the form of income tax liability and loss of contributions and claiming that the revocation would violate petitioner's rights to free exercise of religion, to free association, and to due process and equal protection of the laws. The District Court granted the relief sought despite § 7421(a) of the Code, which provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court." The Court of Appeals reversed, holding that § 7421(a), as construed in *Enochs* v. *Williams Packing & Navigation Co.*, 370 U. S. 1, [Ct. D. 1874, 1962-2 C.B. 349], foreclosed relief. Under that decision a preenforcement injunction against tax assessment or collection may be granted only if (1) "it is clear that under no circumstances could the Government ultimately prevail. . . ." and (2) "if equity jurisdiction otherwise exists." *Held:*

1. The suit is one "for the purpose of restraining the assessment or collection of any tax" within the meaning of § 7421(a).

(a) Petitioner's allegation that revocation of the ruling letter would subject it to "substantial" income tax liability demonstrates that a primary purpose of the suit is to prevent the IRS from assessing and collecting income taxes; but even if no income tax liability resulted, the suit would still be one to restrain the assessment and collection of federal social security and unemployment taxes, as well as to restrain the collection of taxes from petitioner's donors.

(b) Petitioner has not shown that the contemplated revocation of its ruling letter is not based on the IRS' good-faith effort to enforce the technical requirements of the Code.

2. Petitioner's contention that § 7421(a) is subject to judicially created exceptions other than the *Williams Packing* test is without merit. That decision constitutes an all-encompassing reading of § 7421(a), and it rejected the contention, relied upon by petitioner, that irreparable injury alone is sufficient to lift the statutory bar.

3. Denying injunctive relief to petitioner under the standards of *Williams Packing*, *supra*, will not, because of alleged irreparable injury pending resort to alternative remedies, deny petitioner due process of law, since this is not a case where an aggrieved party has no access at all to judicial review. The review procedures that are

available are constitutionally adequate, even though involving serious delay.

4. Petitioner has not met the standards of *Williams Packing, supra,* since its contentions are sufficiently debatable to foreclose any notion that "under no circumstances could the Government ultimately prevail."

472 F. 2d 903 and 476 F. 2d 259, affirmed.

POWELL, J., delivered the opinion of the Court, in which BURGER, C. J., and BRENNAN, STEWART, WHITE, MARSHALL, and REHNQUIST, JJ., joined. BLACKMUN, J., filed an opinion concurring in the result. DOUGLAS, J., took no part in the decision of the case.

MR. JUSTICE POWELL delivered the opinion of the Court.

This case and *Alexander* v. *"Americans United" Inc., post,* p. —, involve the application of the Anti-Injunction Act, § 7421(a) of the Internal Revenue Code of 1954 (the Code), 26 U. S. C. § 7421(a), to the ruling letter program of the Internal Revenue Service (the Service) for organizations claiming tax-exempt status under Code § 501(c)(3), 26 U. S. C. § 501(c)(3). The question presented is whether, prior to the assessment and collection of any tax, a court may enjoin the Service from revoking a ruling letter declaring that petitioner qualifies for tax-exempt status and from withdrawing advance assurance to donors that contributions to petitioner will constitute charitable deductions under Code § 170(c)(2), 26 U. S. C. § 170(c)(2). We hold that it may not.

I

Section 501(a) of the Code exempts from federal income taxes organizations described in § 501(c)(3). The latter provision encompasses:

"Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

Section 501(c)(3) organizations are also exempt from federal social security (F. I. C. A.) taxes by virtue of Code § 3121(b)(8)(B), 26 U. S. C. § 3121(b)(8)(B), and from federal unemployment (F. U. T. A.) taxes by virtue of § 3306(c)(8), 26 U. S. C. § 3306(c)(8). Donations to § 501(c)(3) organizations are tax-deductible under § 170(c)(2).[1]

As a practical matter, an organization hoping to solicit tax-deductible contributions may not rely solely on technical compliance with the language of §§ 501(c)(3) and 170(c)(2). The organization must also obtain a ruling letter from the Service, pursuant to Revenue Procedures 72-3 and 72-4, 1972-1 C.B. 698, 706, declaring that it qualifies under § 501(c)(3). Receipt of such a ruling letter leads, in the ordinary case, to inclusion in the Service's periodically updated Publication No. 78, "Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1954" (the Cumulative List). In essence, the Cumulative List is the Service's official roster of tax-exempt organizations: "The listing of an organization in [the Cumulative List] signifies it has received a ruling or determination letter . . . stating that contributions by donors to the organization are deductible as provided in section 170 of the Code." Revenue Procedure 72-39, 1972-2 C.B. 818. An organization's inclusion in the Cumulative List assures potential donors in advance that contributions to the organization will qualify as charitable deductions under § 170(c)(2). The Service has announced that, with narrowly limited exceptions, a donor may rely on the Cumulative List for so long as the beneficiaries of his largesse maintain their listing, regardless of their actual tax status.[2] For this reason, appear-

[1] Section 170(a) of the Code provides that "[t]here shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. . . ." Section 170(c)(2) declares:

"Charitable contribution defined.—For purposes of this section, the term 'charitable contribution' means a contribution or gift to or for the use of—

* * * * *

"(2) A corporation, trust, or community chest, fund or foundation—

"(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

"(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

"(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

"(D) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

The organizations set forth in § 170(c)(2) are, but for a few unimportant exceptions, the same as those described in § 501(c)(3). Analogous deductions for contributions to § 501(c)(3) organizations are provided for federal estate and gift tax purposes. See Code §§ 2055(a)(2) and 2522(a)(2), 26 U. S. C. §§ 2055(a)(2) and 2522(a)(2).

[2] Section 3.01 of Revenue Procedure 72-39, 1972-7 C.B. 818, provides:

"Where an organization listed in [the Cumulative List] ceases to qualify as an organization contributions to which are deductible under section 170 of the Code and the Service subsequently revokes a ruling or a determination letter previously issued to it, contributions made to the organization by persons unaware of the changes in the status of the organization generally will be considered allowable if made on or before the date of publication of the Internal Revenue Bulletin announcing that contributions are no longer deductible. However, the Service is not precluded from disallowing a deduction for any contribution made after an organization ceases to qualify under section 170, where the contributor

ance on the Cumulative List is a prerequisite to successful fund-raising for most charitable organizations. Many contributors simply will not make donations to an organization that does not appear on the Cumulative List.[3]

Because of the importance of inclusion in the Cumulative List, revocation of a § 501(c)(3) ruling letter and consequent removal from the Cumulative List is likely to result in serious damage to a charitable organization.[4] Revocation not only threatens the flow of contributions, it also subjects the affected organization to F. I. C. A. and F. U. T. A. taxes and, assuming that the organization has taxable income and does not qualify as tax exempt under another subsection of § 501, to federal income taxes.[5] Upon the assessment and attempted collection of income taxes, the organization may litigate the legality of the Service's action by petitioning the Tax Court to review a notice of deficiency. See Code §§ 6212 and 6213, 26 U. S. C. §§ 6212 and 6213. Or, following the collection of any federal tax and the denial of a refund by the Service, the organization may bring a refund suit in a federal district court or in the Court of Claims. See Code § 7422, 26 U. S. C. § 7422; 28 U. S. C. §§ 1346(a)(1) and 1491. Finally, a donor to the organization may bring a refund suit to challenge the denial of a charitable deduction under § 170(c)(2). *Ibid.* Presumably such a "friendly donor" would be able to attack the legality of the Service's revocation of an organization's § 501(c)(3) status. But these post-revocation avenues of review take substantial time, during which the organization is certain to lose contributions from those donors whose gifts are contingent on entitlement to charitable deductions under § 170(c)(2). Accordingly, any organization threatened with revocation of a § 501(c)(3) ruling letter has a powerful incentive to bring a preenforcement suit to prevent the Service from taking action in the first instance.

The pressures operating on organizations facing revocation of § 501(c)(3) status to seek injunctive relief against the Service pending judicial review of the proposed action conflict directly with a congressional prohibition of such preenforcement tax suits. In force continuously since its enactment in 1867, the Anti-Injunction Act, now Code § 7421(a), provides in pertinent part that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court. . . ." [6] Because an injunction preventing the Service from withdrawing a § 501(c)(3) ruling letter would necessarily preclude the collection of F. I. C. A., F. U. T. A., and possibly income taxes from the affected organization, as well as the denial of § 170(c)(2) charitable deductions to donors to the organization, a suit seeking such relief falls squarely within the literal scope of the Act.[7]

(1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for, or was aware of, the activities or deficiencies on the part of the organization that gave rise to the loss of qualification."

[3] This is particularly so with respect to tax-exempt private foundations, because they are subject to tax liability if they contribute funds to an organization that does not qualify under § 170(c)(2). See Code § 4945(d)(5), 26 U. S. C. § 4945(d)(5).

[4] In recognition of the significance of such a change in status, the Service provides several stages of internal administrative review. If the Service indicates, pursuant to prescribed procedures, that cause for revocation exists, the affected organization is entitled to submit written protests and to conferences at both the District Director and National Office level. Section 11, Revenue Procedure 72-4, 1972-1 C. B., at 708-709; Section 4, Revenue Procedure 72-39, 1972-2 C. B., at 818-819.

[5] An organization may lose its § 501(c)(3) status but still be exempt from federal income taxes if it qualifies, for example, as a § 501(c)(4) social welfare organization. But the loss of § 501(c)(3) status inevitably means that the exemptions from F. I. C. A. and F. U. T. A. taxes no longer apply, since those exemptions are keyed to § 501(c)(3). See Code §§ 3121(b)(8)(B) and 3306(c)(8).

[6] See Act of March 2, 1867, § 10, 14 Stat. 475; Rev. Stat. § 3224 (2d ed. 1878); Int. Rev. Code of 1939, § 3653. Section 7421(a) of the Code states:

"Except as provided in sections 6212(a) and (c), 6213(a), and 7426(a) and (b)(1), *no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court* by any person, whether or not such person is the person against whom such tax was assessed." (Emphasis added.)

The italicized portion of § 7421(a) is identical to § 10 of the Act of March 2, 1867, but for the first "any," which the revisers added to the Revised Statutes version. See *Snyder* v. *Marks,* 109 U. S. 189, 192 (1883). None of the exceptions in § 7421(a) is relevant to this case. The phrase commencing with "by any person . . ." was added by § 110(c) of the Federal Tax Lien Act of 1966, Pub. L. 89-719, 80 Stat. 1125, 1144, [1966-2 C.B. 623]. The main purpose of the addition of this language was to deal with cases where third parties who are not themselves subject to tax liability hold property liens that compete with federal tax liens. Due to the literal meaning of the Anti-Injunction Act, such persons were, prior to 1966, often unable to protect their legitimate property interests when the Service foreclosed on property on which it held a tax lien. See H. R. Rep. No. 1884, 89th Cong., 2d Sess., at 27-28 (1966) [1966-2 C.B. 815]. Such persons are now given a right of action under Code § 7426, 26 U. S. C. § 7426, and the language of § 7421(a), as amended, renders that action exclusive. The "by any person" phrase is, however, also a reaffirmation of the plain meaning of the emphasized portion of § 7421(a). In this respect, it is declaratory, not innovative. Cf. Bittker & Kaufman, Taxes and Civil Rights: "Constitutionalizing" the Internal Revenue Code, 82 Yale L. J. 51, 57, n. 22 (1972). We are aware of the contrary reading of the "by any person" phrase in *McGlotten* v. *Connally,* 338 F. Supp. 448, 453 n. 25 (D. D. C. 1972) (Three-judge court), but we are of a different view.

[7] The congressional antipathy for premature interference with the assessment or collection of any federal tax also extends to declaratory judgments. In 1935, one year after the enactment of the Declaratory Judgment Act, 48 Stat. 955, now 28 U. S. C. § 2201-2202 (1970), Congress amended that Act to exclude suits "with respect to Federal taxes . . . ," § 405 of the Revenue Act of 1935, c. 829, 49 Stat. 1027, [Pub. L. 407, XIV-2 C.B. 556, 567 (1935)], thus reaffirming the restrictions set out in the Anti-Injunction Act. The Declaratory Judgment Act now reads:

"§ 2201. Creation of Remedy.

"In a case of actual controversy within its jurisdiction, *except with respect to Federal taxes,* any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration

The clash between the language of the Anti-Injunction Act and the desire of § 501(c)(3) organizations to block the Service from withdrawing a ruling letter has been resolved against the organizations in most cases. *E. g., Crenshaw County Private School Foundation* v. *Connally,* 474 F. 2d 1185 (CA5 1973), petition for cert. pending in No. 73-170; *National Council on the Facts of Overpopulation* v. *Caplin,* 224 F. Supp. 313 (D. D. C. 1963); *Israelite House of David* v. *Holden,* 14 F. 2d 701 (WD Mich. 1926) [T. D. 3920, V-2 C. B. 125 (1926)].[8] But see, *McGlotten* v. *Connally,* 338 F. Supp. 448 (D. D. C. 1972) (Three-judge court). Cf. *Green* v. *Connally,* 330 F. Supp. 1150 (D. D. C.), aff'd *per curiam sub nom. Coit* v. *Green,* 404 U. S. 997 (1971).

In the present case, the Court of Appeals for the Fourth Circuit followed the majority view. *Bob Jones University* v. *Connally,* 472 F. 2d 903, petition for rehearing denied, 476 F. 2d 259 (1973). In light of the contrary result reached by the Court of Appeals for the District of Columbia Circuit in *"Americans United" Inc.* v. *Walters,* — U. S. App. D. C. —, 477 F. 2d 1169 (1973), *sub nom. Alexander* v. *"Americans United" Inc., post,* p. —, we granted Bob Jones University's petition for certiorari. 414 U. S. 817 (1973).

Petitioner refers to itself as "the world's most unusual university." Founded in 1927 and now located in Greenville, South Carolina, the University is devoted to the teaching and propagation of its fundamentalist religious beliefs. All classes commence and close with prayer, and courses in religion are compulsory. Students and faculty are screened for adherence to certain religious precepts and may be expelled or dismissed for lack of allegiance to them. One of these beliefs is that God intended segregation of the races and that the Scriptures forbid interracial marriage. Accordingly, petitioner refuses to admit Negroes as students. On pain of expulsion students are prohibited from interracial dating, and petitioner believes that it would be impossible to enforce this prohibition absent the exclusion of Negroes.

In 1942, the Service issued petitioner a ruling letter under § 101(6) of the Internal Revenue Code of 1939, the predecessor of § 501(1)(3). In 1970, however, the Service announced that it would no longer allow § 501(c)(3) status for private schools maintaining racially discriminatory admissions policies and that it would no longer treat contributions to such schools as tax-deductible. See Revenue Ruling 71-447, 1971-2 C. B. 230. The Service requested proof of a nondiscriminatory admissions policy from all such schools and warned that tax-exempt ruling letters would be reviewed in light of the information provided. At the end of 1970, petitioner advised the Service that it did not admit Negroes, and in September 1971, further stated that it had no intention of altering this policy. The Commissioner of Internal Revenue therefore instructed the District Director to commence administrative procedures leading to the revocation of petitioner's § 501(c)(3) ruling letter.

Petitioner brought these administrative proceedings to a halt by filing suit in the United States District Court for the District of South Carolina for preliminary and permanent injunctive relief preventing the Service from revoking or threatening to revoke petitioner's tax-exempt status. Petitioner alleged irreparable injury in the form of substantial federal income tax liability and the loss of contributions. Petitioner asserted that the Service's threatened action was outside its lawful authority and would violate petitioner's rights to the free exercise of religion, to free association, and to due process and equal protection of the law.

The District Court rejected a motion to dismiss for lack of jurisdiction,

shall have the force and effect of a final judgment or decree and shall be reviewable as such." (Emphasis added.)
"§ 2202. Further relief.
"Further necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment."

Some have noted that the federal tax exception to the Declaratory Judgment Act may be more sweeping than the Anti-Injunction Act. *E. g.,* E. Borchard, Declaratory Judgments 855 (2d ed. 1941); Bittker & Kaufman, Taxes and Civil Rights: "Constitutionalizing" the Internal Revenue Code, 82 Yale L. J. 51, 58 (1972). See S. Rep. No. 1240, 74th Cong., 1st Sess., 11 (1935). The Service takes that position in this case, arguing that any suit for an injunction is also an action for a declaratory judgment and thus is barred by the literal terms of the Declaratory Judgment Act, without regard to the independent force of § 7421(a). A number of courts, on the other hand, have held that the federal tax exception to the Declaratory Judgment Act and the Anti-Injunction Act have coterminous application. *E. g., "Americans United" Inc.* v. *Walters,* — U. S. App. D. C. —, —, 477 F. 2d 1169, 1176 (1973), *sub nom. Alexander* v. *"Americans United" Inc., post,* p. —; *Tomlinson* v. *Smith,* 128 F. 2d 808 (CA7 1942); *McGlotten* v. *Connally,* 338 F. Supp. 448 (D. D. C. 1972) (Three-judge court); *Jules Hairstylists of Maryland, Inc.* v. *United States,* 268 F. Supp. 511 (Md. 1967), aff'd, 389 F. 2d 389 (CA4), cert. denied, 391 U. S. 934 (1968). Petitioner cites these cases in response to the Service's reliance on the Declaratory Judgment Act. There is no dispute, however, that the federal tax exception to the Declaratory Judgment Act is at least as broad as the Anti-Injunction Act. Because we hold that the instant case is barred by the latter provision, there is no occasion to resolve whether the former is even more preclusive. Nor need we decide whether any action for an injunction is of necessity a request for a declaration of rights that triggers the terms of the Declaratory Judgment Act.

[8] Several courts have reached the same result under the federal tax exception to the Declaratory Judgment Act, set forth in n. 7, *supra. E. g., Liberty Amendment Committee of the U. S. A.* v. *United States,* Civil Action No. 70-721 (D. C. D. Cal. June 19, 1970) (unpublished), aff'd per curiam, No. 26,507 (CA9 July 7, 1972) (unpublished), cert. denied, 409 U. S. 1076 (1972); *Mitchell* v. *Riddell,* 402 F. 2d 842 (CA9 1968), appeal dismissed and cert. denied, 394 U. S. 456 (1969); *Jolles Foundation, Inc.* v. *Moysey,* 250 F. 2d 166 (CA2 1957); *Kyron Foundation* v. *Dunlop,* 110 F. Supp. 428 (D. D. C. 1952).

and it preliminarily enjoined the Service from revoking or threatening to revoke petitioner's tax-exempt status and from withdrawing advance assurance of the deductibility of contributions made to petitioner. *Bob Jones University* v. *Connally,* 341 F. Supp. 277 (S. C. 1971). The Court of Appeals for the Fourth Circuit reversed, with one judge dissenting. 472 F. 2d 903, petition for rehearing denied, 476 F. 2d 259 (1973). That court held that petitioner' suit was barred by the Anti-Injunction Act as interpreted by this Court in *Enochs* v. *Williams Packing & Navigation Co.,* 370 U. S. 1 (1962).

The Anti-Injunction Act apparently has no recorded legislative history,[9] but its language could scarcely be more explicit—"no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court. . . ." The Court has interpreted the principal purpose of this language to be the protection of the Government's need to assess and collect taxes as expeditiously as possible with a minimum of preenforcement judicial interference, "and to require that the legal right to the disputed funds be determined in a suit for a refund." *Enochs* v. *Williams Packing & Navigation Co.,* 370 U. S. 1, 7 (1962) [Ct. D. 1874, 1962-2 C. B. 349]. See also, *e. g., State Railroad Tax Cases,* 92 U. S. 575, 613-614 (1876). Cf. *Cheatham* v. *United States,* 92 U. S. 85, 88-89 (1876). The Court has also identified "a collateral objective of the Act—protection of the collector from litigation pending a suit for refund." *Williams Packing,* 370 U. S., at 7-8.

In furtherance of these goals, the Court in its most recent reading gave the Act almost literal effect. In *Williams Packing,* an employer sought to enjoin the collection of F. I. C. A. and F. U. T. A. taxes that the employer alleged were not owed and would destroy its business. The Court held unanimously that the suit was barred by the Act. Only upon proof of the presence of two factors could the literal terms of § 7421(a) be avoided: first, irreparable injury, the essential prerequisite for injunctive relief in any case; and second, certainty of success on the merits. *Id.,* at 6-7. An injunction could issue only "if it is clear that under no circumstances could the Government ultimately prevail. . . ." *Id.,* at 7. And this determination would be made on the basis of the information available to the Government at the time of the suit. "Only if it is then apparent that, under the most liberal view of the law and facts, the United States cannot establish its claim, may the suit for an injunction be maintained." *Ibid.*

Perhaps in recognition of the stringent nature of the *Williams Packing* standard and its implications for this case, petitioner makes little effort to argue that it can meet that test. Rather, it asserts that the Anti-Injunction Act, properly construed, is not applicable, that *Williams Packing* is not the controlling reading of the Act, and that rejection of both these contentions would work a denial of due process of law. We find these arguments unpersuasive.

A

First, petitioner contends that the Act is inapplicable because this is not a suit "for the purpose of restraining the assessment or collection of any tax. . . ." Under petitioner's theory, its suit is intended solely to compel the Service to refrain from withdrawing petitioner's § 501(c)(3) ruling letter and from depriving petitioner's donors of advance of deductibility. Petitioner describes its goal as the maintenance of the flow of contributions, not the obstruction of revenue.

Petitioner's complaint and supporting documents filed in the District Court belie any notion that this is not a suit to enjoin the assessment or collection of federal taxes from petitioner. In support of its claim of irreparable injury, petitioner alleged in part that it would be subject to "substantial" federal income tax liability if the Service were allowed to carry out its threatened action. App. 6. Petitioner buttressed this contention with sworn affidavits alleging federal income tax liability of three-quarters of a million dollars for one year and in excess of half a million dollars for another and stressing the detrimental effect such tax liability would have on petitioner's capacity to operate its institution, to support its personnel, and to continue with its expansion plans. *Id.,* at 10-11, 43-44. These allegations leave little doubt that a primary purpose of this lawsuit is to prevent the Service from assessing and collecting income taxes from petitioner.

We recognize that petitioner's assertions that it will owe federal income taxes should its § 501(c)(3) status be revoked are open to debate, because they are based in part on a failure to take into account possible deductions for depreciation of plant and equipment. Even if it could be shown, however, that petitioner would owe no federal income taxes if its § 501(c)(3) status were revoked, this would still be a suit to restrain the assessment or collection of taxes because petitioner would also be liable for F. I. C. A. and F. U. T. A. taxes. Section 7421(a) speaks of "any tax"; it does not differentiate between federal income taxes or F. I. C. A. or F. U. T. A. taxes. See, *e. g., Williams Packing, supra.* Moreover, petitioner seeks to restrain the collection of taxes from its donors—to force the Service to continue to provide advance assurance to those donors that contributions to petitioner will be recognized as tax-deductible, thereby reducing their tax liability. Although in this regard peti-

[9] See Note, Enjoining the Assessment and Collection of Federal Taxes Despite Statutory Prohibition, 49 Harv. L. Rev. 109, n. 9 (1935); Gorovitz, Federal Tax Injunctions and the Standard Nut Cases, 10 Tax Magazine (Taxes) 446, n. 6 (1932).

tioner seeks to lower the taxes of those other than itself, the Act is nonetheless controlling.[10] Thus in any of its implications, this case falls within the literal scope and the purposes of the Act.

Petitioner further contends that the Service's actions do not represent an effort to protect the revenues but an attempt to regulate the admissions policies of private universities. Under this line of argument, the Anti-Injunction Act is said to be inapplicable because the case does not truly involve taxes. We disagree.

The Service bases its present position with regard to the tax status of segregative private schools on its interpretation of the Code.[11] There is no evidence that that position does not represent a good-faith effort to enforce the technical requirements of the tax laws, and, without indicating a view as to whether the Service's interpretation is correct, we cannot say that its position has no legal basis or is unrelated to the protection of the revenues. The Act is therefore applicable. Petitioner's attribution of nontax related motives to the Service ignores the fact that petitioner has not shown that the Service's action is without an independent basis in the requirements of the Code. Moreover, petitioner's argument fails to give appropriate weight to *Bailey* v. *George*, 259 U. S. 16 (1922) [T. D. 3347, I-2 C. B. 342 (1922)]. In that case, the Court held that the Act blocked a preenforcement suit to enjoin the federal Child Labor Tax, although the tax was challenged as a regulatory measure beyond the taxing power of Congress. Significantly, the Court announced *Bailey* v. *George* on the same day that it issued *Bailey* v. *Drexel Furniture Co.*, 259 U. S. 20 (1922) [T. D. 3346, I-2 C.B. 337 (1922)], a tax-refund case in which the Court struck down the Child Labor Tax as unconstitutional on the grounds that the taxpayer attempted to raise prematurely in *Bailey* v. *George*.[12]

Petitioner also argues that § 7421 (a) is not controlling because when the Act was passed in 1867 Congress could not possibly have foreseen something as sophisticated as the comparatively recent ruling letter program[13] and the special importance of that program for § 501(c)(3) organizations. This argument proves too much, however, since the same Congress also could not have foreseen, for example, F. I. C. A. or F. U. T. A. taxes, to which the prohibitory command of § 7421(a) indisputably applies. See, *e. g., Williams Packing, supra.* Moreover, through the years Congress has repeatedly reenacted the Anti-Injunction Act[14] at times when it was obviously aware of the continuously increasing complexity of the federal tax system.[15]

B

Petitioner next argues that *Enochs* v. *Williams Packing & Navigation Co.*, 370 U. S. 1 (1970), does not constitute an all-encompassing reading of the Act. Petitioner contends, on the basis of prior precedents, that § 7421(a) is subject to judicially created exceptions other than the "under no circumstances" test announced in *Williams Packing*. But the Court's unanimous opinion in *Williams Packing* indicates that the case was meant to be the capstone to judicial construction of the Act. It spells an end to a cyclical pattern of allegiance to the plain meaning of the Act, followed by periods of uncertainty caused by a judicial departure from that meaning, and followed in

[10] See n. 6, *supra*. Petitioner argues that the revenues will be unaffected by the loss of its § 501(c)(3) status, since if petitioner loses its ruling letter donors will simply redirect their gifts to organizations whose tax-exempt status is secure, thus obtaining the same § 170(c)(2) charitable deductions they presently enjoy when they make contributions to petitioner. It follows, according to petitioner, that the Act's principal purpose of protecting the revenues is not threatened by an injunction preserving petitioner's § 501(c)(3) status. Thus, the Act should be found inapplicable.

The argument is too speculative to be persuasive. It presumes that all donors who take § 170(c)(2) deductions will desert petitioner if the ruling letter is withdrawn and that all such donors will make gifts in equivalent amounts to other tax-exempt organizations. We deem it unlikely that either premise is wholly true. To the extent that either premise is inaccurate, an injunction preserving petitioner's § 501 (c)(3) ruling letter will interrupt the assessment and collection of taxes.

[11] See Rev. Rul. 71-447, 1971-2 C. B. 230. The question of whether a segregative private school qualifies under § 501(c)(3) has not received plenary review in this Court, and we do not reach that question today. Such schools have been held not to qualify under § 501(c)(3) in *Green* v. *Connally*, 330 F. Supp. 150 (D. D. C.) (Three-judge court), aff'd *per curiam sub nom. Coit* v. *Green*, 404 U. S. 997 (1971). As a defendant in *Green*, the Service initially took the position that segregative private schools were entitled to tax-exempt status under § 501(c)(3), but it reversed its position while the case was on appeal to this Court. Thus, the Court's affirmance in *Green* lacks the precedential weight of a case involving a truly adversary controversy.

[12] In support of its argument that this case does not involve a "tax" within the meaning of § 7421(a), petitioner cites such cases as *Hill* v. *Wallace*, 259 U. S. 44 (1922) (tax on unregulated sales of commodities futures), and *Lipke* v. *Lederer*, 259 U. S. 557 (1922) (tax on unlawful sales of liquor). It is true that the Court in those cases drew what it saw at the time as distinctions between regulatory and revenue-raising taxes. But the Court has subsequently abandoned such distinctions. *E. g., Sonzinsky* v. *United States*, 300 U. S. 506, 513 (1937) [Ct. D. 1217, 1937-1 C.B. 351]. Even if such distinctions have merit, it would not assist petitioner, since his challenge is aimed at the imposition of federal income, F. I. C. A., and F. U. T. A. taxes which clearly are intended to raise revenue.

[13] The currently prevailing ruling letter program of the Service commenced in 1940, see Caplin, Taxpayer Rulings Policy of the Internal Revenue Service: A Statement of Principles, N. Y. U. 20th Ann. Inst., on Fed. Tax 1, 2, 4-5 (1962), although its formal announcement did not take place until 1953. Revenue Ruling 10, 1953-1 C.B. 488.

[14] The most recent reenactment, in the Internal Revenue Code of 1954, postdates both the actual and the formal commencement of the Service's ruling letter program for § 501(c)(3) organizations. See n. 13, *supra*.

[15] In addition to repeatedly reenacting the Anti-Injunction Act, Congress reaffirmed the Act's purpose by adding the federal tax exception to the Declaratory Judgment Act. See n. 7, *supra*.

turn by the Court's rediscovery of the Act's purpose.

During the first half century of the Act's existence, the Court gave it literal force, without regard to the character of the tax, the nature of the preenforcement challenge to it, or the status of the plaintiff. See *State Railroad Tax Cases,* 92 U. S. 575, 613-614 (1876); *Snyder* v. *Marks,* 109 U. S. 189 (1883); *Pacific Steam Whaling Co.* v. *United States,* 187 U. S. 447 (1903); *Dodge* v. *Osborn,* 240 U. S. 118 (1916); *Bailey* v. *George,* 259 U. S. 16 (1922).[16] Occasionally, however, the Court noted in dictum that unspecified extraordinary and exceptional circumstances might justify an injunction despite the Act. *E. g., Dodge* v. *Osborn,* 240 U. S., at 122; *Bailey* v. *George,* 259 U. S., at 20. In 1922, the Court seized upon this dicta and permitted preenforcement injunctive suits against tax statutes that were viewed as penalties or as adjuncts to the criminal law. *Hill* v. *Wallace,* 259 U. S. 44 (1922); *Lipke* v. *Lederer,* 259 U. S. 557 (1922); *Regal Drug Corp.* v. *Wardell,* 260 U. S. 386 (1922). Shortly thereafter, however, the Court made clear that *Hill, Lipke,* and *Regal Drug* were of narrow scope and had no application to preenforcement challenges to truly revenue-raising tax statutes. *Grahma* v. *DuPont,* 262 U. S. 234 (1923) [Ct. D. 33, II-1 C. B. 226 (1923)].[17] Thus, the Court's first departure from a literal reading of the Act produced a prompt correction in course.

In the 1930's the Court decided *Miller* v. *Standard Nut Margarine Co.,* 284 U. S. 498 (1932) [Ct. D. 457, XI-1 C. B. 370 (1932)], and *Allen* v. *Regents of the University System of Georgia,* 304 U. S. 439 (1938) [Ct. D. 1344, 1938-1 C. B. 530], the cases relied on most heavily by petitioner. *Standard Nut* set forth a new definition of the extraordinary and exceptional circumstances test, which was followed in *Regents.* In *Standard Nut* the Court stated that the Act is merely "declaratory of the principle" of cases prior to its passage that equity usually, but not always, disavows interference with tax collection; thus, the Act was to be construed "as near as may be in harmony with [equity doctrine] and the reasons upon which it rests." 284 U. S., at 509. Through this interpretation, the concept of extraordinary and exceptional circumstances was reduced to the traditional equitable requirements for issuance of an injunction.

Standard Nut was such a significant deviation from precedent that it was referred to by a commentator at the time as "a tribute to the tenacity of the American taxpayer . . ." and "little short of phenomenal." [18] Read literally, the Court's opinion effectively repealed the Act, since the Act was viewed as requiring nothing more than equity doctrine had demanded before the Act's passage. The incongruity of this position has not escaped notice.[19] It undoubtedly led directly to the Court's reexamination of the requirements of the Act in *Williams Packing,* the second time the Court has undertaken to rehabilitate the Act following debilitating departures from its explicit language. See *Graham* v. *DuPont, supra.*

Williams Packing switched the focus of the extraordinary and exceptional circumstances test from a showing of the degree of harm to the plaintiff absent an injunction to the requirement that it be established that the Service's action is plainly without a legal basis. The Court in essence read *Standard Nut* not as an instance of irreparable injury but as a case where the Service had no chance of success on the merits. 370 U. S., at 7. And the Court explicitly held that the Act may not be evaded "merely because collection would cause an irreparable

[16] The Anti-Injunction Act was written against the background of general equitable principles disfavoring the issuance of federal injunctions against taxes, absent clear proof that available remedies at law were inadequate. *E. g., Dowes* v. *City of Chicago,* 11 Wall. 108, 109-110 (1870); *Shelton* v. *Platt,* 139 U. S. 591 (1891); *Pittsburgh & C. R.* v. *Bd. of Pub. Works,* 172 U. S. 32 (1898). See *California* v. *Latimer,* 305 U. S. 255, 261-262 (1938) [Ct. D. 1376, 1939-1 (Part 1) C. B. 321] (Brandeis, J., for a unanimous Court):
"[The delay inherent in pursuing remedies at law], it is urged, is a special circumstance which justifies resort to a suit for an injunction in order that the question of liability may be promptly determined. If the delay incident to such proceedings justified refusal to pay a tax, the federal rule that a suit in equity will not lie to restrain collection on the sole ground that the tax is illegal, could have like application. For possible delay of that character is the common incident of practically every contest over the validity of a federal tax." (Footnote omitted.)
Since equitable principles militating against the issuance of federal injunctions in tax cases existed independent of the Anti-Injunction Act, it is most unlikely that Congress would have chosen the stringent language of the Act if its purpose was merely to restate existing law and not to compel litigants to make use solely of the avenues of review opened by Congress. For this reason, it is not surprising that the early cases interpreting the Act read it at face value.

[17] As noted earlier, the Court has also abandoned the view that bright line distinctions exist between regulatory and revenue-raising taxes. See n. 12, *supra.*

[18] Gorovitz, Federal Tax Injunctions and the Standard Nut Cases, 10 Tax Magazine (Taxes) 446 (1932). Mr. Justice Stone, joined in dissent by Mr. Justice Brandeis, underlined the tension between *Standard Nut* and prior precedent: "Enacted in 1867, [the Anti-Injunction Act], for more than sixty years, has been consistently applied as precluding relief, whatever the equities alleged." 284 U. S., at 511.

[19] *E. g.,* Lenoir, Congressional Control Over Suits to Restrain the Assessment or Collection of Federal Taxes, 3 Ariz. L. Rev. 177, 195 (1961).
"In effect [*Standard Nut*] says that if special circumstances exist which bring the case within some acknowledged head of equity jurisdiction, [the Anti-Injunction Act] does not apply, and the Court may issue an injunction. But in the absence of such circumstances the Court will lack equity jurisdiction because there will be no basis for such jurisdiction. To say that [the Act] applies only in such cases seems a little absurd. It is tantamount to saying that [the Act] forbids the courts to issue injunctions only when they would not have the authority to issue them anyway! It denies any force whatever to [the Act] except as declaratory of an equitable rule previously followed by the courts."

injury, such as the ruination of the taxpayer's enterprise." *Id.*, at 6. Yet petitioner's argument that we should find *Williams Packing* inapplicable turns, in the last analysis, on its claim that to do otherwise would subject it to great harm. The Court rejected that consideration in *Williams Packing* itself, and we reject it as a reason for finding that case not controlling. Under the language of the Act, the degree of harm is not a factor, and as a matter of judicial construction, it does not provide a meaningful stopping point between *Standard Nut* and *Williams Packing*. Acceptance of petitioner's irreparable injury argument would simply revive the evisceration of the Act inherent in *Standard Nut*.

C

Assuming *arguendo* the applicability of § 7421(a) and *Williams Packing*, petitioner contends that forcing it to meet the standards of those authorities will deny it due process of law in light of the irreparable injury it will suffer pending resort to alternate procedures for review and of the alleged inadequacies of those remedies at law. The Court dismissed out of hand similar contentions nearly 60 years ago,[20] and we find such arguments no more compelling now than then.

This is not a case in which an aggrieved party has no access at all to judicial review. Were that true, our conclusion might well be different. If, as alleged in its complaint, petitioner will have taxable income upon the withdrawal of its § 501(c)(3) status, it may in accordance with prescribed procedures petition the Tax Court to review the assessment of income taxes. Alternatively, petitioner may pay income taxes, or, in their absence, an installment of F. I. C. A. or F. U. T. A. taxes, exhaust the Service's internal refund procedures, and then bring suit for a refund. These review procedures offer petitioner a full, albeit delayed, opportunity to litigate the legality of the Service's revocation of tax-exempt status and withdrawal of advance assurance of deductibility. See, *e.g., Christian Echoes National Ministry, Inc.* v. *United States,* 470 F. 2d 849 (CA10 1972), cert. denied, 414 U. S. 864 (1973); *Center on Corporate Responsibility, Inc.* v. *Shultz,* 368 F. Supp. 863 (D. D. C. 1973).[21]

We do not say that these avenues of review are the best that can be devised. They present serious problems of delay, during which the flow of donations to an organization will be impaired and in some cases perhaps even terminated. But, as the Service notes, some delay may be an inevitable consequence of the fact that disputes between the Service and a party challenging the Service's actions are not susceptible of instant resolution through litigation. And although the congressional retriction to postenforcement review may place an organization claiming tax-exempt status in a precarious financial position, the problems presented do not rise to the level of constitutional infirmities, in light of the powerful governmental interests in protecting the administration of the tax system from premature judicial interference, *e.g., Cheatham* v. *United States,* 92 U. S. 85, 88-89 (1876); *State Railroad Tax Cases,* 92 U. S. 575, 613-614 (1876), and of the opportunities for review that are available.[22]

[20] See *Dodge* v. *Osborn,* 240 U. S. 118, 122 (1916):

"There is a contention that the provisions requiring an appeal to the Commissioner of Internal Revenue after payment of the taxes and giving a right to sue in case of his refusal to refund are wanting in due process and therefore there is jurisdiction [to issue injunctive relief prior to the assessment or collection of any tax]. But we think it suffices to state that contention to demonstrate its entire want of merit."

[21] Because of the availability of F. I. C. A. and F. U. T. A. refund actions, we need not address the adequacy of another possible means of seeking postenforcement judicial review—the "friendly donor" refund suit. Under this approach, there must be a donor willing to file a refund action claiming a § 170(c)(2) charitable deduction for a contribution to an organization after the Service has revoked the organization's ruling letter and withdrawn advance assurance of deductibility. To utilize this approach, the organization must first be able to find a donor willing to subject himself to the rigors of litigation against the Service and then must rely on the donor to present the relevant arguments on the organization's behalf. These and other possible differences between a donor refund suit and an action brought directly by an organization leave open the question whether a donor's refund suit constitutes an adequate legal remedy for correcting illegal actions on the part of the Service. We reserve this question for a case that turns upon its resolution.

[22] Petitioner did not bring this case as a refund action. Accordingly, we have no occasion to decide whether the Service is correct in asserting that a district court may not issue an injunction in such a suit, but is restricted in any tax case to the issuance of money judgments against the United States. Brief for Respondents 37, n. 35. We note, however, that the Service's position with regard to the range of relief available in a refund suit raises several considerations not presented by a preenforcement suit for an injunction. For example, it may be possible to conclude that a suit for a refund is not "for the purpose of restraining the assessment or collection of any tax . . . ," and thus that neither the literal terms nor the principal purpose of § 7421(a) are applicable. Moreover, such a suit obviously does not clash with what the Court referred to in *Williams Packing, supra,* as a "collateral objective of the Act—protection of the collector from litigation pending a suit for a refund." 370 U. S., at 7-8. And there would be serious question about the reasonableness of a system that forced a § 501(c)(3) organization to bring a series of backward looking refund suits in order to establish repeatedly the legality of its claim to tax-exempt status and that precluded such an organization from obtaining prospective relief even though it utilized an avenue of review mandated by Congress.

The Service indicates that "its normal practice is to issue a favorable ruling upon the application of an organization which has prevailed in a court suit." Brief for Respondents 35, n. 31. When the Service adheres to that position following a refund suit decided in favor of the plaintiff, there is of course little likelihood that injunctive relief would be necessary or appropriate. But our decision today that § 7421(a) bars preenforcement injunctive suits by organizations claiming § 501(c)(3) status unless the standards of *Williams Packing* are met should not be interpreted as deciding whether injunctive relief is possible in a refund suit in a district court.

Since we hold that *Williams Packing, supra,* governs this case, the remaining issue is whether petitioner has met the standards of that case. Without deciding the merits, we think that petitioner's First Amendment, due process, and equal protection contentions are sufficiently debatable to foreclose any notion that "under no circumstances could the Government ultimately prevail . . . ." 370 U.S., at 7. See, *e.g., Green* v. *Connally,* 330 F. Supp. 1150 (D. D. C.), aff'd *per curiam sub nom. Coit* v. *Green,* 404 U.S. 997 (1971). Accordingly, the Court of Appeals did not err in holding that § 7421(a) deprived the District Court of jurisdiction to issue the injunctive relief petitioner sought.

In holding that § 7421(a) blocks the present suit, we are not unaware that Congress has imposed an especially harsh regime on § 501(c)(3) organizations threatened with loss of tax-exempt status and with withdrawal of advance assurance of deductibility of contributions. A former Commissioner of the Internal Revenue Service has sharply criticized the system applicable to such organizations.[28] The degree of bureaucratic control that, practically speaking, has been placed in the Service over those in petitioner's position is susceptible to abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities. Specific treatment of not-for-profit organizations to allow them to seek preenforcement review may well merit consideration. But this matter is for Congress, which is the appropriate body to weigh the relevant, policy-laden considerations, such as the harshness of the present law, the consequences of an unjustified revocation of § 501(c)(3) status, the number of organizations in any year threatened with such revocation, the comparability of those organizations to others who rely on the Service's ruling letter program, and the litigation burden on the Service and the effect on the assessment and collection of federal taxes if the law were to be changed.

The judgment is affirmed.

It is so ordered.

MR. JUSTICE DOUGLAS took no part in the decision of this case.

[28] See Thrower, IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations, 34 Journal of Taxation 168 (1971):

"There is no practical possibility of quick judicial appeal at the present. If we deny tax exemptions or the benefit to the organization of its donors having the assurance of deductibility of contributions, the organization must either create net taxable income or other tax liability for itself as a litigable issue, or find a donor who as a guinea pig is willing to make a contribution, have it disallowed, and litigate the disallowance. Assuming the readiness of the organization or donor to litigate, the issue under the best of circumstances could hardly come before a court until at least a year after the tax year in which the issue arises. Ordinarily, it would take much longer for the case of the organization's status to be tried. . . . While all of this time is passing, the organization is dormant for lack of contributions and those otherwise interested in its program lose their interest and move on to other organizations blessed with the Internal Revenue Service imprimatur; and the right to judicial review is not pursued.

"This is an extremely unfortunate situation for several reasons. First, it offends my sense of justice for undue delay to be imposed on one who needs a prompt decision. Second, in practical effect it gives a greater finality to IRS decisions than we would want or Congress intended. Third, it inhibits the growth of a body of case law interpretative of the exempt organization provisions that could guide the IRS in its further deliberations."

Section 7424.—Intervention

26 CFR 301.7424-2: Intervention.

United States intervention to assert its lien rights in civil suits. See T.D. 7305, page 339.

Section 7426.—Civil Actions By Persons Other Than Taxpayers

26 CFR 301.7426-1: Civil actions by persons other than taxpayers.

Suits by persons other than taxpayers to assert rights in property levied upon or to recover property wrongfully levied upon by the United States. See T.D. 7305, page 339.

Section 7502.—Timely Mailing Treated as Timely Filing and Paying

26 CFR 301.7502-1. Timely mailing treated as timely filing.

Whether the 45-day period within which no interest is allowable on an overpayment of tax under section 6611(e) of Code is computed from the date the return is timely mailed under the terms of an extension of time to file or the date the return is actually received by the Service. See. Rev. Rul. 74-236, page 348.

Section 7503.—Time for Performance of Acts Where Last Day Falls on Saturday, Sunday, or Legal Holiday.

26 CFR 301.7503-1: Time for performance of acts where last day falls on Saturday, Sunday, or legal holiday.

T.D. 7309

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Time for performance of acts where last day falls on a legal holiday

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

By a notice of proposed rule making appearing in the Federal Register for Monday, July 16, 1973 (38 F.R. 18897), an amendment to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7503 of the Internal Revenue Code of 1954 was proposed in order to conform such regulations to the changes made by Pub. L. 90-363, 82 Stat. 250, which amended 5 U.S.C. 6103(a), regarding the observance of certain legal holidays on Monday. The amendment of 5 U.S.C. 6103(a) was

effective on January 1, 1971. After consideration of all such relevant matter as was presented by interested persons, certain changes were made, and the proposed amendment of the regulations, subject to the changes indicated below, is adopted by this document.

The amendment to the regulations is designed to conform § 301.7503-1 (b)(1) to the present District of Columbia law regarding the date of observance of legal holidays. The District of Columbia now observes Washington's Birthday on the third Monday in February, Memorial Day on the last Monday in May, Veterans' Day on the fourth Monday in October, and Thanksgiving on the fourth Thursday in November. Columbus Day is also considered a legal holiday in the District of Columbia for all calendar years after 1970, and is observed on the second Monday in October. Under the amendment of the regulations, the dates of observance of these holidays for purposes of the Internal Revenue Code of 1954 will correspond to the dates of observance of these holidays in the District of Columbia. So that the amendment to the regulations will not adversely affect certain taxpayers who relied on the current regulations, for the calendar years 1971, 1972, 1973, and 1974, taxpayers may, at their option (except with respect to the performance of any act relating to the jurisdiction of a court), treat Washington's Birthday as falling on either February 22 or the third Monday in February. For the calendar years 1971, 1972, and 1973, taxpayers may, at their option (except with respect to the performance of any act relating to the jurisdiction of a court), treat Memorial Day as falling on either May 30 or the last Monday in May, and Veterans' Day as falling on either November 11 or the fourth Monday in October. The option is denied to taxpayers in those cases where the performance of an act relates to the jurisdiction of a court in order to be consistent with *William M. Winkler,* 56 T.C. 844 (1971). In that case the United States Tax Court held that in computing the 150-day filing requirement of section 6213(a) of the Code, Monday, February 15, 1971, was a legal holiday (Washington's Birthday) in the District of Columbia. The Tax Court made no mention of the availability of an option in cases where the performance of an act relates to the jurisdiction of a court.

The proposed regulations did not extend optional treatment to Veterans' Day for 1973 or Washington's Birthday for 1974.

Pursuant to paragraph 4(a) of Treasury Order 221 [1972-2 C.B. 899], published in the Federal Register for June 10, 1972 (37 F.R. 11696), certain regulations of the Internal Revenue Service continue in effect as regulations of the Bureau of Alcohol, Tobacco and Firearms until superseded or revised. The regulations amended by this Treasury decision are among those that continue to apply for purposes of the laws administered by the Bureau in addition to applying for purposes of the laws administered by the Internal Revenue Service. The Director, Bureau of Alcohol, Tobacco and Firearms has, for this reason, joined as a signatory to this Treasury decision.

Adoption of amendment to the regulations

On Monday, July 16, 1973, a notice of proposed rule making was published in the Federal Register (38 F.R. 18897) to amend the Regulations on Procedure and Administration (26 CFR Part 301) under section 7503 of the Internal Revenue Code of 1954 in order to conform such regulations to the changes made by Pub. L. 90-363, 82 Stat. 250, which amended 5 U.S.C. 6103(a), regarding the observance of certain legal holidays on Monday. After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

Paragraph (b)(1) of § 301.7503-1 is amended to read as follows:

§ 301.7503-1 Time for performance of acts where last day falls on Saturday, Sunday, or legal holiday.

* * * * *

(b) *Legal holidays.* (1) For the purpose of section 7503, the term "legal holiday" includes the legal holidays in the District of Columbia. Such legal holidays found in D. C. Code Ann. § 28-2701 (1967) and 5 U.S.C. 6103(a), as enacted and made effective by the Act of June 28, 1968 (82 Stat. 250), are—

(i) January 1, New Year's Day,

(ii) January 20, when such day is Inauguration Day,

(iii) Third Monday in February, Washington's Birthday,

(iv) Last Monday in May, Memorial Day,

(v) July 4, Independence Day,

(vi) First Monday in September, Labor Day,

(vii) Second Monday in October, Columbus Day,

(viii) Fourth Monday in October, Veterans' Day,

(ix) Fourth Thursday in November, Thanksgiving Day,

(x) December 25, Christmas Day.

When a legal holiday in the District of Columbia falls on a Sunday, the next day is a legal holiday in the District of Columbia (see D. C. Code Ann. § 28-2701 (1967)). For the purpose of section 7503, when a legal holiday in the District of Columbia (other than Inauguration Day) falls on a Saturday it shall be treated as falling on the preceding Friday. For calendar years prior to 1971, Washington's Birthday will be treated as falling on February 22, Memorial Day on May 30, and Veterans' Day on November 11. For calendar years

1971, 1972, 1973, and 1974, the taxpayer may, at his option (except with respect to the performance of any act relating to the jurisdiction of a court), treat Washington's Birthday as falling on either February 22 or the third Monday in February. For calendar years 1971, 1972, and 1973, the taxpayer may, at his option (except with respect to the performance of any act relating to the jurisdiction of a court), treat Memorial Day as falling on either May 30 or the last Monday in May, and Veterans' Day as falling on either November 11 or the fourth Monday in October. Columbus Day is not a legal holiday in the District of Columbia in any calendar year prior to 1971.

* * * * *

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

REX D. DAVIS,
Director, Bureau of Alcohol, Tobacco and Firearms.

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved March 22, 1974.

JOHN H. HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 27, 1974; 8:45 a.m., and published in the issue of the Federal Register for March 29, 1974, 39 F.R. 11536)

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26 CFR 301.7503-1. Time for performance of acts where last day fall on Saturday, Sunday, or legal holiday.

Computation of interest and addition to the tax for failure to pay the tax shown on the return when the payment of tax was not performed on the next succeeding day which was not a Saturday, Sunday, or legal holiday. See Rev. Rul. 74-235, page 347.

Chapter 78.—Discovery of Liability and Enforcement of Title
Subchapter A.—Examination and Inspection

Section 7602.—Examination of Books and Witnesses

26 CFR 301.7602-1: Examination of books and witnesses.

T.D. 7297

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Examination and inspection of taxpayers and taxable objects

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C. 20224.

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

Preamble

This Treasury decision amends the Regulations on Procedure and Administration (26 CFR Part 301) under sections 7601, 7602, 7603, 7604, 7606, 7608, 7622, 7623, 7652, and 7653 of the Internal Revenue Code of 1954. These amendments accomplish two objectives. First, they remove the authority of certain designated Internal Revenue Service personnel to issue summons, serve a summons, administer an oath, etc., and give that authority to the Commissioner. It is anticipated that the Commissioner in turn will issue delegation orders empowering appropriate Internal Revenue Service personnel to perform the various tasks.

Second, these amendments delete references in 26 CFR §§ 301.7601-301.7655 to matters which were formerly under the jurisdiction of the Internal Revenue Service, but which are now the responsibility of the newly-created Bureau of Alcohol, Tobacco and Firearms. The Bureau is publishing a simultaneous Treasury decision which promulgates its own regulations in 27 CFR Part 70 for the applicable Code sections.

Adoption of Amendments to the regulations

The Regulations on Procedure and Administration (26 CFR Part 301) are amended as follows:

Paragraph 1. Section 301.7601-1 is amended by deleting the last sentence. The amended section reads as follows:

§ 301.7601-1 Canvass of districts for taxable persons and objects.

Each district director shall, to the extent he deems it practicable, cause officers or employees under his supervision and control to proceed, from time to time, through his district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

Par. 2. Section 301.7602-1 is amended by deleting paragraph (c) and revising paragraph (b) to read as follows:

§ 301.7602-1 Examination of books and witnesses.

* * * * *

(b) *Summons.* For the purposes described in paragraph (a) of this section the Commissioner is authorized to summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of accounts containing entries relating to the business of the person liable for tax or required to perform the act, or any other person deemed proper, to appear before a designated officer or employee of the Internal Revenue Service at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and take

such testimony of the person concerned, under oath, as may be relevant or material to such inquiry. The Commissioner may designate any employee of the Internal Revenue Service as the individual before whom a person summoned pursuant to section 6420(e)(2), 6421(f)(2), 6424(d)(2), 6427(e)(2), or 7602 shall appear. Any such employee, when so designated in a summons, is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records, or other data produced in compliance with the summons.

Par. 3. Section 301.7603-1 is amended by revising paragraph (b) to read as follows:

§ 301.7603-1 Service of summons.

* * * * *

(b) *Persons who may serve a summons.* The officers and employees of the Internal Revenue Service whom the Commissioner has designated to carry out the authority given him by § 301.7602-1(b) to issue a summons are authorized to serve a summons issued under section 6420(e)(2), 6421(f)(2), 6424(d)(2), 6427(e)(2), or 7602.

Par. 4. Paragraph (b) of § 301.7604-1 is amended to read as follows:

§ 301.7604-1 Enforcement of summons.

* * * * *

(b) *Persons who may apply for an attachment.* The officers and employees of the Internal Revenue Service whom the Commissioner has designated to carry out the authority given him by § 301.7602-1(b) to issue a summons are authorized to apply for an attachment as provided in paragraph (a) of this section.

Par. 5. Section 301.7606-1 is amended by deleting the last sentence. The amended section reads as follows:

§ 301.7606-1 Entry of premises for examination of taxable objects.

Any officer or employee of the Internal Revenue Service may, in the performance of his duty, enter in the daytime any building or place where any articles or objects subject to tax are made, produced, or kept, so far as it may be necessary for the purpose of examining said articles or objects and also enter at night any such building or place, while open, for a similar purpose.

Par. 6. Section 301.7608 is repealed.

Par. 7. Section 301.7608-1 is repealed.

Par. 8. Section 301.7622-1 is amended to read as follows:

§ 301.7622-1 Authority to administer oaths and certify.

The officers and employees of the Internal Revenue Service whom the Commissioner has designated to carry out the authority given him by § 301.7602-1(b) to issue a summons are authorized to administer such oaths or affirmations and to certify to such papers as may be necessary under the internal revenue laws or regulations issued thereunder, except that the authority to certify shall not be construed as applying to those papers or documents the certification of which is authorized by separate order or directive.

Par. 9. Section 301.7623-1 is amended by deleting paragraph (g).

Par. 10. Section 301.7652-1 is repealed.

Par. 11. Section 301.7653-1 is repealed.

Because the amendments contained in this Treasury decision are concerned with rules of procedure and practice, it is found to be unnecessary to issue it with notice and public procedure thereon under section 553(b) of title 5 of the United States Code, or subject to the effective date limitation of subsection (d) of that section.

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

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 13, 1973.

JOHN HALL,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 18, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 19, 1973, 38 F.R. 34803)

Section 7605.—Time and Place of Examination

26 CFR 301.7605-1: Time and place of examination.

Rules governing the reopening of cases closed after examination in the office of a District Director. See Rev. Proc. 74-5, page 416.

Chapter 79.—Definitions

Section 7701.—Definitions

26 CFR 301.7701-2: Associations, including organizations labeled "corporations".

Whether a certain arrangement whereby savings and loan associations acquire mortgage participation certificates is considered an association taxable as a corporation. See Rev. Rul. 74-221, below.

26 CFR 301.7701-3: Partnerships.

Conditions under which the Internal Revenue Service will not issue advance rulings or determination letters concerning the classification of organizations which raise factual questions as to whether their principal purpose is the reduction of Federal taxes. See Rev. Proc. 74-17, page 438.

26 CFR 402.1-2: Post 1969 domestic building and loan association.
(Also 301.7701-2.)
(Also Sections 61, 162, 451, 501, 593, 671, 1232; 1.61-1, 1.162-1, 1.451-1, 1.501(a)-1, 1.593-11, 1.671-1, 1.1232-1.)

FHLMC participation certificates. The tax consequences of the purchase and sale of mortgage participation certificates by the Federal Home Loan Mortgage Corporation

(FHLMC), described in Rev. Rul. 71-399, as amplified by Rev. Rul. 72-376, are not altered by the modification of the procedures of the FHLMC to provide for combining participation certificates purchased by the FHLMC with whole loans it owned and its sale of the certificates representing undivided interests in each at various certificate yields; Rev. Rul. 71-399 amplified.

Rev. Rul. 74-221

Advice has been requested whether the conclusions of Rev. Rul. 71-399, 1971-2 C.B. 433, as amplified by Rev. Rul. 72-376, 1972-2 C.B. 647, relating to the purchase and sale of mortgage participation certificates by the Federal Home Loan Mortgage Corporation (FHLMC) are applicable under modified procedures now being used by FHLMC.

FHLMC purchases mortgage participation certificates (participation certificates) and sells participation sales certificates (sales certificates). In order to attract a broader range of investors, FHLMC recently adopted the procedure of combining participation certificates it purchased, and whole loans (or interests therein) owned by it, and issuing sales certificates representing undivided interests in each of the whole loans and in each of the mortgage loans represented by the participation certificates. The certificate yields at which such sales certificates are sold may differ from the certificate yields at which the underlying certificates were purchased by FHLMC and may differ from the mortgage interest rate on the whole loans owned by FHLMC. The sales certificates are guaranteed as to principal and interest in the same manner as the certificates described in Rev. Rul. 71-399.

Rev. Rul. 71-399, as amplified by Rev. Rul. 72-376, contemplates that FHLMC will sell sales certificates corresponding to, and representing undivided interests in, each of the mortgage loans covered by participation certificates which FHLMC purchased from a seller. FHLMC may sell one sales certificate representing the identical undivided interests covered by the participation certificate(s) which it purchased, or it may sell several sales certificates corresponding to one participation certificate which it purchased.

Rev. Rul. 71-399 holds that the use of a certificate yield computation amounts to a sale of each individual mortgage interest at a premium or discount depending upon the relationship of the certificate yield to the mortgage interest rate.

Under the procedures recently adopted by FHLMC, sales to the certificate holders are at certificate yields that may vary from the yields of the particular participation certificates purchased by FHLMC and from the yields of the underlying individual mortgages. Thus, the certificate holder's premium or discount will be measured by the relationship between his certificate yield and the individual mortgage interest rates.

Based on the foregoing facts, it is held that the modification in procedures used by FHLMC from that contemplated by Rev. Rul. 71-399, amplified by Rev. Rul. 72-376, as described herein, will not alter the Federal income tax consequences to FHLMC, the purchasers, and the sellers described in Rev. Rul. 71-399, provided that the sales certificates sold by FHLMC bear sufficient identification so as to permit tracing them to the participation certificates purchased by FHLMC and to the whole loans owned by FHLMC to which they relate and to the underlying mortgages represented by the purchased certificates and the whole loans.

Rev. Rul. 71-399 as amplified by Rev. Rul. 72-376 is further amplified.

Chapter 80.—General Rules
Subchapter A. Application of Internal Revenue Laws

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Obsolete rulings. Additional pre-1953 obsolete rulings relating primarily to income and profits taxes are listed.

Rev. Rul. 74-12

Rev. Proc. 67-6, 1967-1 C.B. 576, announced a program for the review of rulings published in the Internal Revenue Bulletin before 1953 with the immediate objective of identifying and publishing lists of those rulings that, although not specifically revoked or superseded, are not considered determinative with respect to future transactions.

In accordance with that program and based on a review of rulings relating to income and profits taxes, the rulings listed below are hereby declared obsolete.

Appeals and Review Memorandum (A.R.M.) Ruling Series

A.R.M. Number	C.B. Citation	
151	I-1, 214	(1922)

Appeals and Review Recommendation (A.R.R.) Ruling Series

A.R.R. Number	C.B. Citation	
156	2, 39	(1920)
252	3, 46	(1920)
521	4, 221	(1921)

General (or Chief) Counsel's Memorandum (G.C.M.) Ruling Series

G.C.M. Number	C.B. Citation	
77	V-1, 14	(1926)
2519	VI-2, 231	(1927)
6195	VIII-1, 99	(1929)
9086	X-1, 243	(1931)
10423	XI-2, 127	(1932)
15875	XIV-2, 100	(1935)
22647	1941-1, 381	
24617	1945, 235	

Income Tax (I.T.) Ruling Series

I.T. Number	C.B. Citation	
1462	I-2, 160	(1922)
1594	II-1, 91	(1923)
1622	II-1, 135	(1923)
1803	II-2, 36	(1923)
2646	XI-2, 59	(1932)
3066	1937-1, 113	
3227	1938-2, 70	
3601	1943, 412	

Office Decision (O.D.) Ruling Series

O.D. Number	C.B. Citation	
554	2, 108	(1920)
632	3, 204	(1920)

The purpose of this declaration of obsoleteness is to make it clear to all concerned that the above-listed rulings are not determinative with respect to future transactions. It is not the purpose of this Revenue Ruling to determine the applicability of any of the listed rulings to past transactions.

A further review is being made of other old rulings. Therefore, failure to include any particular ruling in this or previous lists should not be construed as an indication that the ruling necessarily is determinative with respect to future transactions.

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26 CFR 301.7805-1: Rules and regulations.

Obsolete rulings. Additional pre-1953 rulings relating to income and profits taxes are obsoleted.

Rev. Rul. 74-268

Rev. Proc. 67-6, 1967-1 C.B. 576, announced a program for the review of rulings published in the Internal Revenue Bulletin before 1953 with the immediate objective of identifying and publishing lists of those rulings that, although not specifically revoked or superseded, are not considered determinative with respect to future transactions.

In accordance with that program and based on a review of rulings relating to income and profits taxes, the rulings listed below are hereby declared obsolete.

General (or Chief) Counsel's Memorandum (G.C.M.) Ruling Series

G.C.M. No.	*C.B. Citation*
222	V-2, 110 (1926)
2185	VI-2, 75 (1927)
4956	VII-2, 128 (1928)
7545	IX-1, 215 (1930)
7871	IX-1, 207 (1930)
18383	1937-2, 244
22682	1941-1, 307
27440	1952-2, 97

Income Tax (I.T.) Ruling Series

I.T. No.	*C.B. Citation*
1522	I-2, 199 (1922)
1650	II-1, 48 (1923)
2129	IV-1, 29 (1925)
2841	XIII-2, 584 (1934)
3082	1937-1, 77
3084	1937-1, 64
3093	1937-2, 80
3094	1937-2, 80
3257	1939-1, (Part 1) 402
3259	1939-1, (Part 1) 127
3275	1939-1, (Part 1) 403
3278	1939-1, (Part 1) 76
3282	1939-1, (Part 1) 406
3284	1939-1, (Part 1) 407
3289	1939-1, (Part 1) 409
3308	1939-2, 404
3377	1940-1, 280
3393	1940-2, 393
3398	1940-2, 396
3400	1940-2, 415
3514	1941-2, 91
3748	1945, 152
3758	1945, 159
3774	1945, 204
3822	1946-2, 186
3990	1950-1, 57
4067	1951-2, 55

Mimeograph (Mim.) Ruling Series

Mim. No.	*C.B. Citation*
3886	X-2, 164 (1931)
6340	1949-1, 261
6366	1949-1, 270

Office Decision (O.D.) Ruling Series

O.D. No.	*C.B. Citation*
14	1, 67 (1919)
1082	5, 175 (1921)

Treasury Decisions (T.D.) Ruling Series

T.D. No.	*C.B. Citation*
4013	VI-1, 59 (1927)
4098	VI-2, 58 (1927)
4227	VII-2, 125 (1928)
4269	VIII-2, 146 (1929)

The purpose of this declaration of obsoleteness is to make it clear to all concerned that the above-listed rulings are not determinative with respect to future transactions. It is not the purpose of this Revenue Ruling to determine the applicability of any of the listed rulings to past transactions.

A further review is being made of old rulings. Therefore, failure to include any particular ruling in this or previous lists should not be construed as an indication that the ruling necessarily is determinative with respect to future transactions.

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26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of a Revenue Ruling relating to the taxation of political organizations. See Rev. Rul. 74-21, page 14.

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26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of ruling with respect to gains realized from securities sold prior to October 3, 1972. See Rev. Rul. 74-23, page 17.

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26 CFR 301.7805-1: Rules and regulations.

Basis for manufacturers excise tax where tools and dies are sold to a customer by the manufacturer. See Rev. Rul. 74-201, page 314.

Miscellaneous Provisions

26 CFR 3.1: Capital construction fund.

T.D. 7303

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 3.—CAPITAL CONSTRUCTION FUND

Deposits

DEPARTMENT OF THE TREASURY,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D.C. 20224.
DEPARTMENT OF COMMERCE,
MARITIME ADMINISTRATION,
NATIONAL OCEANIC AND
ATMOSPHERIC ADMINISTRATION,
Washington, D.C. 20235.

To Officers and Employees of the Internal Revenue Service, the Maritime Administration, the National Oceanic and Atmospheric Administration, and Others Concerned:

This document contains amendments to the temporary regulations, in § 3.1 of Part 3 of 26 CFR Chapter I dealing with capital construction funds under section 607 of the Merchant Marine Act, 1936 (46 U.S.C. 1177), as amended by section 21(a) of the Merchant Marine Act of 1970 (P.L. 91-469, 84 Stat. 1026) [1970-2 C.B. 372]. The present temporary regulations were published on December 31, 1970 (T.D. 7082) [1971-1 C.B. 424], and amended by further temporary regulations published on June 5, 1971 (T.D. 7124) [1971-2 C.B. 436], December 30, 1971 (T.D. 7156) [1972-1 C.B. 409], November 10, 1972 (T.D. 7219) [1972-2 C.B. 655], and December 30, 1972 (T.D. 7245) [1973-1 C.B. 615].

The outstanding temporary regulations, as amended, provide transitional rules for the execution of capital construction fund agreements (between citizens of the United States owning or leasing one or more vessels defined by the Act to be eligible and the Secretary of Commerce) and the deposit of funds under such agreements for taxable years beginning during 1970, 1971, and 1972. As a general rule, those outstanding regulations provide that the agreement must be executed and entered into on or prior to the due date, with extensions, for the filing of the tax return in order to be effective for the year to which that return relates. Deposits must also be made on or before that date, or within 60 days after the date of execution of the agreement, whichever is later, in order to be effective for such taxable year.

For taxable years beginning during 1970 and 1971, special rules applied to extend the time within which an effective agreement could have been executed and entered into, and within which deposits could have been made. These special rules are contained in § 3.1(b) and (c) of Part 3 of 26 CFR Chapter I.

This document would further amend the temporary regulations by extending the rules established by the outstanding temporary regulations, as amended, to taxable years beginning during 1973.

The temporary regulations are effective until the issuance of final regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary or his delegate and prescribed by the Secretary of Commerce or his delegate. These temporary regulations have been issued jointly by the Secretary of the Treasury and the Secretary of Commerce and also appear under 46 CFR Part 390 (Maritime) and 50 CFR Part 259 (Fisheries).

Adoption of amendments to the regulations

In order to extend the provisions of the temporary regulations under section 21(a) of the Merchant Marine Act of 1970 to taxable years beginning in 1973, § 3.1 of Chapter I of 26 CFR is amended by revising so much of such § 3.1 as precedes paragraph (a) thereof and by revising paragraph (d) thereof as follows:

§ 3.1 Capital construction fund.

In the case of a taxable year of a taxpayer beginning after December 31, 1969, and before January 1, 1974, the rules governing the execution of agreements and deposits under such agreements shall be as follows:

* * * * *

(d) Nothing in this section shall alter the rules and regulations governing the timing of deposits with respect to existing capital and special reserve funds or with respect to the treatment of deposits for any taxable year or years other than a taxable year or years beginning after December 31, 1969, and before January 1, 1974.

Because of the need for immediate guidance with respect to the provisions contained in this Treasury decision, it is found impracticable to issue it with notice and public procedure thereon under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d).

(This Treasury decision is issued under the authority contained in section 607 of the Merchant Marine Act, 1936 (46 U.S.C. 1177) as amended by section 21(a) of the Merchant Marine Act of 1970 (84 Stat. 1026), and under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Approved December 27, 1973.

FREDERIC W. HICKMAN,
Assistant Secretary of the Treasury.

ROBERT M. WHITE,
Administrator, National Oceanic and Atmospheric Administration.

ROBERT J. BLACKWELL,
Assistant Secretary of Commerce for Maritime Affairs.

(Filed by the Office of the Federal Register on December 27, 1973, 4:07 p.m., and published in the issue of the Federal Register for January 2, 1974, 39 F.R. 11)

Part IV. Treaties and Tax Legislation

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Part IV. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-Canada Income Tax Convention

T.D. 5206, 1943 C.B. 526, 1955-1 C.B. 624. (Also Part I, Section 894; 1.894-1.)

Canada; nonresident professor; exemption. Remuneration for teaching for a school year at a university in the U.S., paid to a professor from Canada who entered the U.S. on a student visa to pursue graduate studies leading to a doctorate degree and whose duties as a teaching assistant during this period required at least 60 percent of his time, is exempt from Federal income tax under Article VIII A of the U.S.-Canada Income Tax Convention.

Rev. Rul. 74-174

Advice has been requested whether, under the circumstances described below, remuneration paid to a citizen of Canada engaged in teaching and pursuing studies at a university in the United States is exempt from Federal income tax under Article VIII A of the United States-Canada Income Tax Convention, T.D. 5206, 1943 C.B. 526, supplemented in 1955-1 C.B. 624.

The taxpayer, an assistant professor at a Canadian university, received permission from that school to make application for further studies at a university located in the United States for the purpose of receiving a doctorate degree. The taxpayer contacted *S* University, located in the United States, requesting information regarding its graduate college as well as the availability of scholarship and fellowship grants.

The taxpayer was advised by *S* University that it had several openings for teaching assistants in his area of interest. The taxpayer applied for a position as a teaching assistant and submitted a formal application for admission to the graduate college.

The taxpayer was offered a position as a teaching assistant at *S* University which he accepted. He was subsequently admitted to the graduate college. The appointment as a teaching assistant was explicitly stated to be "for that portion of the period stated during which you remain in good standing in the graduate college." The taxpayer was given a year's leave by the Canadian university.

The taxpayer entered the United States as a nonimmigrant alien resident of a foreign country as a student under an F-1 visa. See 8 USC section 1101(a)(15)(F)(i) (1970). Beginning in September 1972 the taxpayer assumed duties as a teaching assistant and commenced studies leading to a doctorate degree.

As a teaching assistant, the taxpayer was assigned full responsibilities for the conduct of the course work of his class, including classroom instructions, preparation of assignments, evaluation of papers and projects, and individual and group discussions. His employment required that at least 60 percent of his time be devoted to his duties as a teaching assistant. As a student during both semesters of his stay in the United States, he took two courses in the graduate college and engaged in additional research in connection with a research paper to be submitted following his return to Canada.

The term nonimmigrant alien as defined in 8 U.S.C. section 1101(a)(15)(F)(i) (1970) includes an alien having a residence in a foreign country which he has no intention of abandoning, who is a bona fide student qualified to pursue a full course of study and who seeks to enter the United States temporarily and solely for the purpose of pursuing such a course of study at an established institution of learning.

In relevant part 8 C.F.R. section 214.2(f)(6) (1973) provides that on-campus employment pursuant to the terms of a fellowship, scholarship, or assistantship is deemed to be part of the academic program of a student otherwise taking a full course of study if related thereto.

Article VIII A of the United States-Canada Income Tax Convention provides that a professor or teacher who is a resident of one of the contracting States and who temporarily visits the other contracting State for the purpose of teaching, for a period not exceeding two years, at a university, college, school or other educational institution in such other State, shall be exempt by such other State from tax on his remuneration for such teaching for such period .

In Rev. Rul. 55-211, 1955-1 C.B. 676, which deals with a similar provision in the United States-United Kingdom Income Tax Convention, T.D. 5569, 1947-2 C.B. 100, it is stated that if the primary purpose of the professor or teacher from the United Kingdom in visiting the United States is to teach, lecture, or instruct at a university for a period of not more than two years from the date of arrival, and a substantial portion of his time is devoted to such duties, his entire remuneration is regarded as arising from teaching and is exempt from Federal income tax under Article XVII of the United States-United Kingdom Income Tax Convention even though a portion of his time is devoted to research or other functions. Where, however, the primary purpose of his presence in the United States is the pursuit of research and like duties and any teaching is incidental to such research it cannot be considered that he is present in the United States "for the purpose of teaching" within the meaning of the exemption provided in Article XVIII.

Rev. Rul. 55-211 reflects recognition of the fact that teachers frequently visit the United States under programs which involve the performance of activities in addition to teaching and related duties. Under Rev. Rul. 55-211 the taxpayer's entire income will be attributed to his teaching activities, even though he engages in research and other nonteaching functions, if his primary purpose in visiting the United States is to teach, and if a substantial portion of his time is directed to such activities.

Whether or not the taxpayer's primary purpose in entering the United States is to teach will be determined from an analysis of all the objective facts and circumstances. See section 1.162-2(b)(2) of the Income Tax Regulations. Because the taxpayer was engaged in the business of teaching before coming to the United States and because the taxpayer spent a substantial portion of his time performing teaching duties at *S* University, it is concluded that the taxpayer's primary purpose for being present in the United States was to teach. The fact that the taxpayer entered the United States under an F-1 visa is immaterial since 8 C.F.R. section 214.2(f)(6)(1973) specifically authorizes a taxpayer admitted under such a visa to teach if the teaching occurs on the same campus at which he is a student.

Accordingly, the taxpayer qualifies for the exemption from Federal income tax afforded by Article VIII A of the United States-Canada Income Tax Convention with respect to his remuneration for teaching in the United States.

United States-Canada Income Tax Convention

T.D. 5206, 1943 C.B. 526.
(Also Part I, Sections 1, 2, 4, 142, 6013; 1.1-1, 1.2-2, 1.4-1, 1.142-2, 1.6013-1.)

Dual status Canadian citizen; nondiscrimination clause. The nondiscrimination clause of Paragraph 11 of the Protocol to the U.S.-Canada Income Tax Convention, as amended, providing in effect that citizens of Canada residing in the U.S. may not be subjected to more burdensome taxes than U.S. citizens, does not prevent the U.S. from denying a Canadian citizen who is both a resident and a nonresident of the U.S. during the taxable year the benefits of using the head of household tax rate schedule, optional tax tables, standard deduction, or a joint return.

Rev. Rul. 74-239

Advice has been requested as to the proper treatment for Federal income tax purposes of a citizen of Canada who is a dual status taxpayer (a bona fide resident of the United States for part of the taxable year and a resident of Canada for the remainder of the taxable year).

The specific question is whether the nondiscrimination clause of the United States-Canada Income Tax Convention. T.D. 5206, 1943 C.B. 526, and the Supplemental Conventions, 1955-1 C.B. 624, 1957-2 C.B. 1014, and 1968-1 C.B. 628, prevents the United States from denying a Canadian citizen who is a dual status taxpayer the benefits of using the head of household tax rate tables, optional tax tables, standard deduction, or joint return for Federal income tax purposes.

Paragraph 11 of the Protocol of the United States-Canada Income Tax Convention, as amended, sets forth a nondiscrimination clause. It provides that the citizens of one of the contracting States residing within the other contracting State shall not be subject to the payment of more burdensome taxes than the citizens of such other State.

Article XVII of the Convention contains a savings clause which provides generally that the United States reserves to itself the power to tax its citizens and residents as if the income tax convention had not come into effect.

Section 2(b)(3)(A) of the Internal Revenue Code of 1954 provides, in part, that a taxpayer shall not be considered to be a head of household if at any time during the taxable year he is a nonresident alien.

Section 4(d)(1) of the Code provides that section 3, relating to the optional tax tables for individuals, shall not apply to nonresident alien individuals.

Section 142(b)(1) of the Code provides, in part, that the standard deduction shall not be allowed in computing the taxable income of a nonresident alien individual.

Section 6013(a)(1) of the Code provides that no joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien.

Rev. Rul. 72-330, 1972-2 C.B. 444, states that in the absence of a specific treaty provision or a provision of the regulations under the treaty to the contrary, the nondiscrimination clause in a particular income tax treaty will be applied without regard to the savings clause in such treaty. That Revenue Ruling holds that nationals of certain treaty countries who are resident alien individuals of the United States are eligible for the benefits of section 911 of the Code although they are not also citizens of the United States. The United States-Canada Income Tax Convention is one of the treaties referred to in Rev. Rul. 72-330.

Generally, the nondiscrimination clause found in the income tax conventions entered into by the United States is interpreted to mean that the citizens of one of the contracting States residing within the other contracting State shall not be subject to the payment of more burdensome taxes than the citizens of such other State in *similar (comparable) circumstances.* See the Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation accompanying the United States-Japan Income Tax Convention, 1973-1 C.B.

630 at 645, the United States-Norway Income Tax Convention, 1973-1 C.B. 669, and the United States-France Income Tax Convention, Committee on Foreign Relations, 90th Cong., 2d Sess., Exec. Rep. No. 5, Tax Conventions with Brazil, France, and the Philippines. Also see section 896(b) of the Code which, although enacted to protect United States citizens residing in foreign countries from discriminatory taxes imposed by the foreign country, provides that a more burdensome tax results when under the laws of any foreign country United States citizens are, with respect to any item of income, being subjected to a higher effective rate of tax than the nationals or residents of such foreign country under *similar circumstances.*

The dual status Canadian citizen is not in similar circumstances with the United States citizen. That is, by virtue of being a nonresident alien for part of the taxable year, not all of his world-wide income is necessarily subjected to Federal income tax. By contrast, a United States citizen, whether residing at home or abroad, is generally taxable on his world-wide income. See section 1.1-1(b) of the Income Tax Regulations.

A United States citizen who becomes a nonresident alien during the taxable year is similarly circumstanced with the dual status Canadian citizen at least in the sense that his income from sources without the United States that was not effectively connected with his United States trade or business, if any, and that was earned and received after his change of status but during the same taxable year, is not subject to Federal income tax. However, like the dual status Canadian citizen, this former United States citizen cannot elect the head of household tax rate schedules, the optional tax tables, the standard deduction, or the joint return for the year of the change. See Rev. Rul. 73-62, 1973-1 C.B. 56, Rev. Rul. 64-60, 1964-1 (Part 1) C.B. 84, and Rev. Rul. 56-365, 1956-2 C.B. 934. Thus, even when compared with a former United States citizen who is similarly circumstanced for Federal income tax purposes the dual status Canadian citizen has not been subjected to a more burdensome tax by being denied the right to use the head of household tax rate schedules, optional tax tables, standard deduction, or joint return.

Accordingly, it is held, that the nondiscrimination clause of Paragraph 11 of the Protocol to the United States-Canada Income Tax Convention does not prevent the United States from denying a Canadian citizen who is both a resident and a nonresident of the United States during the taxable year the benefits of using the head of household tax rate schedules, optional tax tables, standard deduction, or joint return.

United States-Federal Republic of Germany Income Tax Convention

1955-1 C.B. 635.

Germany; operation of ships; containers. Income of shipping companies from certain ancillary activities connected with use of the container method of ocean transportation for which no special charge is made is exempt from tax as income from the "operation of ships" under Article V of the U.S.-Federal Republic of Germany Income Tax Convention.

Rev. Rul. 74-92

The Internal Revenue Service has been requested to define the scope of activities that the Service deems to be included within the exemption contained in Article V of the United States-Federal Republic of Germany Income Tax Convention (Convention), TIAS 3133, 1955-1 C.B. 635, with respect to shipping companies using the container method of ocean transportation.

Article V of the Convention provides that profits derived by an enterprise of one of the contracting States from the operation of ships or aircraft shall be exempt from tax by the other State.

Under the authority granted by Article XIX(2) of the Convention the competent authority of the Internal Revenue Service and the German Federal Minister for Economic and Finance have agreed pursuant to an exchange of letters to interpret the phrase "operation of ships" as that phrase is used in Article V of the Convention in the following manner:

> In view of the fact that shipping companies are utilizing the "container" method of ocean transportation, certain ancillary activities connected with container transportation would be included within the provisions applicable to the operation of ships in international traffic.
>
> The specific activities of the shipping company to be included are the following:
>
> 1. Providing the containers and special under-carriage for transportation to the port of departure and on board the ship during the ocean transportation;
> 2. Transferring the containers from the under-carriage or from railway carriages on board the ship;
> 3. Transportation on board ship;
> 4. Unloading the containers on special under-carriage or railway carriages in the port of destination;
> 5. Providing the containers and special under-carriages for transportation from the port of destination to the customer.

Income from the above activities will be treated as income from the "operation of ships," as that term is used in Article V of the Convention, provided that no special charge is imposed on the customer for the ancillary activities mentioned in items 1 and 5 above.

Accordingly, the United States will grant a reciprocal tax exemption to those German shipping enterprises covered under the Convention engaged in such ancillary activities.

United States-Federal Republic of Germany Income Tax Convention

T.D. 6122, 1955-1 C.B. 632; 1965-1 C.B. 360; Section 503.1: Introductory.

Outline of new German filing procedure to be followed by a resident, corporation, or other entity of the United States in order to obtain German treaty benefits under the dividend, interest, and royalty provision of the Income Tax Convention between the United States and the Federal

Republic of Germany, as modified by the Protocol of December 27, 1965. See Rev. Proc. 74-14, page 436.

United States—Norway Income Tax Convention

Directors' fees paid by Norwegian corporation. Directors' fees received solely for services as a director on the board of a Norwegian corporation are subject to Article 13 of the U.S.-Norway Income Tax Convention as income from independent personal services; however, any portion of the fees that represents compensation for employment is subject to Article 14 and any portion that represents distribution of profits is subject to either Article 8 as dividends or Article 5 as profits.

Rev. Rul. 74-163

Advice has been requested regarding the treatment of directors' fees under the United States-Norway Income Tax Convention, TIAS 7474, 1973-1 C.B. 669.

Article 13 of the United States-Norway Income Tax Convention provides, in general, that income earned by an individual resident of one State from independent personal services performed in the other State may not be taxed in that other State. However, such income may be subject to tax in the State of source (i.e., where the services are performed) if the recipient is present in that State for a period or periods aggregating 183 days or more in the taxable year.

"Independent personal services" means services performed by an individual for his own account where he receives the proceeds or bears the losses arising from such services. Commercial, industrial, or agricultural activities are not considered independent personal services and the income therefrom is taxed as industrial or commercial profits under Article 5 (Business Profits) of the Convention.

Article 14 of the Convention provides, generally, that income from labor or personal services as an employee may be taxed in the State in which such labor or personal services are performed except as provided in Articles 15 (Teachers), 16 (Students and Trainees), 17 (Governmental Functions), and 18 (Private Pensions and Annuities) of the Convention. However, such income will be exempt from tax in the State of source if (1) the recipient, being a resident of one of the Contracting States, is present in the State of source for a period or periods aggregating less than 183 days during the taxable year; (2) the recipient is an employee of a resident of the State of his residence (or of a permanent establishment located in the State of his residence maintained by a resident of a State other than that State); and (3) the remuneration is not borne as such by a permanent establishment which the employer has in the State of source.

Article 8 of the Convention provides, in pertinent part, that dividends from sources within one of the Contracting States paid to a resident of the other Contracting State shall be subject to tax by the source country at a rate not exceeding 15 percent of the amount actually distributed, provided the dividend was not effectively connected with a permanent establishment of the recipient in the source country.

Article 5 of the Convention provides, in part, that industrial or commercial profits of a resident of one of the Contracting States shall be exempt from tax by the other Contracting State unless the resident is engaged in industrial or commercial activity in that other Contracting State through a permanent establishment situated therein. If such resident is so engaged, tax may be imposed by that other Contracting State on the industrial or commercial profits of such resident but only on so much of such profits as is attributable to the permanent establishment.

Directors' fees are generally nominal sums paid for attendance at board meetings. However, what is in fact compensation for services rendered or a distribution of profits is sometimes termed directors' fees by the paying corporation.

Accordingly, compensation paid as directors' fees to a member of a board of directors of a Norwegian corporation in his capacity as such is subject to the provisions of Article 13 of the Convention as payments for independent personal services. If the payments include remuneration for services performed as an employee, as well as a director, then to the extent they are compensation for services as an employee, directors' fees are subject to the provisions of Article 14 of the Convention. If it is determined that the payment to the directors is in the nature of a distribution of profits, then Article 8 of the Convention, pertaining to dividends, or Article 5 of the Convention, pertaining to industrial or commercial profits, whichever is appropriate under the circumstances, is applicable.

United States-Swiss Confederation Income Tax Convention

T.D. 6149, 1955-2 C.B. 814; Sections 509.104, 509.105, 509.108: Definitions, Industrial and Commercial Profits, Dividends. (Also Part I, Sections 864, 871, 894; 26 CFR 1.864-2, 1.871-7, 1.894-1.)

Swiss; dividends and business income received by nonresident alien. Dividend income from sources within the U.S. received by a nonresident alien individual, a Swiss resident engaged in a trade or business in the U.S., that was not effectively connected with the conduct of such trade or business, is taxable at the rate of 15 percent under Article VI(1) of the U.S.-Swiss Confederation Income Tax Convention. However, income received by him from sources without the U.S. is exempt from Federal tax under Article III(1) of the Convention even though that income may be effectively connected with-

in the meaning of section 864(c)(4)(B) of the Code.

Rev. Rul. 74-63

Advice has been requested regarding the taxation of a Swiss resident under the circumstances described below.

The taxpayer, a nonresident alien individual of the United States and a resident of Switzerland, was engaged in an industrial undertaking in Switzerland and was also engaged in a trade or business in the United States through a permanent establishment during his taxable year 1972. He received dividends from United States sources during such year which were not effectively connected with the conduct of such trade or business in the United States. The taxpayer also received income from sources without the United States during his taxable year 1972 that was effectively connected with the conduct of his trade or business within the United States within the meaning of section 864(c)(4)(B) of the Internal Revenue Code of 1954.

The questions presented are (1) whether the taxpayer's United States source dividend income that is not effectively connected with the conduct of a trade or business within the United States may be treated as income that is effectively connected with the conduct of a trade or business within the United States, and (2) whether the taxpayer's foreign source income that is effectively connected with the conduct of a trade or business within the United States is exempt from United States tax under the United States-Swiss Confederation Income Tax Convention, T.D. 6149, 1955-2 C.B. 814.

With respect to question number (1), section 871(a) of the Code imposes a 30 percent tax on the gross amount of certain types of income, including dividend income received by a nonresident alien individual from sources within the United States, if such income is not effectively connected with the conduct of a trade or business within the United States. Section 871(b) provides that a nonresident alien individual who is engaged in trade or business within the United States during the taxable year is taxable at graduated rates, as provided in section 1 or 1201(b), on taxable income that is effectively connected with the conduct of a trade or business within the United States.

Income derived by the taxpayer from his trade or business conducted through a permanent establishment in the United States is taxed in accordance with section 871(b) of the Code and his United States source dividend income not effectively connected with the conduct of his United States trade or business would, absent any other provisions of the Code or the Convention, be taxed at the 30 percent rate in accordance with section 871(a). However, section 894(b) provides, in effect, that for purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party, a nonresident alien individual or a foreign corporation shall, with certain exceptions not here pertinent, be deemed not to have a permanent establishment in the United States at any time during the taxable year, only with respect to income that is not effectively connected with the conduct of a trade or business within the United States.

Article VI(1) of the Convention, in effect, provides for a reduced rate of tax (15 percent) in connection with dividends received from United States sources by a resident of Switzerland not having a permanent establishment in the United States.

In the instant case, by virtue of section 894(b) of the Code which does not provide for an election, the taxpayer is deemed not to have a permanent establishment in the United States with respect to his United States source dividend income. Except for the election under section 871(d), relating to the treatment of real property income, no option exists under the Code whereby the taxpayer may include United States source income that is not effectively connected with his conduct of a trade or business in the United States with his income that is effectively connected with his permanent establishment in the United States.

Accordingly, for his taxable year 1972 the taxpayer's United States source dividend income that is not effectively connected with the conduct of a trade or business within the United States cannot be treated as income that is effectively connected with his conduct of a trade or business within the United States. Such dividend income is taxable at 15 percent as provided in Article VI(1) of the Convention in lieu of 30 percent as provided in section 871(a) of the Code.

With respect to question number (2), section 864(c)(4)(B) of the Code provides, in part, that income from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual if such person has an office or other fixed place of business in the United States to which such income is attributable and such income is of the type described therein.

Article III(1) of the Convention provides, in part, that a Swiss enterprise shall not be subject to taxation by the United States in respect of its industrial and commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, the United States may impose its tax upon the *entire* income of such enterprise from sources *within the United States.*

Article II(1)(h) of the Convention provides the following:

> The term "industrial or commercial profits" includes manufacturing, mercantile, mining, financial and insurance profits, but does not include income in the form of dividends, interest, rents or royalties, or re-

muneration for personal services: Provided, however, that such excepted items of income shall, subject to the provision of this Convention, be taxed separately or together with industrial or commercial profits in accordance with the laws of the contracting States.

Article III(1)(a) of the Convention, however, authorizes the taxation of only the United States source income of a Swiss enterprise that is engaged in trade or business in the United States through a permanent establishment. Section 894(a) of the Code provides, in effect, that income to the extent required by any treaty obligation of the United States, shall be exempt from income tax. See also section 110 of the Foreign Investor Tax Act of 1966, P.L. 89-809, 1966-2 C.B. 656, 690, which provides, in part, that no amendment made by this title (Title 1) shall apply in any case where its application would be contrary to any treaty obligation of the United States.

Accordingly, the taxpayer's income for his taxable year 1972 from sources without the United States is exempt from United States income taxation under the Convention even though that income may be effectively connected with the conduct of the taxpayer's trade or business within the United States within the meaning of section 864(c)(4)(B) of the Code.

United States-Swiss Confederation Income Tax Convention

T.D. 6149, 1955-2 C.B. 814, Section 509.108: Dividends.
T.D. 5867, 1951-2 C.B. 75, Section 509.2: Dividends. (Renumbered from 7.301)

Dividends paid to Swiss parent; withholding rate. A domestic securities broker-dealer corporation wholly-owned by a Swiss bank is not required to be in existence for three full years before dividends it pays to its Swiss parent may qualify for the five percent rate of tax prescribed by Article VI(2) of the U.S.-Swiss Confederation Income Tax Convention.

Rev. Rul. 74-275

Advice has been requested whether a corporation must be in existence for a three-year period in order to qualify for the five percent rate of tax prescribed by Article VI(2) of the United States-Swiss Confederation Income Tax Convention (hereinafter referred to as "Convention"), T.D. 6149, 1955-2 C.B. 814.

The taxpayer, was incorporated in the United States on July 1, 1972, and since its incorporation has been a wholly-owned subsidiary of a Swiss bank incorporated under the laws of Switzerland. The taxpayer is a broker-dealer engaged in the business of purchasing, selling, and underwriting securities, both for its own account and for others. Less than 25 percent of the taxpayer's gross income for the years 1972 and 1973 was derived from interest and dividends. The Swiss bank does not maintain a permanent establishment in the United States and the parent-subsidiary relationship with the taxpayer is not maintained primarily to secure the reduced tax rate under the Convention. On March 1, 1974, the taxpayer paid a dividend to the Swiss bank.

The specific question is what rate of withholding, for Federal income tax purposes, shall apply to the dividend paid by the taxpayer.

Article VI(1) of the Convention provides, in part, that the rate of tax imposed by one of the contracting States upon dividends derived from sources within that State by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall not exceed 15 percent.

Article VI(2) of the Convention provides, however, that the rate of tax shall not exceed five percent if the shareholder is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and if not more than 25 percent of the gross income of the paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. The reduction of the rate to five percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing the reduced rate.

Section 509.108(b) of the regulations issued under the Convention and section 509.2(b) of the withholding regulations under the Convention (as renumbered), T.D. 5867, 1951-2 C.B. 75, 80, provide, in part, that under the provisions of Article VI(2) of the Convention, dividends from sources within the United States paid by a domestic corporation to a Swiss corporation controlling, directly or indirectly, at the time the dividend is paid, 95 percent or more of the entire voting power in the domestic corporation are subject to tax at the rate of only five percent if, among other requirements, not more than 25 percent of the gross income of the paying corporation for the three-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest paid to the domestic corporation by its own subsidiary corporation, if any).

The "three-year-period" (meaning 36 months) contained in sections 509.108(b) and 509.2(b) of the regulations under the Convention does not require that a domestic corporation must exist for three complete years before its dividends may qualify for the five percent rate of tax. The Convention does not specify any period with respect to which the percentage of income is to be measured to determine whether not more than 25 percent of the gross income of the paying corporation is derived from interest and dividends. The three-year period specified by the regulations represents the maximum period of time during which gross income sources of the paying corporation will be considered in making that determination.

Section 509.2(b) of the withholding

regulations under the Convention further provides that any domestic corporation which claims or contemplates claiming that dividends paid or to be paid by it are subject only to the five percent rate shall file, as soon as practicable, with the Commissioner of Internal Revenue, certain specified information. As soon as practicable after such information is filed, the Commissioner of Internal Revenue will determine whether the dividends concerned fall within the provisions of Article VI(2) of the Convention and may authorize the release of excess tax withheld with respect to dividends which come within such provisions. In any case in which the Commissioner of Internal Revenue has notified such domestic corporation that the dividends come within such provisions, the reduced withholding rate of five percent will apply to any dividends subsequently paid by such corporation to the Swiss corporation providing it does not perform an act that would prevent it from meeting the requirements of Article VI(2) of the Convention.

The taxpayer and its Swiss parent corporation fully met the requirements under Article VI(2) of the Convention for the five percent rate of tax throughout the taxpayer's existence, and at the time the dividend was paid. Accordingly, the taxpayer, in the instant case, may, upon complying with the requirements of section 509.2(b) of the withholding regulations of the Convention and upon receiving notification from the Commissioner of Internal Revenue, withhold from the dividends paid at the reduced withholding rate of five percent.

Subpart B.—Legislation

Public Law 93-161
93rd Congress, H.R. 8219 [1]
November 27, 1973

An Act to amend the International Organizations Immunities Act to authorize the President to extend certain privileges and immunities to the Organization of African Unity.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the International Organizations Immunities Act (22 U.S.C. 288-288f) [Pub. L. 291, 1946-1 C.B. 323] is amended by adding at the end thereof the following new section:

"SEC. 12. The provisions of this title may be extended to the Organization of African Unity in the same manner, to the same extent, and subject to the same conditions, as they may be extended to a public international organization in which the United States participates pursuant to any treaty or under the authority of any Act of Congress authorizing such participation or making an appropriation for such participation."

Approved November 27, 1973.

[1] House Report No. 93-349 and Senate Reports Nos. 93-471 and 93-492 are not published herein.

Public Law 93-197
93rd Congress, H.R. 10717[1]
December 22, 1973

An Act to repeal the Act terminating Federal supervision over the property and members of the Menominee Indian Tribe of Wisconsin; to reinstitute the Menominee Indian Tribe of Wisconsin as a federally recognized sovereign Indian tribe; and to restore to the Menominee Tribe of Wisconsin those Federal services furnished to American Indians because of their status as American Indians; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Menominee Restoration Act".

SEC. 2. For the purposes of this Act—

(1) The term "tribe" means the Menominee Indian Tribe of Wisconsin.

(2) The term "Secretary" means the Secretary of the Interior.

(3) The term "Menominee Restoration Committee" means that committee of nine Menominee Indians who shall be elected pursuant to subsections 4(a) and 4(b) of this Act.

SEC. 3. (a) Notwithstanding the provisions of the Act of June 17, 1954 (68 Stat. 250; 25 U.S.C. 891-902), as amended, or any other law, Federal recognition is hereby extended to the Menominee Indian Tribe of Wisconsin and the provisions of the Act of June 18, 1934 (48 Stat. 984; 25 U.S.C. 461 et seq.), as amended, are made applicable to it.

(b) The Act of June 17, 1954 (68 Stat. 250; 25 U.S.C. 891-902), as amended, is hereby repealed and there are hereby reinstated all rights and privileges of the tribe or its members under Federal treaty, statute, or otherwise which may have been diminished or lost pursuant to such Act.

(c) Nothing contained in this Act shall diminish any rights or privileges enjoyed by the tribe or its members now or prior to June 17, 1954, under Federal treaty, statute, or otherwise, which are not inconsistent with the provisions of this Act.

(d) Except as specifically provided in this Act, nothing contained in this Act shall alter any property rights or obligations, any contractual rights or obligations, including existing fishing rights, or any obligations for taxes already levied.

* * * * *

SEC. 6. (a) The Secretary shall negotiate with the elected members of the Menominee Common Stock and Voting Trust and the Board of Directors of Menominee Enterprises, Incorporated, or their authorized representatives, to develop a plan for the assumption of the assets of the corporation. The Secretary shall submit such plan to the Congress within one

[1] This publication of the law is restricted to excerpts involving Internal Revenue matters; House Report No. 93-572, and Senate Report No. 93-604 are not published.

year from the date of the enactment of this Act.

(b) If neither House of Congress shall have passed a resolution of disapproval of the plan within sixty days of the date the plan is submitted to Congress, the Secretary shall, subject to the terms and conditions of the plan negotiated pursuant to subsection (a) of this section, accept the assets (excluding any real property not located in or adjacent to the territory, constituting, on the effective date of this Act, the county of Menominee, Wisconsin) of Menominee Enterprises, Incorporated, but only if transferred to him by the Board of Directors of Menominee Enterprises, Incorporated, subject to the approval of the shareholders as required by the laws of Wisconsin. Such assets shall be subject to all valid existing rights, including, but not limited to, liens, outstanding taxes (local, State, and Federal), mortgages, outstanding corporate indebtedness of all types, and any other obligation. The land and other assets transferred to the Secretary pursuant to this subsection shall be subject to foreclosure or sale pursuant to the terms of any valid existing obligation in accordance with the laws of the State of Wisconsin. Subject to the conditions imposed by this section, the land transferred shall be taken in the name of the United States in trust for the tribe and shall be their reservation. The transfer of assets authorized by this section shall be exempt from all local, State, and Federal taxation. All assets transferred under this section shall, as of the date of transfer, be exempt from all local, State, and Federal taxation.

(c) The Secretary shall accept the real property (excluding any real property not located in or adjacent to the territory constituting, on the effective date of this Act, the county of Menominee, Wisconsin) of members of the Menominee Tribe, but only if transferred to him by the Menominee owner or owners. Such property shall be subject to all valid existing rights including, but not limited to, liens, outstanding taxes (local, State, and Federal), mortgages, and any other obligations. The land transferred to the Secretary pursuant to this subsection shall be subject to foreclosure or sale pursuant to the terms of any valid existing obligation in accordance with the laws of the State of Wisconsin. Subject to the conditions imposed by this subsection, the land transferred shall be taken in the name of the United States in trust for the Menominee Tribe of Wisconsin and shall be part of their reservation. The transfer of assets authorized by this section shall be exempt from all local, State, and Federal taxation. All assets transferred under this section shall, as of the date of transfer, be exempt from all local, State, and Federal taxation.

(d) The Secretary and the Menominee Restoration Committee shall consult with appropriate State and local government officials to assure that the provision of necessary governmental services is not impaired as a result of the transfer of assets provided for in this section.

(e) For the purpose of implementing subsection (d), the State of Wisconsin may establish such local government bodies, political subdivisions, and service arrangements as will best provide the State or local government services required by the people in the territory constituting, on the effective date of this Act, the county of Menominee.

SEC. 7. The Secretary is hereby authorized to make such rules and regulations as are necessary to carry out the provisions of this Act.

SEC. 8. There are hereby authorized to be appropriated such sums as may be necessary to carry out the provisions of this Act.

Approved December 22, 1973.

Public Law 93-198
93rd Congress, S. 1435 [1]
December 24, 1973

An Act to reorganize the governmental structure of the District of Columbia, to provide a charter for local government in the District of Columbia subject to acceptance by a majority of the registered qualified electors in the District of Columbia, to delegate certain legislative powers to the local government, to implement certain recommendations of the Commission on the Organization of the Government of the District of Columbia, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * *

TITLE I—SHORT TITLE, PURPOSES, AND DEFINITIONS

SHORT TITLE

SEC. 101. This Act may be cited as the "District of Columbia Self-Government and Governmental Reorganization Act".

* * * * *

TITLE IV—THE DISTRICT CHARTER

PART A—THE COUNCIL

Subpart 1—Creation of the Council

CREATION AND MEMBERSHIP

SEC. 401. (a) There is established a Council of the District of Columbia; and the members of the council shall be elected by the registered qualified electors of the District.

(b) (1) The Council established under subsection (a) shall consist of thirteen members elected on a partisan basis. The Chairman and four members shall be elected at large in the District and eight members shall be elected one each from the eight election wards established, from time to time, under the District of Columbia

[1] This publication of the law is restricted to excerpts involving tax matters; House Report No. 93-482, Senate Report No. 93-219, and Conference Report No. 93-703 are not published.

Election Act. The term of office of the members of the Council shall be four years, except as provided in paragraph (3), and shall begin at noon on January 2 of the year following their election.

* * * * *

PART E—BORROWING

* * * * *

Subpart 4—Tax Exemption; Legal Investment; Water Pollution; Reservoirs; Metro Contributions; and Revenue Bonds

TAX EXEMPTION

SEC. 485. Bonds and notes issued by the Council pursuant to this title and the interest thereon shall be exempt from all Federal and District taxation except estate, inheritance, and gift taxes.

* * * * *

TITLE VII — REFERENDUM; SUCCESSION IN GOVERNMENT; TEMPORARY PROVISIONS; MISCELLANEOUS; AMENDMENTS TO DISTRICT OF COLUMBIA ELECTION ACT; RULES OF CONSTRUCTION; AND EFFECTIVE DATES

* * * * *

PART G—EFFECTIVE DATES

EFFECTIVE DATES

SEC. 771. (a) * * *

(c) Titles III and IV shall take effect January 2 1975, if title IV is accepted by a majority of the registered qualified electors in the District of Columbia voting on the charter issue in the charter referendum.

* * * * *

Approved December 24, 1973.

Public Law 93-203
93rd Congress, S. 1559[1]
December 28, 1973

An Act to assure opportunities for employment and training to unemployed and underemployed persons.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Comprehensive Employment and Training Act of 1973".

STATEMENT OF PURPOSE

SEC. 2. It is the purpose of this Act to provide job training and employment opportunities for economically disadvantaged, unemployed, and underemployed persons, and to assure that training and other services lead to maximum employment opportunities and enhance self-sufficiency by establishing a flexible and decentralized system of Federal, State, and local programs.

* * * * *

APPLICATION OF PROVISIONS OF FEDERAL LAW

SEC. 416. (a) Except as otherwise specifically provided in the following paragraphs of this subsection, and in section 8143(a) of title 5, United States Code, enrollees in the Job Corps shall not be considered Federal employees and shall not be subject to the provisions of law relating to Federal employment including those regarding hours of work, rates of compensation, leave, unemployment compensation, and Federal employee benefits:

(1) For purposes of the Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.) and title II of the Social Security Act (42 U.S.C. 401 et seq.), enrollees shall be deemed employees of the United States and any service performed by an individual as an enrollee shall be deemed to be performed in the employ of the United States.

* * * * *

EFFECTIVE DATE

SEC. 615. This Act shall take effect on the date of its enactment. Approved December 28, 1973.

[1] This publication of the Law is restricted to excerpts involving tax matters; House Report No. 93-659, Senate Report No. 93-304, House Conference Report No. 93-737, and Senate Conference Report No. 93-636 are not published.

Public Law 93-224
93rd Congress, H.R. 5874[1]
December 29, 1973

An Act to establish a Federal Financing Bank, to provide for coordinated and more efficient financing of Federal and federally assisted borrowings from the public, and for other purposes.

Be is enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal Financing Bank Act of 1973".

FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. The Congress finds that demands for funds through Federal and federally assisted borrowing programs are increasing faster than the total supply of credit and that such borrowings are not adequately coordinated with overall Federal fiscal and debt management policies. The purpose of this Act is to assure coordination of these programs with the overall economic and fiscal policies of the Government, to reduce the costs of Federal and federally assisted borrowings from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions.

DEFINITIONS

SEC. 3. For the purposes of this Act—

(1) The term "Federal agency" means an executive department, an independent Federal establishment, or a corporation or other entity established by the Congress which is owned in whole or in part by the United States.

(2) The term "obligation" means any note, bond, debenture, or other evidence of indebtedness, but does not include Federal Reserve notes or stock

[1] This publication of the Law is restricted to excerpts involving tax matters; House Report No. 93-299, Senate Report No. 93-166, and Conference Report No. 93-700 are not published.

evidencing an ownership interest in the issuing Federal agency.

(3) The term "guarantee" means any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any obligation, but does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions, or any guarantee or pledge arising out of a statutory obligation to insure such deposits, shares, or other withdrawable accounts.

(4) The term "Bank" means the Federal Financing Bank established by section 4 of this Act.

CREATION OF BANK

SEC. 4. There is hereby created a body corporate to be known as the Federal Financing Bank, which shall have succession until dissolved by an Act of Congress. The Bank shall be subject to the general supervision and direction of the Secretary of the Treasury. The Bank shall be an instrumentality of the United States Government and shall maintain such offices as may be necessary or appropriate in the conduct of its business.

BOARD OF DIRECTORS

SEC. 5. (a) The Bank shall have a Board of Directors consisting of five persons, one of whom shall be the Secretary of the Treasury as Chairman of the Board, and four of whom shall be appointed by the President from among the officers or employees of the Bank or of any Federal agency. The Chairman and each other member of the Board may designate some other officer or employee of the Government to serve in his place.

(b) The Board of Directors shall meet at the call of its Chairman. The Board shall determine the general policies which shall govern the operations of the Bank. The Chairman of the Board shall select and effect the appointment of qualified persons to fill such offices as may be provided for in the bylaws, and such persons shall be the executive officers of the Bank and shall discharge such executive functions, powers, and duties as may be provided for in the bylaws or by the Board of Directors. The members of the Board and their designees shall not receive compensation for their services on the Board.

FUNCTIONS

SEC. 6. (a) The Bank is authorized to make commitments to purchase and sell, and to purchase and sell on terms and conditions determined by the Bank, any obligation which is issued, sold, or guaranteed by a Federal agency. Any Federal agency which is authorized to issue, sell, or guarantee any obligation is authorized to issue or sell such obligations directly to the Bank.

(b) Any purchase by the Bank shall be upon such terms and conditions as to yield a return at a rate not less than a rate determined by the Secretary of the Treasury taking into consideration (1) the current average yield on outstanding marketable obligations of the United States of comparable maturity, or (2) whenever the Bank's own obligations outstanding are sufficient, the current average yield on outstanding obligations of the Bank of comparable maturity.

(c) The Bank is authorized to charge fees for its commitments and other services adequate to cover all expenses and to provide for the accumulation of reasonable contingency reserves.

* * * * *

EXEMPTIONS

SEC. 11. (a) The Bank, its property, its franchise, capital, reserves, surplus, security holdings and other funds, and its income shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority; except that (1) any real property and any tangible personal property of the Bank shall be subject to Federal, State, and local taxation to the same extent according to its value as other such property is taxed, and (2) any obligations issued by the Bank shall be subject to Federal taxation to the same extent as the obligations of private corporations are taxed.

* * * * *

EFFECTIVE DATE

SEC. 20. This Act becomes effective upon the date of its enactment, except that section 7 becomes effective upon the expiration of thirty days after such date.

Approved December 29, 1973.

Public Law 93-233
93rd Congress, H.R. 11333 [1]
December 31, 1973

An Act to provide a 7-percent increase in social security benefits beginning with March 1974 and an additional 4-percent increase beginning with June 1974 to provide increases in supplemental security income benefits and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * *

MODIFICATION OF COST-OF-LIVING BENEFIT INCREASE PROVISIONS

SEC. 3. (a) Clause (i) of section 215(i)(1)(A) of the Social Security Act is amended to read as follows: "(i) the calendar quarter ending on March 31 in each year after 1974, or".

(b) Clause (ii) of section 215(i)(1)(B) of such Act is amended by striking out "in which a law" and all that follows and inserting in lieu thereof "if in the year prior to such year a law has been enacted providing a general benefit increase under this title or if in such prior year such a general benefit increase becomes effective; and".

(c) Section 215(i)(2)(A)(i) of such Act is amended by striking out

[1] This publication of the law and House Report No. 93-627, page 384, is restricted to excerpts involving Internal Revenue matters.

"1974" and inserting in lieu thereof "1975", and by striking out "and to subparagraph (E) of this paragraph".

(d) Section 215(i)(2)(A)(ii) of such Act is amended—

(1) by striking out "such base quarter" and inserting in lieu thereof "the base quarter in any year";

(2) by striking out "January of the next calendar year" and inserting in lieu thereof "June of such year"; and

(3) by striking out "(subject to subparagraph (E))".

(e) Section 215(i)(2)(B) of such Act is amended by striking out "December" each place it appears and inserting in lieu thereof "May", and by striking out "(subject to subparagraph (E))".

(f) Section 215(i)(2)(C)(ii) of such Act is amended by striking out "on or before August 15 of such calendar year" and inserting in lieu thereof "within 30 days after the close of such quarter".

(g) Section 215(i)(2)(D) of such Act is amended by striking out "on or before November 1 of such calendar year" and inserting in lieu thereof "within 45 days after the close of such quarter".

(h) Section 215(i)(2) of such Act is amended by striking out subparagraph (E).

(i) For purposes of section 203(f)(8) so much of section 215(i)(1)(B) as follows the semicolon, and section 230(a) of the Social Security Act, the increase in benefits provided by section 2 of this Act shall be considered an increase under section 215(i) of the Social Security Act.

(j)(1) Section 230(a) of such Act is amended—

(A) by striking out "with the first month of the calendar year" and inserting in lieu thereof "with the June"; and

(B) by striking out "(along with the publication of such benefit increase as required by section 215(i)(2)(D))" and by striking out "(unless such increase in benefits is prevented from becoming effective by section 215(i)(2)(E))".

(2) Section 230(c) of such Act is amended by striking out "the first month" and inserting in lieu thereof "the June".

(k)(1) Section 203(f)(8)(A) of such Act is amended to read as follows:

"(A) Whenever the Secretary pursuant to section 215(i) increases benefits effective with the month of June following a cost-of-living computation quarter he shall also determine and publish in the Federal Register on or before November 1 of the calendar year in which such quarter occurs a new exempt amount which shall be effective (unless such new exempt amount is prevented from becoming effective by subparagraph (C) of this paragraph) with respect to any individual's taxable year which ends after the calendar year in which such benefit increase is effective (or, in the case of an individual who dies during the calendar year after the calendar year in which the benefit increase is effective, with respect to such individual's taxable year which ends upon his death, during such year).".

(2) Section 203(f)(8)(B) of such Act is amended by striking out "no later than August 15 of such year" and inserting in lieu thereof "within 30 days after the close of the base quarter (as defined in section 215(i)(1)(A)) in such year".

(3) Section 203(f)(8)(C) is amended by striking out "or providing a general benefit increase under this title (as defined in section 215(i)(3))".

* * * * *

INCREASE IN EARNINGS BASE

SEC. 5. (a)(1) Section 209(a)(8) of the Social Security Act is amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(2) Section 211(b)(1)(H) of such Act is amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(3) Sections 213(a)(2)(ii) and 213(a)(2)(iii) of such Act are each amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(4) Section 215(e)(1) of such Act is amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(b)(1) Section 1402(b)(1)(H) of the Internal Revenue Code of 1954 (relating to definition of self-employment income) is amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(2) Effective with respect to remuneration paid after 1973, section 3121(a)(1) of such Code is amended by striking out the dollar amount each place it appears therein and inserting in lieu thereof "$13,200".

(3) Effective with respect to remuneration paid after 1973, the second sentence of section 3122 of such Code is amended by striking out the dollar amount and inserting in lieu thereof "$13,200".

(4) Effective with respect to remuneration paid after 1973, section 3125 of such Code is amended by striking out the dollar amount each place it appears in subsections (a), (b), and (c) and inserting in lieu of "$13,200".

(5) Section 6413(c)(1) of such Code (relating to special refunds of employment taxes) is amended by striking out "$12,600" each place it appears and inserting in lieu thereof "$13,200"

(6) Section 6413(c)(2)(A) of such Code (relating to refunds of employment taxes in the case of Federal employees) is amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(7) Effective with respect to taxable years beginning after 1973, section 6654(d)(2)(B)(ii) of such Code (relating to failure by individual to pay estimated income tax) is amended by striking out the dollar amount and inserting in lieu thereof "$13,200".

(c) Section 230(c) of the Social Security Act is amended by striking

out "$12,600" and inserting in lieu thereof "$13,200".

(d) Paragraphs (2)(C),(3)(C), (4)(C), and (7)(C) of section 203(b) of Public Law 92–336 [1972-2 C.B. 672] are each amended by striking out "$12,600" and inserting in lieu thereof "$13,200".

(e) The amendments made by this section except subsection (a)(4), shall apply only with respect to remuneration paid after, and taxable years beginning after, 1973. The amendments made by subsection (a)(4) shall apply with respect to calendar years after 1973.

(f) The amendments made by this section to provisions of the Social Security Act, the Internal Revenue Code of 1954, and Public Law 92–336 shall be deemed to be made to such provisions as amended by section 203 of Public Law 93-66 [1973-2 C.B. 439].

CHANGES IN TAX SCHEDULES

SEC. 6. (a)(1) Section 3101(a) of the Internal Revenue Code of 1954 (relating to rate of tax on employees for purposes of old-age, survivors, and disability insurance) is amended by striking out paragraphs (4) through (6) and inserting in lieu thereof the following:

"(4) with respect to wages received during the calendar year 1973, the rate shall be 4.85 percent;

"(5) with respect to wages received during the calendar years 1974 through 2010, the rate shall be 4.95 percent; and

"(6) with respect to wages received after December 31, 2010, the rate shall be 5.95 percent."

(2) Section 3111(a) of such Code (relating to rate of tax on employers for purposes of old-age, survivors, and disability insurance) is amended by striking out paragraphs (4) through (6) and inserting in lieu thereof the following:

"(4) with respect to wages paid during the calendar year 1973, the rate shall be 4.85 percent;

"(5) with respect to wages paid during the calendar years 1974 through 2010, the rate shall be 4.95 percent; and

"(6) with respect to wages paid after December 31, 2010, the rate shall be 5.95 percent.".

(b)(1) Section 1401(b) of such Code (relating to rate of tax on self-employment income for purposes of hospital insurance) is amended by striking out paragraphs (2) through (5) and inserting in lieu thereof the following:

"(2) in the case of any taxable year beginning after December 31, 1972, and before January 1, 1974, the tax shall be equal to 1.0 percent of the amount of the self-employment income for such taxable year;

"(3) in the case of any taxable year beginning after December 31, 1973, and before January 1, 1978, the tax shall be equal to 0.90 percent of the amount of the self-employment income for such taxable year;

"(4) in the case if any taxable year beginning after December 31, 1977, and before January 1, 1981, the tax shall be equal to 1.10 percent of the amount of the self-employment income for such taxable year;

"(5) in the case of any taxable year beginning after December 31, 1980, and before January 1, 1986, the tax shall be equal to 1.35 percent of the amount of the self-employment income for such taxable year; and

"(6) in the case of any taxable year beginning after December 31, 1985, the tax shall be equal to 1.50 percent of the self-employment income for such taxable year."

(2) Section 3101(b) of such Code (relating to rate of tax on employees for purposes of hospital insurance) is amended by striking out paragraphs (2) through (5) and inserting in lieu thereof the following:

"(2) with respect to wages received during the calendar year 1973, the rate shall be 1.0 percent;

"(3) with respect to wages received during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

"(4) with respect to wages received during the calendar years 1978 through 1980, the rate shall be 1.10 percent;

"(5) with respect to wages received during the calendar years 1981 through 1985, the rate shall be 1.35 percent; and

"(6) with respect to wages received after December 31, 1985, the rate shall be 1.50 percent.".

(3) Section 3111(b) of such Code (relating to rate of tax on employers for purposes of hospital insurance) is amended by striking out paragraphs (2) through (5) and inserting in lieu thereof the following:

"(2) with respect to wages paid during the calendar year 1973, the rate shall be 1.0 percent;

"(3) with respect to wages paid during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

"(4) with respect to wages paid during the calendar years 1978 through 1980, the rate shall be 1.10 percent;

"(5) with respect to wages paid during the calendar years 1981 through 1985, the rate shall be 1.35 percent; and

"(6) with respect to wages paid after December 31,1985 the rate shall be 1.50 percent.".

(c) The amendment made by subsection (b)(1) shall apply only with respect to taxable years beginning after December 31, 1973. The remaining amendments made by this section shall apply only with respect to remuneration paid after December 31, 1973.

* * * * *

CLERICAL AND CONFORMING AMENDMENTS TO SOCIAL SECURITY ACT

In General

Inclusion of All Wage Level Increases in Automatic Adjustment of Earnings Test

SEC. 18. (a) Section 203(f)(8)(B)(ii) of the Social Security Act is amended by—

(1) striking out "contribution and benefit base" and inserting "exempt amount" in lieu thereof; and

(2) striking out "section 230(a)" and inserting "subparagraph (A)" in lieu thereof.

* * * * *

Approved December 31, 1973.

Public Law 93-236
93rd Congress, H.R. 9142 [1]
January 2, 1974

An Act to authorize and direct the maintenance of adequate and efficient rail services in the Midwest and Northeast region of the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act, divided into titles and sections according to the following table of contents, may be cited as the "Regional Rail Reorganization Act of 1973".

* * * * *

TITLE II—UNITED STATES RAILWAY ASSOCIATION

FORMATION AND STRUCTURE

SEC. 201. (a) ESTABLISHMENT.—There is established, in accordance with the provisions of this section, an incorporated nonprofit association to be known as the United States Railway Association.

(b) ADMINISTRATION.—The Association shall be directed by a Board of Directors. The individuals designated pursuant to subsection (d)(2) of this section, as the Government members of such Board shall be deemed the incorporators of the Association and shall take whatever steps are necessary to establish the Association, including filing of articles of incorporation, and serving as an acting Board of Directors for a period of not more than 45 days after the date of incorporation of the Association.

(c) STATUS.— The Association shall be a government corporation of the District of Columbia subject, to the extent not inconsistent with this title, to the District of Columbia Nonprofit Corporation Act (D.C. Code, sec. 29–1001 et seq.). Except as otherwise provided, employees of the Association shall not be deemed employees of the Federal Government. The Association shall have succession until dissolved by Act of Congress, shall maintain its principal office in the District of Columbia and shall be deemed to be a resident of the District of Columbia with respect to venue in any legal proceeding.

(d) BOARD OF DIRECTORS.—The Board of Directors of the Association shall consist of 11 individuals as follows:

(1) the Chairman, a qualified individual who shall be appointed by the President, by and with the advice and consent of the Senate;

(2) three Government members, who shall be the Secretary, the Chairman of the Commission, and the Secretary of the Treasury, or their duly authorized representatives; and

(3) seven nongovernment members, who shall be appointed by the President, by and with the advice and consent of the Senate, on the following basis—

(A) one to be selected from a list of qualified individuals recommended by the Association of American Railroads or its successor who are representatives of profitable railroads;

(B) one to be selected from a list of qualified individuals recommended by the American Federation of Labor and Congress of Industrial Organizations or its successor who are representative of railroad labor;

(C) one to be selected from a list of qualified individuals recommended by the National Governors Conference;

(D) one to be selected from a list of qualified individuals recommended by the National League of Cities and Conference of Mayors;

(E) two to be selected from lists of qualified individuals recommended by shippers and organizations representative of significant shipping interests including small shippers;

(F) one to be selected from lists of qualified individuals recommended by financial institutions, the financial community, and recognized financial leaders.

As used in this paragraph, a list of qualified individuals shall consist of not less than three individuals.

Except for the members appointed under paragraphs (1) and (3)(A), (B), (E), and (F), no member of the Board may have any employment or other direct financial relationship with any railroad. A member of the Board who is not otherwise an employee of the Federal Government may receive $300 per diem when engaged in the actual performance of his duties plus reimbursement for travel, subsistence, and other necessary expenses incurred in the performance of such duties.

GENERAL POWERS AND DUTIES OF THE ASSOCIATION

SEC. 202 (a) GENERAL.—* * *

* * * * *

(d) EXEMPTION FROM TAXATION.—The Association, including the franchise, capital reserves, surplus, security holdings, and income shall be exempt from all taxation now or hereafter imposed by the United States, any commonwealth, territory, dependency, or possession thereof, or by any State or political subdivision thereof, except that any real property of the Association shall be subject to taxation to the same extent according to its value as other real property is taxed.

* * * * *

TITLE III—CONSOLIDATED RAIL CORPORATION

FORMATION AND STRUCTURE

SEC. 301. (a) ESTABLISHMENT.—There shall be established within 300

[1] This publication of the law is restricted to excerpts involving tax matters; House Report No. 93-620 and Conference Report No. 93-744 are not published.

days after the date of enactment of this Act, in accordance with the provisions of this section, a corporation to be known as the Consolidated Rail Corporation.

(b) STATUS.—The Corporation shall be a for-profit corporation established under the laws of a State and shall not be an agency or instrumentality of the Federal Government. The Corporation shall be deemed a common carrier by railroad under section 1(3) of the Interstate Commerce Act (49 U.S.C. 1(3)), shall be subject to the provisions of this Act and, to the extent not inconsistent with such Acts, shall be subject to applicable State law. The principal office of the Corporation shall be located in Philadelphia in the Commonwealth of Pennsylvania.

(c) INCORPORATION.—The members of the executive committee of the Association shall be the incorporators of the Corporation and shall take whatever steps are necessary to establish the Corporation, including the filing of articles of incorporation. The incorporators shall also serve as the Board of Directors of the Corporation until the stock and other securities of the Corporation are distributed to the estates of the railroads in accordance with section 303(c) of this title and shall adopt the initial bylaws of the Corporation.

* * * * *

EMPLOYMENT OFFERS

SEC. 502. (a) APPLICABLE LAW.—The Corporation and, where applicable, the Association shall be subject to the provisions of the Railway Labor Act and shall be considered employers for purposes of the Railroad Retirement Act, Railroad Retirement Tax Act, and the Railroad Unemployment Insurance Act. The Corporation, in addition, shall, except as otherwise specifically provided by this Act, be subject to all Federal and State laws and regulations applicable to carriers by railroad.

* * * * *

Approved January 2, 1974.

Subpart C.—Committee Reports

House Report No. 93-627

[Bracketed numerals indicate official report page numbers.]

SOCIAL SECURITY BENEFIT INCREASE

NOVEMBER 9, 1973

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following report together with dissenting, minority, and additional minority views to accompany H.R. 11333.[1]

The Committee on Ways and Means, to whom was referred the bill (H.R. 11333) to provide a 7-percent increase in social security benefits beginning with March 1974 and an additional 4-percent increase beginning with June 1974, to provide increases in supplemental security income benefits, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass. [3]

I. PURPOSE AND SCOPE OF THE BILL

Public Law 93-66 [1973-2 C.B. 439], enacted in July 1973, would provide a 5.9-percent cost-of-living increase applicable only to social security benefits payable for June 1974 through December 1974. This benefit increase was enacted as an advance payment of a portion of the first automatic benefit increase, which would be effective for January 1975. In addition, Public Law 93-66 provided that payments under the supplemental security income (SSI) program, which will replace the State programs of aid to the aged, blind, and disabled beginning January 1, 1974, would be increased from $130 for a single individual and $195 for a couple, to $140 and $210 effective with July 1974 (payable early in July).

Since the enactment of Public Law 93-66 early in July, the cost-of-living index—particularly those elements which have the greatest effect on individuals not in the labor force, such as the price of food—has risen more rapidly than at any time since the post-World War II period. In the 3 months' time, July, August, and September, the index has risen at a seasonally adjusted annual rate of 10.3 percent and the food component of the index has risen at a seasonally adjusted annual rate of 28.8 percent. Your committee believes, therefore, that Congress should act now both to provide assurance to beneficiaries that the social security and supplemental security income programs are responsive to changing needs by improving benefits as quickly as possible, and to maintain confidence in the fiscal integrity of the system by improving the actuarial soundness of the program.

Your committee's bill would provide for a flat 7-percent social security benefit increase for March 1974 (reflected in the checks received early in April) which would be a partial advance payment of a permanent 11-percent benefit increase effective for June 1974 (reflected in the checks payable early in July 1974).

Your committee's bill would also bring the long-range actuarial deficit of the system within acceptable limits by increasing the annual amount of earnings subject to tax and creditable for benefits and by making small increases and adjustments in the social security tax schedule.

In addition, your committee's bill provides that SSI benefits would be increased from $130 to $140 for a single individual and from $195 to $210 for a couple effective in January 1974 (reflected in the checks received in January). A further increase of $6 for a single individual and $9 for a couple would be effective in July 1974 (reflected in the checks received in July).

II. PRINCIPAL PROVISIONS OF THE BILL

The bill would provide a two-step,

[1] Pub. L. 93-233, page 380.

11-percent cost-of-living increase in social security benefits. The first step would be an interim 7-percent increase in benefits payable for March 1974 (the check received in April), while the second step would make the full 11-percent increase

[4]

payable with the June 1974 benefits (the check received in July). Under the bill, the minimum benefit would be increased from $84.50 to $90.50 a month for March through May 1974 and to $93.80 per month for months after May 1974. The average old-age benefit payable for March would rise from $167 to $178 per month and then to $186 a month for June 1974, and the average benefit for an aged couple would increase from $277 to $296 per month for March and to $310 for June 1974. Average benefits for aged widows would increase from $158 to $169 for March and to $177 for June 1974.

Special benefits for persons age 72 and over who are not insured for regular benefits would be increased for individuals from $58 to $62.10 a month for March through May 1974 and to $64.40 per month for June 1974, and for couples from $87 a month to $93.20 a month for March through May and to $96.60 per month for June 1974 and after.

ESTIMATED EFFECT OF SPECIAL BENEFIT INCREASE OF 7 PERCENT, EFFECTIVE MARCH 1974 AND PERMANENT 11-PERCENT INCREASE EFFECTIVE JUNE 1974, ON AVERAGE MONTHLY BENEFIT AMOUNTS IN CURRENT-PAYMENT STATUS FOR SELECTED BENEFICIARY GROUPS

Beneficiary group	Average monthly amount		
	Before 7-percent increase	After 7-percent increase	After 11-percent increase
1. Average monthly family benefits:			
Retired worker alone (no dependents receiving benefits)	$162	$173	$181
Retired worker and aged wife, both receiving benefits)	277	296	310
Disabled worker alone (no dependents receiving benefits)	179	191	199
Disabled worker, wife, and 1 or more children	363	388	403
Aged widow alone	158	169	177
Widowed mother and 2 children	390	417	433
2. Average monthly individual benefits:			
All retired workers (with or without dependents also receiving benefits)	167	178	186
All disabled workers (with or without dependents also receiving benefits)	184	197	206

The provision for automatically adjusting benefits to increases in the cost of living enacted in July 1972 is also modified by the bill so that automatic benefit increases would take effect for June rather than January of each year. The first automatic benefit increase possible would take effect in June 1975 rather than January 1975 as under present law.

The bill would also increase from $8.50 to $9 the amount payable under the special minimum benefit provision for each year of coverage in excess of 10, but not more than 30. Thus, the highest special minimum would increase from $170 to $180 for workers with 30 or more years of coverage.

Approximately 30 million beneficiaries would become entitled to higher payments for March 1974. About $2.4 billion in additional benefits would be paid in calendar year 1974.

The bill provides modifications in the financing of the social security system in order to reduce the long-range actuarial deficit of the system. The amount of annual earnings subject to the tax and creditable for benefits would be increased from $12,600 to $13,200 effective January 1974. The tax schedule would be modified as indicated in the table on page 386:

[5] SOCIAL SECURITY TAX RATES FOR EMPLOYERS, EMPLOYEES, AND SELF-EMPLOYED PERSONS UNDER PRESENT LAW AND COMMITTEE BILL

[In percent]

	Present law						Committee bill					
	Employer and employee, each			Self-employed			Employer and employee, each			Self-employed		
	OASDI	HI	Total	OASDI	HI	Total	OASDI	HI	Total	OASDI	HI	Total
1974 through 1977	4.85	1.00	5.85	7.0	1.00	8.00	4.95	0.90	5.85	7.0	0.90	7.90
1978 through 1980	4.80	1.25	6.05	7.0	1.25	8.25	4.95	1.10	6.05	7.0	1.10	8.10
1981 through 1985	4.80	1.35	6.15	7.0	1.35	8.35	4.95	1.35	6.30	7.0	1.35	8.35
1986 through 2010	4.80	1.45	6.25	7.0	1.45	8.45	4.95	1.50	6.45	7.0	1.50	8.50
2011 plus	5.85	1.45	7.30	7.0	1.45	8.45	5.95	1.50	7.45	7.0	1.50	8.50

The bill advances increases under the SSI program of $10 for an individual and $15 for a couple which would be effective in July 1974, under Public Law 93–66 to the initial payments which will be made under that program in January 1974. Your committee's bill provides further increases of $6 for an individual and $9 for a couple in July 1974, when the second portion of the increase in social security benefits would be paid.

III. GENERAL DISCUSSION

A. Background Information on Existing Legislation

Public Law 92–336 [1972-2 C.B. 672], enacted in July of 1972, contained provisions to increase social security benefits by 20 percent for September 1972 and to increase benefits automatically in the future in proportion to increases in the cost of living. Generally speaking, if the cost of living rises by at least 3 percent between the base periods specified in the law, social security benefits are increased under these provisions by the same percentage as the increase in the cost of living. Each of the benefit increases becomes effective for the January following the year in which the rise in the cost of living is computed. The first of the cost-of-living increases under the provisions of present law cannot take effect until January 1975.

Public Law 93–66, enacted in July of 1973, provided for a special 5.9 percent cost-of-living increase applicable only to benefits payable for June 1974 through December 1974. This increase, which was based upon the increase in the cost of living in the 12-month period between June 1972 and June 1973, was enacted as an advance payment of a portion of the first automatic benefit increase which would be effective for January of 1975. Under it, the 5.9 percent advance benefit increase would, in effect, be deducted from the automatic increase that would be payable for January 1975.

The estimated amount of the automatic benefit increase that would be payable for January of 1975 has been increased on several occasions since Public Law 92–336 was enacted. When the Social Security Amendments of 1972 (Public Law 92–603) [1972-2 C.B. 703] were enacted a little over a year ago, the amount of the automatic benefit increase for January 1975 was estimated to be 5.1 percent. When Public Law 93–66 was enacted in July of 1973, it was estimated that the first automatic benefit increase would be between 7.1 percent and 8.5 percent, as a result of continued high increases in the cost of living. The amount of the automatic benefit increase for January 1975 is now estimated to be

[6]

11.5 percent. These several revisions, which reflect higher increases in living costs than earlier expected, have significant effects upon future social security trust fund balances.

The estimated long-range deficit of the present old-age, survivors, and disability insurance (OASDI) system (over the 75-year period used for making such estimates) is now −0.76 percent of payroll, up from −0.32 percent shown in the trustees report submitted to Congress in July 1973.

* * * * *

C. Changes in the Automatic Benefit Adjustment Provisions

Under present law, the cost of living for the automatic benefit increase provisions is measured from the second quarter of one year to the second quarter of the next year with any benefit increase payable for the following January. This results in a 7-month lag between the end of the period which is used to determine the rise in the cost-of-living for an automatic benefit increase and the payment of such increase. (The January check is actually received in February, 7 months after the close of the second calendar quarter.)

Your committee believes that an increase under the automatic benefit adjustment provisions of the law should reflect the rise in the

[7]

cost of living as closely as possible. In order to achieve this purpose, the

bill would change the automatic adjustment provisions of the law to provide that future benefit increases be computed on the basis of the Consumer Price Index for the first calendar quarter rather than the second calendar quarter of the year as under present law and that the resulting automatic benefit increase be effective for June of the year in which a determination to increase benefits is made. This would reduce the lag between the end of the calendar quarter used to measure the rise in the cost of living and the payment of the resulting benefit increase from 7 months to 3 months. It would also mean that automatic benefit increases in the future would be payable in the month in which any revised premiums under the supplemental medical insurance program would be effective, thus providing the opportunity to make both adjustments in benefit checks at the same time.

Since the 11-percent benefit increase provided for in the bill approximately reflects the estimated rise in the cost of living into the second calendar quarter of 1974, the bill provides specifically that for purposes of determining the first automatic benefit increase effective for June 1975, the increase in living costs would be determined from the second calendar quarter of 1974 to the first calendar quarter of 1975.

These changes would not affect the automatic adjustment provisions relating to the contribution and benefit base and the earnings limitation, except that these increases would occur periodically in January following a June benefit increase rather than in the same January for which benefits would be increased under present law. The bill specifically provides that the 11-percent benefit increase for June of 1974 provided for by the bill shall be considered an automatic benefit increase for purposes of permitting an automatic increase in the contribution and benefit base and the earnings limitation effective beginning January, 1975.

* * * * *

SECTION-BY-SECTION ANALYSIS OF THE BILL

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Section 3. Modification of Cost-of-Living Benefit Increase Provisions

Section 3 of the bill changes the automatic adjustment provisions enacted by Public Law 92–336, so that (except in the case of the first adjustment, discussed below) the basic measuring quarter for determining the increase in the consumer price index which is to be reflected in an automatic increase in benefits will be the first calendar quarter of each year rather than the second, and the increases provided will be effective for June of the year in which the determination of the increase is made rather than for the following January. The amount of the increase would still be measured from the later of the last quarter in which a legislated benefit increase became effective and the last quarter which previously triggered an automatic benefit increase. The earliest month for which an automatic benefit increase could be effective would be June 1975; and the increase in the consumer price index will be measured from the second quarter of 1974 through the first quarter of 1974 to determine the amount of such benefit increase. The requirement that the appropriate committees of the Congress be notified by August 15 of the year prior to the January effective date of an automatic benefit increase, with promulgation of a table for computing the new benefits by November 1 prior to that January, is changed so that notification to the Congress must be accomplished within 30 days after the close of the quarter which triggered an increase and the table for computing the new benefits must be promulgated within 45 days of the close of that quarter.

Automatic benefit increase

Section 3(a) of the bill amends section 215(i)(1)(A)(i) of the Social Security Act to provide that base quarters (the quarters used to measure the increase in the consumer price index) are defined as the first quarter in each year after 1974, rather than the second quarter in each year after 1972 as under present law. The quarter in which a legislated increase becomes effective remains a base quarter.

Section 3(b) of the bill amends section 215(i)(1)(B) of the act to provide that no automatic increase in benefits can take place if in the prior year a legislated general benefit increase was enacted or became effective, thereby reflecting the change in the measuring quarter from the second quarter of the year prior to the automatic increase to the first quarter of the year of the increase.

Section 3(c) of the bill amends section 215(i)(2)(A)(i) to require the Secretary to make the automatic determinations each year beginning in 1975, rather than beginning in 1974.

Section 3(d) of the bill amends section 215(i)(2)(A)(ii) of the act to reflect the change in the measuring quarter and effective date of the automatic benefit increases.

Section 3(e) of the bill amends section 215(i)(2)(B) of the act to make the automatic increases effective with June of a particular year, rather than the following January as under present law.

Section 3(f) of the bill amends section 215(i)(2)(C)(ii) of the act to provide that Congress is to be notified within 30 days after the close of the base quarter which triggers an increase—by the end of April of the year in which the increase occurs—rather than by August 15 of the year prior to the year of the increase.

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Section 3(g) of the bill amends section 215(i)(2)(D) of the act to provide that a new table of benefits to effectuate an automatic benefit in-

crease must be promulgated within 45 days after the close of the base quarter which triggers an increase—by mid-May of the year in which the increase occurs—rather than by November 1 of the year prior to the year of the increase.

Section 3(h) of the bill amends section 215(i)(2) of the act by striking out subparagraph (E), the provision which under present law detriggers a benefit increase if a legislated benefit increase is enacted or becomes effective in the year in which a determination is made that an automatic increase in benefits is required.

Section 3(i) of the bill provides that the 11-percent increase in benefits effective for June 1974 will be considered to be an automatic benefit increase for purposes of section 203(f)(8) (the automatic retirement test provision), section 230(a) (the automatic contribution and benefit base provision), and section 215(i)(1)(B) (the detrigger mechanism in the automatic benefit increase provision). With this change, it will be possible to have an automatic increase in the retirement test exempt amount, in the contribution and benefit base, and in benefits effective in 1975.

Automatic contribution and benefit base increases

Section 3(j)(1)(A) of the bill amends section 230(a) of the act—the provision governing the automatic adjustment of the contribution and benefit base—to provide that the base can be increased automatically only if, in the prior year, benefits were automatically increased.

Section 3(j)(1)(B) of the bill amends section 230(a) of the act to make conforming changes to those made elsewhere in the automatic provisions for benefits—changes reflecting the fact that the table of benefits will not be promulgated by November 1, and that a legislated increase in benefits enacted or effective in the prior year will not detrigger an automatic increase in benefits.

Section 3(j)(2) of the bill makes a conforming change in section 230(c) of the act to reflect the change in the effective date for automatic benefit increases from January to June.

Automatic retirement test increases

Section 3(k) of the bill makes conforming changes in the retirement test automatic adjustment provisions of the law.

Section 3(k)(1) of the bill amends section 203(f)(8)(A) of the act, dealing with the requirement that the Secretary publish in the Federal Register notification of forthcoming increases in the retirement test exempt amount under section 203(f), in order to delete references to the publication of benefit increases under section 215(i).

Section 3(k)(2) of the bill amends section 203(f)(8)(B) of the act by providing that the House Committee on Ways and Means and the Senate Committee on Finance are to be notified of the estimated amount of a forthcoming increase in the exempt amount, and given related actuarial information, within 30 days after the close of the base quarter (as defined in section 215(i)(1)(A)). Under present law, such notice and related information must be given no later than August 15 of the year in which such base quarter occurs.

Section 3(k)(3) of the bill amends section 203(f)(8)(C) so that enactment of a general benefit increase during a year in which a determination is made that an increase in the exempt amount is

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required will not prevent such increase in the exempt amount from going into effect.

Section 4. Supplemental Security Income Benefits

Section 4(a)(1) of the bill amends section 210(c) of Public Law 93–66 to provide that the supplemental security income benefit rates of $1,680 per year for an eligible individual and $2,520 per year for an eligible individual who has an eligible spouse are to become effective beginning with January 1974 instead of July 1974.

Section 4(a)(2) of the bill amends section 211(a)(1)(A) of Public Law 93–66 to provide that the $840 per year supplemental security income benefit amount with respect to essential persons is to become effective beginning with January 1974 instead of July 1974.

Section 4(b)(1) of the bill amends section 1611(a)(1)(A) and section 1611(b)(1) of the Social Security Act (as enacted by section 301 of the Social Security Amendments of 1972 and amended by section 210 of Public Law 93–66) to increase from $1,680 to $1,752 per year the supplemental security income benefit rate for an eligible individual, effective for months beginning with July 1974.

Section 4(b)(2) of the bill amends section 1611(a)(2)(A) and section 1611(b)2) of the act (as so enacted and amended) to increase from $2,520 to $2,628 per year the benefit rate for an eligible individual who has an eligible spouse, effective for months beginning with July 1974.

Section 4(b)(3) of the bill amends section 211(a)(1)(A) of Public Law 93–66 (as amended by section 4(a)(2) of the bill) to increase the benefit amount with respect to essential persons from $840 to $876 per year effective for months beginning with July 1974.

Section 4(c) of the bill amends section 401(b)(1) of the Social Security Amendments of 1972 to provide that for purposes of the limitation on fiscal liability of States for State supplementation, States may increase their adjusted payment levels for months in the calendar year 1974 by the amounts by which supplemental security income benefit levels are increased by section 210(c) of Public Law 93-66 as amended by section 4(a)(1) of the bill (i.e., by $10 in the case of an individual and $15 in the case of a couple).

Section 5. Increase of Earnings Counted for Benefit and Tax Purposes

Section 5 of the bill amends various provisions of the Social Security Act and the Internal Revenue Code of 1954 to increase the amount of annual earnings that is subject to social security contributions and counted toward social security benefits (the contribution and benefit base) from $12,600 to $13,200 for 1974 (subject to automatic increases thereafter).

Amendments to title II of the Social Security Act

Definition of wages

Section 5(a)(1) of the bill amends section 209(a)(8) of the Social Security Act (defining "wages" for benefit purposes) to make the $13,200 contribution and benefit base applicable to wages paid in the calendar year 1974.

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Definition of self-employment income

Section 5(a)(2) of the bill amends section 211(b)(1)(H) of the act (defining "self-employment income" for benefit purposes) to make the $13,200 contribution and benefit base applicable for taxable years beginning after 1973 and before 1975.

Quarter of coverage

Section 5(a)(3) of the bill amends clauses (ii) and (iii) of section 213(a)(2) of the act (defining "quarter of coverage") to provide that an individual will be credited with a quarter of coverage for each quarter of the calendar year 1974 if his wages for such year equal $13,200 (rather than $12,600 as in present law). An individual will also be credited with a quarter of coverage for each quarter any part of which falls within a taxable year which begins after 1973 and before 1975 and in which the sum of his wages and self-employment equals $13,200.

Average monthly wage

Section 5(a)(4) of the bill amends section 215(e)(1) of the act (relating to the amount of annual earnings that can be counted in computing a person's average monthly wage) to increase from $12,600 to $13,200, effective for the calendar year 1974, the maximum amount, of annual earnings that may be counted in the computation of a person's average monthly wage for purposes of determining benefit amounts.

Amendments to the Internal Revenue Code of 1954

Definition of self-employment income

Section 5(b)(1) of the bill amends section 1402(b)(1)(H) of the Internal Revenue Code of 1954 (defining "self-employment income" for social security tax purposes) by increasing from $12,600 to $13,200 the amount of annual self-employment income which is subject to social security contributions for taxable years beginning after 1973 and before 1975.

Definition of wages

Section 5(b)(2) of the bill amends section 3121(a)(1) of the code (defining "wages" for social security tax purposes) by increasing from $12,600 to $13,200 the amount of annual wages subject to contributions, effective for the calendar year 1974.

Federal service

Section 5(b)(3) of the bill amends section 3122 of the code (relating to Federal service) to conform its provisions to the increase in the contribution and benefit base from $12,600 to $13,200.

Returns in the case of certain governmental employees

Section 5(b)(4) of the bill amends section 3125 of the code (relating to returns in the case of governmental employees in Guam, American Samoa, and the District of Columbia) to conform its provisions to the increase in the contribution and benefit base from $12,600 to $13,200.

Special refunds of employee contributions

Section 5(b)(5) and 5(b)(6) of the bill amend section 6413(c)(2)(A) of the code (relating to special refunds of social security contributions paid by an employee who in any calendar year had more than one employer and had total wages in excess of the maximum which may be counted) to conform the special refund provisions to the $13,200 contribution and benefit base.

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Estimated tax on self-employment income

Section 5(b)(7) of the bill amends section 6654(d)(2)(B)(ii) of the code (relating to failure to pay estimated income tax on adjusted self-employment income) to conform to the increase in the contribution and benefit base from $12,600 to $13,200.

Automatic adjustment of the contribution and benefit base

Section 5(c) of the bill amends section 230(c) of the Social Security Act to change the definition of the "contribution and benefit base" from $12,600 to $13,200 prior to 1975 or the first time an automatic increase in the amount becomes effective.

Conforming changes for purposes of the automatic provision for increasing the base

Section 5(d) of the bill amends present law by increasing from $12,600 to $13,200 the amount of the contribution and benefit base which will be in effect prior to the first automatic base increase.

Effective dates

Section 5(e) provides effective dates for the changes made by the section. The amendments made by section 5 (except subsection (a)(4) thereof) are applicable with respect to remuneration paid after, and taxable years beginning after, 1973; the amendments made by subsection 5(a)(4) (relating to the amount of earnings creditable for social security benefits) will apply with respect to the calendar year 1974.

Technical provision

Section 5(f) of the bill provides that the amendments made by the section to the Social Security Act, the

Internal Revenue Code of 1954, and Public Law 92–336 are deemed to be made to those provisions as they were amended by section 203 of Public Law 93–66.

Section 6. Changes in Tax Schedules

Section 6 of the bill provides new schedules of social security tax rates for old-age, survivors, and disability insurance and for hospital insurance.

Old-age, survivors, and disability insurance rates

Section 6(a) of the bill amends sections 3101(a) and 3111(a) of the Internal Revenue Code of 1954 to provide new schedules of old-age, survivors, and disability insurance tax rates for both employees and employers. Under present law, these tax rates for the years involved are as follows:

Calendar years:	*Percent*
1974 through 1977	4.85
1978 through 2010	4.80
2011 and after	5.85

Under the bill, the corresponding tax rates are as follows:

Calendar years:	*Percent*
1974 through 2010	4.95
2011 and after	5.95

Hospital insurance rates

Section 6(b) of the bill amends sections 1401(b), 3101(b), and 3111(b) of the code to provide new schedules of hospital insurance tax rates for the self-employed as well as for both employees and

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employers. Under present law, these tax rates for the years involved (for purposes of the tax on self-employment income as well as the taxes on wages) are as follows:

Calendar years (for purposes of wages) and taxable years beginning in (for purposes of self-employment income):	*Percent*
1974 through 1977	1.00
1978 through 1980	1.25
1981 through 1985	1.35
1986 and after	1.45

Under the bill, the corresponding tax rates are as follows:

Calendar years (for purposes of wages) and taxable years beginning in (for purposes of self-employment income):	*Percent*
1974 through 1977	0.90
1978 through 1980	1.10
1981 through 1985	1.35
1986 and after	1.50

Effective dates

Section 6(c) of the bill provides that the amendment made by section 6(b)(1) is to apply with respect to taxable years which begin after December 31, 1973, and that the remaining amendments made by section 6 are to apply with respect to remuneration paid after December 31, 1973.

Part V. Administrative, Procedural, and Miscellaneous Matters

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Part V. Administrative, Procedural, and Miscellaneous Matters

Ct. D. 1960

Supreme Court of the United States
No. 72-985

The California Bankers Association, Appellant, v. George P. Shultz, Secretary of the Treasury, et al.

No. 72-1073

George P. Shultz, Secretary of the Treasury, et al., Appellants, v. The California Bankers Association, et al.

No. 72-1196

Fortney H. Stark, Jr., et al., Appellants, v. George P. Shultz, et al.

[416 U.S. 21]

On Appeals from the United States District Court for the Northern District of California.

[April 1, 1974]

Syllabus

The Bank Secrecy Act of 1970 [Pub. L. 91-508, 1971-1 C.B. 523], which was enacted following extensive hearings concerning the unavailability of foreign and domestic bank records of customers thought to be engaged in illegal activities, authorizes the Secretary of the Treasury to prescribe by regulation certain bank recordkeeping and reporting requirements, the Act's penalties attaching only upon violation of the regulations thus prescribed. (Unless otherwise indicated, references below to the Act also include the accompanying regulations.) The Act is designed to obtain financial information having "a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." Title I of the Act requires financial institutions to maintain records of their customers' identities, to make microfilm copies of checks and similar instruments, and to keep records of certain other items. Title II of the Act requires the reporting to the Federal Government of certain foreign and domestic financial transactions. Title II, § 231, requires reports of the transportation of currency and specified instruments exceeding $5,000 into or out of the country, exception being made, *inter alia,* for banks and security dealers. Section 241 requires individuals with bank accounts or other relationships with foreign banks to provide specified information on a tax return form. Section 221 delegates to the Secretary of the Treasury the authority to require reports of transactions "if they involve the payment, receipt, or transfer of United States currency, or such other monetary instruments as the Secretary may specify . . . ," § 222 providing that he may require such reports from the domestic financial institution involved, the parties to the transaction, or both, and § 223 providing that he may designate financial institutions to receive the reports. Under the implementing regulations only financial institutions must file reports with the Internal Revenue Service (IRS), and then only where the transaction involves the deposit, withdrawal, exchange, or other payment of currency exceeding $10,000. The regulations provide that the Secretary may grant exemptions from the requirements of the regulations. Suits were brought by various plaintiffs challenging the constitutionality of the Act, principally on the ground that it violated the Fourth Amendment, because when the bank makes and keeps records under compulsion of the Secretary's regulations it acts as a Government agent and thereby engages in a "seizure" of its customer's records. A three-judge District Court, though upholding the recordkeeping requirements of Title I of the Act and the foreign transaction reporting requirements of Title II, concluded that the domestic reporting provisions of Title II, §§ 221-223, contravened the Fourth Amendment, and enjoined their enforcement. Three separate appeals were taken. In No. 72-985, the California Bankers Association, a plaintiff below, asserts that Title I's recordkeeping provisions violate (1) due process, because there is no rational relationship between the Act's objectives and the required recordkeeping and because the Act is unduly burdensome, and (2) rights of privacy. In No. 27-1196, a bank plaintiff, certain plaintiff depositors, and the American Civil Liberties Union (ACLU), also a plaintiff, as a depositor in a bank subject to the recordkeeping requirements and as a representative of its bank customer members, attack both the Title I recordkeeping requirements and the Title II foreign financial transaction reporting requirements on Fourth Amendment grounds; on Fifth Amendment grounds, as violating the privilege against compulsory self-incrimination; and on First Amendment grounds, as violating free speech and free association rights. In No. 72-1073, the United States asserts that the District Court erred in holding Title II's domestic financial transaction reporting requirements facially invalid without considering the actual implementation of the statute by the regulations. *Held:*

1. Title I's recordkeeping requirements, which are a proper exercise of Congress' power to deal with the problem of crime in interstate and foreign commerce, do not deprive the bank plaintiffs of due process of law.

(a) There is a sufficient nexus between the evil Congress sought to address and the recordkeeping procedure to meet the requirements of the Due Process Clause of the Fifth Amendment, and the fact that banks are not mere bystanders in transactions involving negotiable instruments but have a substantial stake in their availability and acceptance and are the most easily identifiable party to the instruments, make it appropriate for the banks rather than others to do the recordkeeping. *United States* v. *Darby,* 312 U. S. 100; *Shapiro* v. *United States,* 335 U. S. 1.

(b) The cost burdens on the banks of the recordkeeping requirements are not unreasonable.

(c) The bank plaintiffs claim that the recordkeeping requirements undermine the right of a depositor effectively to challenge an IRS third-party summons is premature, absent the issuance of such process involving a depositor's transactions.

2. Title I's recordkeeping provisions do not violate the Fourth Amendment rights of either the bank or depositor plaintiffs, the mere maintenance by the bank of records without any requirement that they be disclosed to the Government (which can secure access only by existing legal process) constituting no illegal search and seizure.

3. Title I's recordkeeping provisions do not violate the Fifth Amendment rights of either the bank or depositor plaintiffs.

(a) The bank plaintiffs, being corporations, have no constitutional privilege against compulsory self-incrimination by virtue of the Fifth Amendment. *Hale* v. *Henkel,* 201 U. S. 43, 74-75.

(b) A depositor plaintiff incriminated by evidence produced by a third party sustains no violation of his own Fifth Amendment rights. *Johnson* v. *United States,* 228 U. S. 457, 458; *Couch* v. *United States,* 409 U. S. 322, 328 [Ct. D. 1955, 1973-1 C.B. 609].

4. The ACLU's claim that Title I's recordkeeping requirements violate its members' First Amendment rights since the challenged provisions could possibly be used to identify its members and contributors (cf. *NAACP* v. *Alabama,* 357 U. S. 440), is premature, the Government having sought no such disclosure here.

5. The reporting requirements in Title II applicable to foreign financial dealings, which single out transactions with the greatest potential for avoiding enforcement of federal laws and which involve substantial sums, do not abridge plaintiffs' Fourth Amendment rights and are well within Congress' powers to legislate with respect to foreign commerce. *Carroll* v. *United States,* 267 U. S. 132, 154; *Almeida-Sanchez* v. *United States,* 413 U. S. 226, 272.

6. The regulations for the reporting by financial institutions of domestic financial transactions, are reasonable and abridge no Fourth Amendment rights of such institutions, which are themselves parties to the transactions involved, since neither "incorporated nor unincorporated associations [have] an unqualified right to conduct their affairs in secret," *United States* v. *Morton Salt Co.,* 338 U. S. 632, 652.

7. The depositor plaintiffs, who do not allege engaging in the type of $10,000 domestic currency transaction requiring reporting, lack standing to challenge the domestic reporting regulations. It is therefore unnecessary to consider contentions made by the bank and depositor plaintiffs that the regulations are constitutionally defective because they do not require the financial institution to notify the customer that a report will be filed concerning the domestic currency transaction.

8. The depositor plaintiffs who are parties in this litigation are premature in challenging the foreign and domestic reporting provisions under the Fifth Amendment.

(a) Since those plaintiffs merely allege that they intend to engage in foreign currency transactions with foreign banks and make no additional allegation that any of the information required by the Secretary will tend to incriminate them, their challenge to the foreign reporting requirements cannot be considered at this time. *Communist Party* v. *SACB,* 367 U. S. 1, 105-110, followed; *Albertson* v. *SACB,* 382 U. S. 70, distinguished.

(b) The depositor plaintiffs' challenge to the domestic reporting requirements are similarly premature, since there is no allegation that any depositor engaged in a $10,000 domestic transaction with a bank that the latter was required to report and no allegation that any bank report would contain information incriminating any depositor. *Marchetti* v. *United States,* 390 U. S. 39 [Ct. D. 1919, 1968-1 C.B. 500]; *Grosso* v. *United States,* 390 U. S. 62 [Ct. D. 1918, 1968-1 C.B. 495]; and *Haynes* v. *United States,* 390 U. S. 85 [Ct. D. 1920, 1968-1 C.B. 615], distinguished.

9. The bank plaintiffs cannot vicariously assert Fifth Amendment claims on behalf of their depositors under the cricumstances present here, since the depositors cannot assert those claims themselves at this time. See para. 8, *supra* P. 47.

10. The contentions of the ACLU that the reporting requirements with respect to foreign and domestic transactions invade its First Amendment associational interests are too speculative and hypothetical to warrant consideration, in view of the fact that the ACLU alleged only that it maintains accounts at a San Francisco bank but not that it regularly engages in abnormally large domestic currency transactions, transports or receives monetary instruments from foreign commercial channels, or maintains foreign bank accounts.

347 F. Supp. 1242, affirmed in part, reversed in part, and remanded.

REHNQUIST, J., delivered the opinion of the Court, in which BURGER, C. J., and STEWART, WHITE, BLACKMUN, and POWELL, JJ., joined. POWELL, J., filed a concurring opinion, in which BLACKMUN, J., joined. DOUGLAS, BRENNAN, and MARSHALL, JJ., filed dissenting opinions.

MR. JUSTICE REHNQUIST delivered the opinion of the Court.

These appeals present questions concerning the constitutionality of the so-called Bank Secrecy Act of 1970, and the implementing regulations promulgated thereunder by the Secretary of the Treasury. The Act, Pub. L. No. 508, 84 Stat. 1114 (1970) [1971-1 C.B. 523], 12 U. S. C. §§ 1829b, 1730d, 1951-1959, and 31 U. S. C. §§ 1051-1122, was enacted by Congress in 1970 following extensive hearings concerning the unavailability of foreign and domestic bank records of customers thought to be engaged in activities entailing criminal or civil liability. Under the Act, the Secretary of the Treasury is authorized to prescribe by regulation certain recordkeeping and reporting requirements for banks and other financial institutions in this country. Because it has a bearing on our treatment of some of the issues raised by the parties, we think it important to note that the Act's civil and criminal penalties attach only upon violation of regulations promulgated by the Secretary; if the Secretary were to do nothing, the Act itself would impose no penalties on anyone.

The express purpose of the Act is to require the maintenance of records, and the making of certain reports, which "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." 12 U. S. C. §§ 1829b(a)(2), 1951; 31 U. S. C. § 1051. Congress was apparently concerned with two major problems in connection with the enforcement of the regulatory, tax, and criminal laws of the United States.[1]

[1] See generally S. Rep. No. 91-1139, 91st Cong., 2d Sess. (1970) [1971-1 C.B. 562]; H. R. Rep. No. 91-975, 91st Cong., 2d Sess. (1970) [1971-1 C.B. 559]; Hearings before the House Committee on Banking and Currency on Foreign Bank Secrecy and Bank Records, 91st Cong., 1st and 2d Sess. (1970); Hearings before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency on Foreign Bank Secrecy (S. 3678), 91st Cong., 2d Sess. (1970).

First, there was a need to insure that domestic banks and financial institutions continued to maintain adequate records of their financial transactions with their customers. Congress found that the recent growth of financial institutions in the United States had been paralleled by an increase in criminal activity which made use of these institutions. While many of the records which the Secretary by regulation ultimately required to be kept had been traditionally maintained by the voluntary action of many domestic financial institutions, Congress noted that in recent years some larger banks had abolished or limited the practice of photocopying checks, drafts, and similar instruments drawn on them and presented for payment. The absence of such records, whether through failure to make them in the first instance or through failure to retain them, was thought to seriously impair the ability of the Federal Government to enforce the myriad criminal, tax, and regulatory provisions of laws which Congress had enacted. At the same time, it was recognized by Congress that such required records would "not be automatically available for law enforcement purposes [but could] only be obtained through existing legal process." S. Rep. No. 91-1139, 91st Cong., 2d Sess., 10 (1970); see H. R. Rep. No. 91-975, 91st Cong., 2d Sess., 5 (1970).

In addition, Congress felt that there were situations where the deposit and withdrawal of large amounts of currency or of monetary instruments which were the equivalent of currency should be actually reported to the Government. While reports of this nature had been requested by previous regulations issued by the Treasury Department, it was felt that more precise and detailed reporting requirements were needed. The Secretary was therefore authorized to require the reporting of what may be described as large domestic financial transactions in currency or its equivalent.

Second, Congress was concerned

about a serious and widespread use of foreign financial institutions, located in jurisdictions with strict laws of secrecy as to bank activity, for the purpose of violating or evading domestic criminal, tax, and regulatory enactments. The House Report on the bill, No. 91-975, *supra,* at 12, described the situation in these words:

"Considerable testimony was received by the Committee from the Justice Department, the United States Attorney for the Southern District of New York, the Treasury Department, the Internal Revenue Service, the Securities and Exchange Commission, the Defense Department and the Agency for International Development about serious and wide spread use of foreign financial facilities located in secrecy jurisdictions for the purpose of violating American law. Secret foreign bank accounts and secret foreign financial institutions have permitted proliferation of 'white collar' crime; have served as the financial underpinning of organized criminal operations in the United States; have been utilized by Americans to evade income taxes, conceal assets illegally and purchase gold; have allowed Americans and others to avoid the law and regulations governing securities and exchanges; have served as essential ingredients in frauds including schemes to defraud the United States; have served as the ultimate depository of black market proceeds from Vietnam; have served as a source of questionable financing for conglomerate and other corporate stock acquisitions, mergers and takeovers; have covered conspiracies to steal from the U. S. defense and foreign aid funds; and have served as a cleansing agent for 'hot' or illegally obtained monies.

* * * * *

"The debilitating effects of the use of these secret institutions on Americans and the American economy are vast. It has been estimated that hundreds of millions in tax revenues have been lost. Unwarranted and unwanted credit is being pumped into our markets. There have been some cases of corporation directors, officers and employees who, through deceit and violation of law, enriched themselves or endangered the financial soundness of their companies to the detriment of their stockholders. Criminals engaged in illegal gambling, skimming, and narcotics traffic are operating their financial affairs with an impunity that approaches statutory exemption.

"When law enforcement personnel are confronted with the secret foreign bank account or the secret financial institution they are placed in an impossible position. In order to receive evidence and testimony regarding activities in the secrecy jurisdiction they must subject themselves to a time consuming and ofttimes fruitless foreign legal process. Even when procedural obstacles are overcome, the foreign jurisdictions rigidly enforce their secrecy laws against their own domestic institutions and employees.

"One of the most damaging effects of an American's use of secret foreign financial facilities is its undermining of the fairness of our tax laws. Secret foreign financial facilities, particularly in Switzerland, are available only to the wealthy. To open a secret Swiss account normally requires a substantial deposit, but such an account offers a convenient means of evading U. S. taxes. In these days when the citizens of this country are crying out for tax reform and relief, it is grossly unfair to leave the secret foreign bank account open as a convenient avenue of tax evasion. The former U. S. Attorney for the Southern District of New York has characterized the secret foreign bank account as the largest single tax loophole permitted by American law."

While most of the recordkeeping requirements imposed by the Secretary under the Act merely require the banks to keep records which most of them had in the past voluntarily kept and retained, and while much of the required reporting of domestic transactions had been required by earlier Treasury regulations in effect for nearly 30 years,[2] there is no denying the impressive sweep of the authority conferred upon the Secretary of the Treasury by the Bank Secrecy Act of 1970 [Pub. L. 91-508, 1971-1 C.B. 523]. While an Act conferring such broad authority over transactions such as these might well surprise or even shock those who lived in an earlier era, the latter did not live to see the time when bank accounts would join chocolate, cheese, and watches as a symbol of the Swiss economy. Nor did they live to see the heavy utilization of our domestic banking system by the minions of organized crime as well as by millions of legitimate businessmen. The challenges made here to the Bank Secrecy Act are directed not to any want of legislative authority in Congress to treat the subject, but instead to the Act's asserted violation of specific constitutional prohibitions.

I

Title I of the Act, and the implementing regulations promulgated thereunder by the Secretary of the Treasury, require financial institutions to maintain records of the identities of their customers, to make microfilm copies of certain checks drawn on them, and to keep records of certain other items. Title II of the Act and its implementing regulations require reports of certain domestic and foreign currency transactions.

A. Title I—The Recordkeeping Requirements

Title I of the Bank Secrecy Act contains the general recordkeeping requirements for banks and other financial institutions, as provided by the Secretary by regulation. Section 101 of the Act, 12 U. S. C. § 1829b, applies by its terms only to federally insured banks. It contains congressional findings "that adequate records maintained by insured banks have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings." The major requirements

[2] See n. 11, *infra.*

of the section are that insured banks record the identities of persons having accounts with them and of persons having signature authority thereover, in such form as the Secretary may require. To the extent that the Secretary determines by regulation that such records would have the requisite "high degree of usefulness," the banks must make and maintain microfilm or other reproductions of each check, draft, or other instrument drawn on it and presented to it for payment, and must maintain a record of each check, draft, or other instrument received by it for deposit or collection, together with an identification of the party for whose account it is to be deposited or collected. Section 101 further authorizes the Secretary to require insured banks to maintain a record of the identity of all individuals who engage in transactions which are reportable by the bank under Title II of the Act, and authorizes the Secretary to prescribe the required retention period for such records. Section 102, 12 U. S. C. § 1730d, amends the National Housing Act to authorize the Secretary to apply similar recordkeeping requirements to institutions insured thereunder. Sections 121 and 123 of the Act, 12 U. S. C. §§ 1953, 1955, authorize the Secretary to issue regulations applying similar recordkeeping requirements to additional domestic financial institutions.[3]

Although an initial draft of Title I, see H. R. 15073, 91st Cong., 1st Sess., would have compelled the Secretary of the Treasury to promulgate regulations requiring banks to maintain copies of all items received for collection or presented for payment, the Act as finally passed required the maintenance only of such records and microfilm copies as the Secretary determined to have a "high degree of usefulness."[4] Upon passage of the Act, the Treasury Department established a task force which consulted with representatives from financial institutions, trade associations, and governmental agencies to determine the type of records which should be maintained. Whereas the original regulations promulgated by the Secretary of Treasury had required the copying of all checks, the task force decided, and the regulations were accordingly amended, to require check copying only as to checks in excess of $100.[5] The regulations also require the copying of only "on us" checks: checks drawn on the bank or issued and payable by it. 31 CFR § 103.34(b)(3). The regulations exempt from the copying requirements certain "on us" checks such as dividend, payroll, and employee benefit checks, provided they are drawn on an account expected to average at least one hundred checks per month.[6] The regulations also require banks to maintain records of the identity and taxpayer identification number of each person maintaining a financial interest in each deposit or share account opened after June 30, 1972, and to microfilm various other financial documents. 31 CFR § 103.34.[7] In addition, the Secretary's regulations require all financial insti-

[3] Under section 123(b), the authority of the Secretary extends to any person engaging in the business of:

"(1) Issuing or redeeming checks, money orders, travelers' checks, or similar instruments, except as an incident to the conduct of its own nonfinancial business.

"(2) Transferring funds or credits domestically or internationally.

"(3) Operating a currency exchange or otherwise dealing in foreign currencies or credits.

"(4) Operating a credit card system.

"(5) Performing such similar, related, or substitute functions for any of the foregoing or for banking as may be specified by the Secretary in regulations."

Section 122 of the Act, 12 U. S. C. § 1954, authorizes the Secretary to require reports with respect to the ownership, control, and management of uninsured domestic financial institutions.

[4] See House Hearings, n. 1, *supra*, at 60-61, 80, 146, 162, 314, 316, 321, 333; S. Rep. No. 91-1139, *supra*, at 18-19 (supplemental views).

[5] For a summary of the task force study, see Hearings before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs to amend the Bank Secrecy Act (S. 3814), 92d Cong., 2d Sess., 60-64 (1972). The Secretary of the Treasury initially issued regulations on April 5, 1972, implementing the provisions of the Act. See 31 C. F. R. Part 103 (37 Fed. Reg. 6912) [1972-1 C.B. 771]. The Treasury Department task force found that law enforcement would not be greatly impaired by limiting the check-copying requirement to checks in excess of $100. An Assistant Secretary of the Treasury estimated that this exclusion would eliminate 90% of all personal checks from the microfilming requirement. Senate Hearings on S. 3814, *supra*, at 42, 44, 57-58. The regulations were thus amended shortly after their promulgation to exclude the copying of checks drawn for $100 or less. 31 CFR § 103.34(b)(3), as amended, 37 Fed. Reg. 23114 (1972), 38 Fed. Reg. 2174 (1973), effective January 17, 1973.

[6] Exempted by 31 CFR § 103.34(b)(3) are dividend checks, payroll checks, employee benefit checks, insurance claim checks, medical benefit checks, checks drawn on governmental agency accounts, checks drawn by brokers or dealers in securities, checks drawn on fiduciary accounts, checks drawn on other financial institutions, and pension or annuity checks, provided they are drawn on an account expected to average at least one hundred checks per month.

[7] 31 CFR § 103.34(b) requires that each bank retain either the original or a microfilm or other copy or reproduction of (1) documents granting signature authority over accounts; (2) statements or ledger cards showing transactions in each account; (3) each item involving more than $10,000 remitted or transferred to a person, account, or place outside the United States; (4) a record of each remittance or transaction of funds, currency, monetary instruments, checks, investment securities, or credit, of more than $10,000 to a person, account, or place outside the United States; (5) each check or draft in an amount exceeding $10,000 drawn on or issued by a foreign bank which the domestic bank has paid or presented to a nonbank drawee for payment; (6) each item of more than $10,000 received directly from a bank, broker, or dealer in foreign exchange outside the United States; (7) a record of each receipt of currency, monetary instruments, checks, or investment securities, and each transfer of funds or credit in amounts exceeding $10,000 received directly from a bank, broker, or dealer in foreign exchange outside the United States; (8) records needed to reconstruct a demand deposit account and to trace checks in excess of $100 deposited in such account.

31 CFR § 103.35 requires brokers and dealers in securities to maintain similar information with respect to their brokerage accounts.

The prescribed retention period for all records under the regulations is five years, except for the records required for reconstructing a demand deposit account, which must be retained for only two years. 31 CFR § 103.36(c).

tutions to maintain a microfilm or other copy of each extension of credit in an amount exceeding $5,000 except those secured by interest in real property, and to microfilm each advice, request, or instruction given or received regarding the transfer of funds, currency or other money or credit in amounts exceeding $10,000 to a person, account or place outside the United States. 31 CFR § 103.33.

Reiterating the stated intent of the Congress, see, *e.g.*, H. R. Rep. No. 91-975, *supra*, at 5; S. Rep. No. 91-1139, *supra*, at 10, the regulations provide that inspection, review or access to the records required by the Act to be maintained is governed by existing legal process. 31 CFR § 103.51.[8] Finally, sections 125 through 127 of the Act provide for civil and criminal penalties for willful violations of the recordkeeping requirements. 12 U. S. C. §§ 1955-1957.

B. Title II—Foreign Financial Transaction Reporting Requirements

Chapter 3 of Title II of the Bank Secrecy Act and the regulations promulgated thereunder generally require persons to report transportations of monetary instruments into or out of the United States, or receipts of such instruments in the United States from places outside the United States, if the transportation or receipt involves instruments of a value greater than $5,000. Chapter 4 of Title II of the Act and the implementing regulations generally require United States citizens, residents, and businessmen to file reports of their relationships with foreign financial institutions. The legislative history of the foreign transaction reporting provisions indicates that the Congress was concerned with the circumvention of United States regulatory, tax and criminal laws which United States citizens and residents were accomplishing through the medium of secret foreign bank transactions. S. Rep. No. 91-1139, *supra*, at 7 [1971-1 C.B. 562, 565]; H. R. Rep. No. 91-975, *supra*, at 13 [1971-1 C.B. 559, 561].

Section 231 of the Act, 31 U. S. C. § 1101, requires anyone connected with the transaction to report, in the manner prescribed by the Secretary, the transportation into or out of the country of monetary instruments [9] exceeding $5,000 on any one occasion. As provided by the Secretary's regulations, the report must include information as to the amount of the instrument, the date of receipt, the form of instrument, and the person from whom it was received. See 31 CFR §§ 103.23, 103.25.[10] The regulations exempt various classes of persons from this reporting requirement, including banks, brokers or dealers in securities, common carriers and others engaged in the business of transporting currency for banks. 31 CFR § 103.23(c). Monetary instruments which are transported without the filing of a required report, or with a materially erroneous report, are subject to forfeiture under section 232 of the Act, 31 U. S. C. § 1102; a person who has failed to file the required report or who has filed a false report is subject to civil penalties under sections 207 and 233, 31 U. S. C. §§ 1056, 1103, as well as criminal penalties under sections 209 and 210, 31 U. S. C. §§ 1058, 1059.

Section 241 of the Act, 31 U. S. C. § 1121, authorizes the Secretary to prescribe regulations reguiring residents and citizens of the United States, as well as nonresidents in the United States and doing business therein, to maintain records and file reports with respect to their transactions and relationships with foreign financial agencies. Pursuant to this authority, the regulations require each person subject to the jurisdiction of the United States to make a report on yearly tax returns of any "financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country." 31 CFR § 103.24. Violations of the reporting requirement of section 241 as implemented by the regulations are also subject to civil and criminal penalties under sections 207, 209, and 210 of the Act, 31 U. S. C. §§ 1056, 1058, 1059 [Pub. L. 91-508, 1971-1 C.B. 523].

C. Title II—Domestic Financial Transaction Reporting Requirements

In addition to the foreign transaction reporting requirements discussed above, Title II of the Bank Secrecy Act provides for certain reports of domestic transactions where such reports have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. Prior to the enactment of the Bank Secrecy Act, financial institutions had been providing reports of their customers' large currency transactions pursuant to regulations promulgated by the Secretary

[8] 31 CFR § 103.51 provides:

"Except as provided in §§ 103.34(a)(1) and 103.35(a)(1), and except for the purpose of assuring compliance with the recordkeeping and reporting requirements of this part, this part does not authorize the Secretary or any other to inspect or review the records required to be maintained by subpart C of this part. Other inspection, review or access to such records is governed by other applicable law."

This regulation became effective January 17, 1973. 37 Fed. Reg. 23114 (1972); 38 Fed. Reg. 2174 (1973).

[9] "Monetary instrument" is defined by section 203(1) of the Act as "coin and currency of the United States, and in addition, such foreign coin and currencies, and such types of travelers' checks, bearer negotiable instruments, bearer investment securities, bearer securities, and stock with title passing upon delivery, or the equivalent thereof, as the Secretary may by regulation specify for the purposes of the provision of this title to which the regulation relates." 31 U. S. C. § 1052.

[10] The form provided by the Treasury Department for the reporting of these transactions is Form 4790 (Report of International Transportation of Currency or Monetary Instruments). See Motion to Affirm on behalf of the United States in No. 72-985, App. C, at 29-30. The report must identify the person required to file the report, his capacity and the identity of persons for whom he acts, and must specify the amounts and types of monetary instruments, the method of transportation, and, if applicable, the name of the person from whom the shipment was received.

of Treasury [11] which had required reports of all currency transactions that, in the judgment of the institution, exceeded those "commensurate with the customary conduct of the business, industry or profession of the person or organization concerned." [12] In passing the Bank Secrecy Act, Congress recognized that the use of financial institutions, both domestic and foreign, in furtherance of activities designed to evade the regulatory mechanisms of the United States had markedly increased. H. R. Rep. No. 91-975, *supra,* at 10; S. Rep. No. 91-1139, *supra,* at 2-3. Congress recognized the importance of reports of large and unusual currency transactions in ferreting out criminal activity and desired to strengthen the statutory basis for requiring such reports. H. R. Rep. No. 91-975, *supra*, at 11-12. In particular, Congress intended to authorize more definite standards for determining what constitutes the type of unusual transaction that should be reported. S. Rep. No. 91-1139, *supra*, at 6.

Section 221 of the Bank Secrecy Act, 31 U. S. C. § 1081, therefore delegates to the Secretary of the Treasury the authority for specifying the currency transactions which should be reported, "if they involve the payment, receipt, or transfer of United States currency, or such other monetary instruments as the Secretary may specify." Section 222 of the Act, 31 U. S. C. § 1082, provides that the Secretary may require such reports from the domestic financial institution involved or the parties to the transactions or both.[13] Section 223 of the Act, 31 U. S. C. § 1083, authorizes the Secretary to designate financial institutions to receive such reports.

In the implementing regulations promulgated under this authority, the Secretary of the Treasury has required only that financial institutions file certain reports with the Commissioner of Internal Revenue. The regulations require that a report be made for each deposit, withdrawal, exchange of currency[14] or other payment or transfer "which involves a transaction in currency of more than $10,000." 31 CFR § 103.22.[15] The regulations exempt from the reporting requirement certain intrabank transactions and "transactions with an established customer maintaining a deposit relationship [in amounts] commensurate with the customary conduct of the business industry or profession of the customer concerned." *Ibid.*[16] Provision is also made in the regulations whereby information obtained by the Secretary of the Treasury may in some instances and in confidence be available to other departments or agencies of the United States. 31 CFR § 103.43; see 31 U. S. C. § 1061.[17] There is also provision made in the regulations whereby the Secretary may in his sole discretion make exceptions to or grant exemptions from the requirements of the regulation. 31 CFR § 103.45(a).[18]

[11] In issuing these regulations, the Secretary relied upon the authority of two statutory provisions: (1) the Trading with the Enemy Act, 40 Stat. 411, as amended by § 2, Act of Mar. 9, 1933, c. 1, 48 Stat. 1, and by § 301, First War Powers Act, c. 593, 55 Stat. 838 (1941). See 12 U. S. C. § 95a (Supp. V, 1940 ed.); (2) § 251 of the Revised Statutes, 31 U. S. C. § 427.

[12] The previous regulations promulgated by the Secretary, see 31 CFR § 102.1 (1949 ed.), 10 Fed. Reg. 6556, originally mentioned transactions involving $1,000 or more in denominations of $50 or more, or $10,000 or more in any denominations. In 1952, the former amount was raised to $2,500 in denominations of $100 or more. See 17 Fed. Reg. 1822, 2306. When these regulations were revised in 1959 to simplify the reporting form, the Secretary noted the great value of the reports to law enforcement. See Treasury Release No. A-590, August 3, 1959, included in the Jurisdictional Statement for the United States in No. 72-1073, App. E, at 127-130.

[13] The proper interpretation of this section is a source of dispute in these appeals. See n. 29, *infra.*

[14] "Currency" is defined in the Secretary's regulations as the "coin and currency of the United States or of any other country, which circulate in and are customarily used and accepted as money in the country in which issued. It includes United States silver certificates, United States notes and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money." 31 CFR § 103.11.

[15] The form prescribed by the Secretary, see 31 CFR § 103.25(a), for the reporting of the domestic currency transactions is Treasury Form 4789 (Currency Transaction Report). See Jurisdictional Statement for the United States in No. 72-1073, App. D, at 121. Form 4789 requires information similar to that required by the previous Treasury reporting form, see n. 12, *supra,* including (1) the name, address, business or profession and social security number of the person conducting the transaction; (2) similar information as to the person or organization for whom it was conducted; (3) a summary description of the nature of the transaction, the type, amount and denomination of the currency involved and a description of any check involved in the transaction; (4) the type of identification presented; and (5) the identity of the reporting financial institution.

The regulations also provide that the names of all customers whose currency transactions in excess of $10,000 are not reported on Form 4789 must be reported to the Secretary on demand. 31 CFR § 103.22.

[16] Transactions with Federal Reserve Banks or Federal Home Loan Banks, or solely with or originated by financial institutions or foreign banks, are also excluded from these reporting requirements. 31 CFR § 103.22.

[17] Section 212 of the Act, 31 U. S. C. § 1061, authorizes the Secretary to provide by regulation for the availability of information provided in the reports required by the Act to other departments and agencies of the Federal Government. Pursuant to this authority, the Secretary has promulgated 31 CFR § 103.43, which provides:

"The Secretary may make any information set forth in any report received pursuant to this part available to any other department or agency of the United States upon the request of the head of such department or agency, made in writing and stating the particular information desired, the criminal, tax, or regulatory investigation or proceeding in connection with which the information is sought, and the official need therefor. Any information made available under this section to other departments or agencies of the United States shall be received by them in confidence, and shall not be disclosed to any person except for official purposes relating to the investigation or proceeding in connection with which the information is sought."

The last sentence of this regulation was added by an amendment, see 37 Fed. Reg. 23114 (1972), 38 Fed. Reg. 2174 (1973), effective January 17, 1973.

[18] 31 CFR § 103.45(a) provides:

"The Secretary, in his sole discretion, may by written order or authorization make exceptions to, or grant exemptions from, the requirements of this part. Such exceptions, or exemptions, may be conditional or unconditional, may apply to particular persons or to classes of persons, and may apply to particular transactions or classes of transactions. They shall, however, be appli-

Failure to file the required report or the filing of a false report subjects the banks to criminal and civil penalties. 31 U. S. C. §§ 1056, 1058, 1059.

II

This litigation began in June 1972 in the United States District Court for the Northern District of California. Various plaintiffs applied for a temporary restraining order prohibiting the defendants, including the Secretary of the Treasury and heads of other federal agencies, from enforcing the provisions of the Bank Secrecy Act, enacted by Congress on October 26, 1970, and thereafter implemented by the Treasury Regulations. The plaintiffs below included several named individual bank customers, the Security National Bank, the California Bankers Association, and the American Civil Liberties Union, suing on behalf of itself and its various bank customer members.

The plaintiffs' principal contention in the District Court was that the Act and the Regulations were violative of the Fourth Amendment's guarantee against unreasonable search and seizure. The complaints also alleged that the Act violated the First, Fifth, Ninth, Tenth, and Fourteenth Amendments. The District Court issued a temporary restraining order enjoining the enforcement of the foreign and domestic reporting provisions of Title II of the Act, and requested the convening of a three-judge court pursuant to 28 U. S. C. 2284 to entertain the myriad of constitutional challenges to the Act.

The three-judge District Court unanimously upheld the constitutionality of the recordkeeping requirements of Title I of the Act and the accompanying Regulations, and the requirements of Title II of the Act and the Regulations requiring reports concerning the import and export of currency and monetary instruments and relationships with foreign financial institutions. The District Court concluded, however, with one judge dissenting, that the domestic reporting provisions of section 221-223 of Title II of the Act, 31 U. S. C. §§ 1081-1083, were repugnant to the Fourth Amendment of the Constitution. 347 F. Supp. 1242 (1972). The court held that since the domestic reporting provisions of the Act permitted the Secretary of the Treasury to require detailed reports of virtually all domestic financial transactions, including those involving personal checks and drafts, and since the Act could conceivably be administered in such a manner as to compel disclosure of all details of a customer's financial affairs, the domestic reporting provisions must fall as facially violative of the Fourth Amendment. Their enforcement was enjoined.

Both the plaintiffs and the Government defendants filed timely notices of appeal from the portions of the District Court judgment adverse to them. We noted probable jurisdiction over three separate appeals from the decision below pursuant to 28 U. S. C. §§ 1252 and 1253. 414 U.S. 816 (1973).

No. 72-985. The appellant in this appeal is the California Bankers Association, an association of all state and national banks doing business in California. The Association challenges the constitutionality of the recordkeeping provisions of Title I, as implemented by the regulations, on two grounds. First, the Association contends that the Act violates the Due Process Clause of the Fifth Amendment because there is no rational relationship between the objectives of the Act and the recordkeeping required, and because the Act places an unreasonable burden on the Association's member banks. Second, the Association contends that the recordkeeping requirements of Title I violate the First Amendment right of privacy and anonymity of the member banks' customers.

No. 72-1196. This appeal was filed on behalf of a number of plaintiffs in the original suit in the District Court: on behalf of the Security National Bank, on behalf of the American Civil Liberties Union as a depositor in a bank subject to the recordkeeping requirements and as a representative of its bank customer members, and on behalf of certain bank customers. The appeal first challenges the constitutionality of the recordkeeping requirements of Title I of the Act and the implementing regulations, as does the appeal in 72-985, *supra*. Second, the appeal challenges the constitutionality of the foreign financial transaction reporting requirements of Title II of the Act and the implementing regulations. These recordkeeping and foreign reporting requirements are challenged on three grounds: first, that the requirements constitute an unreasonable search and seizure in violation of the Fourth Amendment; second, that the requirements constitute a coerced creation and retention of documents in violation of the Fifth Amendment privilege against compulsory self-incrimination; and third, that the requirements violate the First Amendment rights of free speech and free association.

No. 72-1073. In this appeal, the United States, as appellant, challenges that portion of the District Court's order holding the domestic financial transaction reporting requirements of Title II to violate the Fourth Amendment. The Government contends that the District Court erred in holding these provisions of Title II to be unconstitutional on their face, without considering the actual implementation of the statute by the Treasury Regulations. The Government urges that since only those who violate these

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cable only as expressly stated in the order or authorization, and they shall be revocable in the sole discretion of the Secretary."

When originally promulgated, this regulation additionally gave the Secretary the authority to "impose additional recordkeeping or reporting requirements authorized by statute, or otherwise modify the requirements of" the Act. 37 Fed. Reg. 6912 (1972) [1972-1 C.B. 771]. The amendment to the present form became effective January 17, 1973. 37 Fed. Reg. 23114 (1972); 38 Fed. Reg. 2174 (1973).

regulations may incur civil or criminal penalties, it is the actual regulations issued by the Secretary of the Treasury, and not the broad authorizing language of the statute, which are to be tested against the standards of the Fourth Amendment; and that when so tested they are valid.

For convenience, we will refer throughout the remainder of this opinion to the District Court plaintiffs as plaintiffs, since they are both appellants and appellees in the appeals filed in this Court.

III

We entertain serious doubt as to the standing of the plaintiff California Bankers Association to litigate the claims which it asserts here. Its complaint alleged that it is an unincorporated association consisting of 158 state and national banks doing business in California. So far as appears from the complaint, the Association is not in any way engaged in the banking business, and is not even subject to the Secretary's regulations which it challenges. While the District Court found that the Association sued on behalf of its member banks, the Association's complaint contains no such allegation. The Association seeks to litigate not only claims on behalf of its member banks, but also claims of injury to the depositors of its member banks. Since the Government has not questioned the standing of the Association to litigate the claims peculiar to banks, and more importantly since plaintiff Security National Bank has standing as an affected bank, and therefore determination of the Association's standing would in no way avoid resolution of any constitutional issues, we assume without deciding that the Association does have standing. See *Doe* v. *Bolton*, 410 U. S. 179, 189 (1973); *Sierra Club* v. *Morton*, 405 U. S. 727, 739 (1972); *NAACP* v. *Button*, 371 U. S. 415, 428 (1963).

We proceed then to consider the initial contention of the bank plaintiffs that the recordkeeping requirements imposed by the Secretary's regulations under the authority of Title I deprives the banks of due process by imposing unreasonable burdens upon them, and by seeking to make the banks the agents of the Government in surveillance of its citizens. Such recordkeeping requirements are scarcely a novelty. The Internal Revenue Code, for example, contains a general authorization to the Secretary of Treasury to prescribe by regulation records to be kept by both business and individual taxpayers, 26 U. S. C. § 6001, which has been implemented by the Secretary in various regulations.[19] And this Court has been faced with numerous cases involving similar recordkeeping requirements. Similar requirements imposed on the countless businesses subject to the Price Control Act during the Second World War were upheld in *Shapiro* v. *United States*, 335 U. S. 1 (1948), the Court observing that there was "a sufficient relation between the activity sought to be regulated and the public concern so that the Government can constitutionally regulate or forbid the basic activity concerned, and can constitutionally require the keeping of particular records, subject to inspection. . . ." *Id.*, at 32. In *United States* v. *Darby*, 312 U. S. 100 (1941), the Court held that employers subject to the Fair Labor Standards Act could be required to keep records of wages paid and hours worked:

"Since, as we have held, Congress may require production for interstate commerce to conform to [wage and hour] conditions, it may require the employer, as a means of enforcing the valid law, to keep a record showing whether he has in fact complied with it." *Id.*, at 125.

We see no reason to reach a different result here. The plenary authority of Congress over both interstate and foreign commerce is not open to dispute, and that body was not limited to any one particular approach to effectuate its concern that negotiable instruments moving in the channels of that commerce were significantly aiding criminal enterprise. The Secretary of the Treasury, authorized by Congress, concluded that copying and retention of certain negotiable instruments by the bank upon which they were drawn would facilitate the detection and apprehension of participants in such criminal enterprises. Congress could have closed the channels of commerce entirely to negotiable instruments, had it thought that so drastic a solution were warranted; it could have made the transmission of the proceeds of any criminal activity by negotiable instruments in interstate or foreign commerce a separate criminal offense. Had it chosen to do the latter, under the precise authority of *Darby* or *Shapiro, supra,* it could have required that each individual engaging in the sending of negotiable instruments through the channels of commerce maintain a record of such

[19] See, *e.g.*, Treas. Reg. § 1.368-3 (records to be kept by taxpayers who participate in tax-free exchanges in connection with a corporate reorganization); § 1.374-3 (records to be kept by a railroad corporation engaging in a tax-free exchange in connection with a railroad reorganization); § 1.857-6 (real estate investment trusts must keep records of stock ownership); § 1.964-3 (shareholders must keep records of their interest in a controlled foreign corporation); § 1.1101-4 (records must be kept by a stock or security holder who receives stock or securities or other property upon a distribution made by a qualified bank holding corporation); § 1.1247-5 (foreign investment company must keep records sufficient to verify what taxable income it may have); § 1.6001-1 (all persons liable to tax under subtitle A of the Int. Rev. Code shall keep records sufficient to establish gross income, deductions, and credits); § 31.6001 *et seq.* (requirements that various employers keep records of withholding under the Railroad Retirement Tax Act and the Federal Unemployment Tax Act); § 45.6001 (records to be kept by manufacturers of butter and cheese), § 46.6001 (records to be kept by manufacturers of sugar); § 46.6001-4 (records to be kept by persons paying premiums on policies issued by foreign insurers). Treas. Reg. § 301.7207-1 provides for criminal penalties for willful delivery or disclosure to the Internal Revenue Service of a document known by the person disclosing it to be false as to any material matter.

action; the bank plaintiffs concede as much.[20]

The bank plaintiffs contend, however, that the Act does not have as its primary purpose regulation of the banks themselves, and therefore the requirement that the banks keep the records is an unreasonable burden on the banks. *Shapiro* and *Darby*, which involved legislation imposing recordkeeping requirements in aid of substantive regulation, are therefore said not to control. But provisions requiring reporting or recordkeeping by the paying institution, rather than the individual who receives the payment, are by no means unique. The Internal Revenue Code and its regulations, for example, contain provisions which require businesses to report income payments to third parties (26 U. S. C. § 6041 (a)), employers to keep records of certain payments made to employees (Treas. Reg. § 31.6001), corporations to report dividend payments made to third parties (26 U. S. C. § 6042), cooperatives to report patronage dividend payments (26 U. S. C. § 6044), brokers to report customers' gains and losses (26 U. S. C. § 6045), and banks to report payments of interest made to depositors (26 U. S. C. § 6049).

In *Darby* an identifiable class of employer was made subject to the Fair Labor Standards Act, and in *Shapiro* an identifiable class of businesses had been placed under the Price Control Act; in each of those instances, Congress found that the purpose of its regulation was adequately secured by requiring records to be kept by the persons subject to the substantive commands of the legislation. In this case, however, Congress determined that recordkeeping alone would suffice for its purposes, and that no correlative substantive legislation was required. Neither this fact, nor the fact that the principal congressional concern is with the activities of the banks' customers, rather than with the activities of the banks themselves, serve to invalidate the legislation on due process grounds.

The bank plaintiffs proceed from the premise that they are complete bystanders with respect to transactions involving drawers and drawees of their negotiable instruments. But such is hardly the case. A voluminous body of law has grown up defining the rights of the drawer, the payee, and the drawee bank with respect to various kinds of negotiable instruments. The recognition of such rights, both in the various States of this country and in other countries, is itself a part of the reason why the banking business has flourished and played so prominent a part in commercial transactions. The bank is a party to any negotiable instrument drawn upon it by a depositor, and upon acceptance or payment of an instrument incurs obligations to the payee. While it obviously is not privy to the background of a transaction in which a negotiable instrument is used, the existing wide acceptance and availability of negotiable instruments is of inestimable benefit to the banking industry as well as to commerce in general.

Banks are therefore not conscripted neutrals in transactions involving negotiable instruments, but parties to the instruments with a substantial stake in their continued availability and acceptance. Congress not illogically decided that if records of transactions of negotiable instruments were to be kept and maintained, in order to be available as evidence under customary legal process if the occasion warranted, the bank was the most easily identifiable party to the instrument and therefore should do the recordkeeping. We believe this conclusion is consistent with *Darby* and *Shapiro*, and that there is a sufficient connection between the evil Congress sought to address and the recordkeeping procedure it required to pass muster under the Due Process Clause of the Fifth Amendment.[21]

The bank plaintiffs somewhat half-heartedly argue, on the basis of the costs which they estimate will be incurred by the banking industry in complying with the Secretary's recordkeeping requirements, that this cost burden alone deprives them of due process of law. They cite no cases for this proposition, and it does not warrant extended treatment. In its complaint filed in the District Court, plaintiff Security National Bank asserted that it was an "insured" national bank; to the extent that Congress has acted to require records on the part of banks insured by the Federal Deposit Insurance Corpora-

[20] Brief for Appellant California Bankers Association in No. 72-985, at 25.

[21] Congress had before it ample testimony that the requirement that banks reproduce checks and maintain other records would significantly aid in the enforcement of federal tax, regulatory, and criminal laws. See House Hearings, n. 1, *supra*, at 151, 322, 359; Senate Hearings, n. 1, *supra*, at 61-68, 175, 230, 250-255, 282. While a substantial portion of the checks drawn on banks in the United States may never be of any utility for law enforcement, tax or regulatory purposes, the regulations do limit the check-copying requirement to checks in excess of $100. 31 CFR § 103.34(b)(3) and (4). This $100 exception was added to the regulations since this litigation was instituted, see n. 5, *supra*; in reviewing the judgment of the District Court in this case, we look to the statute and the regulations as they now stand, not as they once did. *Hall* v. *Beals*, 396 U. S. 45, 48 (1969) (*per curiam*); *Thorpe* v. *Housing Authority*, 393 U. S. 268, 281 n. 38 (1969).

The California Bankers Association contends that the $100 exception is meaningless since microfilm cameras cannot discriminate between checks in different amounts. There was, however, testimony during the House Hearings that an additional step could be added to the check-handling procedures to sort out those checks not required to be copied, and that many banks have equipment that can sort checks on a dollar-amount basis. House Hearings, n. 1, *supra*, at 322, 359. In any event, it is clear that the Act and regulations do not require banks to microfilm all checks, which some banks have traditionally done, but instead leaves the decision to the banks. Given the fact that the cost burdens placed on the banks in implementing the recordkeeping requirements of the statute and regulations are also reasonable ones, see n. 22, *infra*, we do not think that the recordkeeping requirements are unreasonable.

tion, or of financial institutions insured under the National Housing Act, Congress is simply imposing a condition on the spending of public funds. See, *e.g., Steward Machine Co.* v. *Davis*, 301 U. S. 548 (1937) [Ct. D. 1236, 1937-1 C.B. 444]; *Helvering* v. *Davis*, 301 U.S. 619 (1937) [Ct. D. 1235, 1937-1 C.B. 360]. Since there was no allegation in the complaints filed in the District Court, nor is it contended here that any bank plaintiff is not covered by FDIC or Housing Act Insurance, it is unnecessary to consider what questions would arise had Congress relied solely upon its power over interstate commerce to impose the recordkeeping requirements. The cost burdens imposed on the banks by the recordkeeping requirements are far from unreasonable, and we hold that such burdens do not deny the banks due process of law.[22]

The bank plaintiffs also contend that the recordkeeping requirements imposed by the Secretary pursuant to the Act undercut a depositor's right to effectively challenge a third-party summons issued by the Internal Revenue Service. See *Reisman* v. *Caplin*, 375 U. S. 440 (1964) [Ct. D. 1887, 1964-1 (Part 1 C.B. 517)]; *Donaldson* v. *United States*, 400 U.S. 517 (1970) [Ct. D. 1942, 1971-1 C.B. 416]; *Couch* v. *United States*, 409 U.S. 322 (1973) [Ct. D. 1955, 1973-1 C.B. 609]. Whatever wrong such a result might work on a depositor, it works no injury to his bank. It is true that in a limited class of cases this Court has permitted a party who suffered injury as a result of the operation of a law to assert his rights even though the sanction of the law was borne by another, *Pierce* v. *Society of Sisters*, 268 U. S. 510 (1925), and conversely, the Court has allowed a party upon whom the sanction falls to rely on the wrong done to a third party in obtaining relief, *Barrows* v. *Jackson*, 346 U. S. 249 (1953); *Eisenstadt* v. *Baird*, 405 U. S. 438 (1972). Whether the bank might in other circumstances rely on an injury to its depositors, or whether instead this case is governed by the general rule that one has standing only to vindicate his own rights, *e.g.*, *Moose Lodge* v. *Irvis*, 407 U. S. 163, 166 (1972), need not now be decided, since, in any event, the claim is premature. Claims of depositors against the compulsion by lawful process of bank records involving the depositors' own transactions must wait until such process issues.

Certain of the plaintiffs below, appellants in No. 72-1196, including the American Civil Liberties Union, the Security National Bank, and various individual plaintiff depositors, argue that "the dominant purpose of an Act is the creation, preservation, and collection of evidence of crime [and] . . . . [i]t is against the standards applicable to the criminal law, then, that its constitutionality must be measured." They contend that the recordkeeping requirements violate the provisions of the Fourth, Fifth, and First Amendments to the Constitution. At this point, we deal only with such constitutional challenges as they relate to the recordkeeping provisions of Title I of the Act.

We see nothing in the Act which violates the Fourth Amendment rights of any of these plaintiffs. Neither the provisions of Title I nor the implementing regulations require that any information contained in the records be disclosed to the Government; both the legislative history and the regulations make specific reference to the fact that access to the records is to be controlled by existing legal process.

Plaintiffs urge that when the bank makes and keeps records under the compulsion of the Secretary's regulations it acts as an agent of the Government, and thereby engages in a "seizure" of the records of its customers. But all of the records which the Secretary requires to be kept pertain to transactions to which the bank was itself a party. See *United States* v. *Biswell*, 406 U. S. 311, 316 (1972). The fact that a large number of banks voluntarily kept records of this sort before they were required to do so by regulation is an indication that the records were thought useful to the bank in the conduct of its own business, as well as in reflecting transactions of its customers. We decided long ago that an Internal Revenue summons directed to a third-party bank was not a violation of the Fourth Amendment rights of either the bank or the person under investigation by the taxing authorities. See *First National Bank* v. *United States*, 267 U. S. 576 (1925), aff'g 295 Fed. 142 (SD Ala. 1924); *Donaldson* v. *United States*, 400 U. S. 517, 522 (1971). "[I]t is difficult to see how the summoning of a third party, and the records of a third party, can violate the rights of the taxpayer, even if a criminal prosecution is contemplated or in progress." *Donaldson* v. *United States, supra*, at 537 (DOUGLAS, J., concurring).

Plaintiffs nevertheless contend that the board authorization given by the Act to the Secretary to require the maintenance of records, coupled with the broad authority to require certain reports of financial transactions, amounts to the power to commit an unlawful search of the banks and the customers. This argument is based

[22] The only figures in the record as to the cost burdens placed on the banks by the recordkeeping requirements show that the Bank of America, one of the largest banks in the United States, with 997 branches, 29 billion dollars in deposits and a net income in excess of 178 million dollars (Moody's Bank and Finance Manual (1972), at 633-636), expended 392 thousand dollars in 1971, including startup costs, to comply with the microfilming requirements of Title I of the Act. Affidavit of William Ehler, App. 24-25.

The hearings before the House Committee on Banking and Currency indicated that the cost of making microfilm copies of checks ranged from 1½ mills per check for small banks down to about ½ mill or less for large banks. See House Hearings, n. 1, *supra*, at 341, 354-356; H. Rep. No. 91-975, *supra*, at 11 [1971-1 C.B. 559, 560]. The House Report further indicates that the legislation was not expected to significantly increase the costs of the banks involved since it was found that many banks already followed the practice of maintaining the records contemplated by the legislation.

on the fact that 31 CFR § 103.45, as it existed when the District Court ruled in the case, permitted the Secretary to impose additional recordkeeping or reporting requirements by written order or authorization; this authority has now been deleted from the regulation;[23] plaintiffs thus argue that the Secretary could order the immediate reporting of any records made or kept under the compulsion of the Act. We of course must examine the statute and the regulations as they now exist. *Hall* v. *Beals*, 396 U. S. 45, 48 (1969) (*per curiam*); *Thorpe* v. *Housing Authority*, 393 U. S. 268, 281 n. 38 (1969). Even if plaintiffs were correct in urging that we decide the case on the basis of the regulation as it existed at the time the District Court ruled, their contention would be without merit. Whatever the Secretary *might* have authorized under the regulation, he did not in fact require the reporting of any records made or kept under the compulsion of the Act. Indeed, since the legislative history of the Act clearly indicates that records which it authorized the Secretary to require were to be available only by normal legal process, it is doubtful that the Secretary would have the authority ascribed to him by appellants even under the earlier form of the regulation. But in any event, whether or not he had the authority, he did not exercise it, and in fact none of the records were required to be reported. Since we hold that the mere maintenance of the records by the banks under the compulsion of the regulations invaded no Fourth Amendment right of any depositor, plaintiffs' attack on the recordkeeping requirements under that Amendment fails.[24] That the bank in making the records required by the Secretary acts under the compulsion of the regulation is clear, but it is equally clear that in doing so it neither searches nor seizes records in which the depositor has a Fourth Amendment right.

Plaintiffs have briefed their contentions in such a way that we cannot be entirely certain whether their Fifth Amendment attack is directed only to the reporting provisions of the regulations, or to the recordkeeping provisions as well. To the extent that it is directed to the regulations requiring the banks to keep records, it is without merit. Incorporated banks, like other organizations, have no privilege against compulsory self-incrimination, *e.g.*, *Hale* v. *Henkel*, 201 U. S. 43, 74-75 (1906); *Wilson* v. *United States*, 221 U. S. 361, 382-384 (1911); *United States* v. *White*, 322 U. S. 694, 699 (1944). Since a party incriminated by evidence produced by a third party sustains no violation of his own Fifth Amendment rights, *Johnson* v. *United States*, 228 U. S. 457, 458 (1913); *Couch* v. *United States*, 409 U. S. 322, 328 (1973), the depositor plaintiffs here present no meritorious Fifth Amendment challenge to the recordkeeping requirements.

Plaintiff ACLU makes an additional challenge to the recordkeeping requirements of Title I. It argues that those provisions, and the implementing regulations, violate its members' First Amendment rights, since the provisions could possibly be used to obtain the identities of its members and contributors through the examination of the organization's bank records. This Court has recognized that an organization may have standing to assert that constitutional rights of its members to be protected from governmentally compelled disclosure of their membership is the organization, and that absent a countervailing governmental interest, such information may not be compelled. *NAACP* v. *Alabama*, 357 U. S. 440 (1958). See *Pollard* v. *Roberts*, 283 F. Supp. 258 (ED Ark. 1968), aff'd *per curiam*, 393 U. S. 14 (1968).

Those cases, however, do not elicit a *per se* rule that would forbid such disclosure in a situation where the government interest would override the associational interest in maintaining such confidentiality. Each of them was litigated after a subpoena or summons had already been served for the records of the organization, and an action brought by the organization to prevent the actual disclosure of the records.[25] No such disclosure has been sought by the Government here, and the ACLU's challenge is therefore premature. This Court, in the absence of a concrete fact situation in which competing associational and governmental interests can be weighed, is simply not in a position to determine whether an effort to compel disclosure of such records would or would not be barred by cases such as *NAACP*

[23] See n. 18, *supra*.

[24] Chapter 4 of the Act, section 241, 31 U. S. C. § 1121, authorizes the Secretary to by regulation require the maintenance of records by persons who engage in any transaction or maintain a relationship, directly or indirectly, on behalf of themselves or others, with a foreign financial agency. The Secretary has by regulation required the maintenance of such records by persons having such financial interests and by domestic financial institutions who engage in monetary transactions outside the United States. 31 CFR §§ 103.32, 103.33. The Act also provides that production of such records shall be compelled only by "a subpena or summons duly authorized and issued or as may otherwise be required by law." 31 U. S. C. § 1121(b). Though it is not apparent from the various briefs filed in this Court by the plaintiffs below whether this particular recordkeeping requirement is challenged, our holding that a mere requirement that records be kept does not violate any constitutional right of the banks or of the depositors necessarily disposes of such a claim, since there is no indication at this point that there has been any attempt to compel the production of such records.

[25] The ACLU recognizes that these cases, and the other cases it cites involved situations in which a subpoena or summons had already issued. Brief for the Appellant ACLU in No. 72-1196, at 57. See *Lamont* v. *Postmaster General*, 381 U. S. 301 (1965); *Gibson* v. *Florida Legislative Investigations Comm.*, 372 U. S. 539 (1963); *Louisiana ex rel. Gremillion* v. *NAACP*, 366 U. S. 293 (1961); *Shelton* v. *Tucker*, 364 U. S. 479 (1960); *Bates* v. *Little Rock*, 361 U. S. 516 (1960); *NAACP* v. *Alabama*, 357 U. S. 449 (1958); *United States* v. *Rumely*, 345 U. S. 41 (1953).

v. *Alabama, supra.*[26] The threat to any First Amendment rights of the ACLU or its members from the mere existence of the records in the hands of the bank is a good deal more remote than the threat assertedly posed by the Army's system of compilation and distribution of information which we declined to adjudicate in *Laird* v. *Tatum*, 408 U. S. 1 (1972).

IV

We proceed now to address the constitutional challenges directed at the reporting requirements of the regulations authorized in Title II of the Act. Title II authorizes the Secretary to require reporting of two general categories of banking transactions: foreign and domestic. The District Court upheld the constitutionality of the foreign transaction reporting requirements of regulations issued under Title II; certain of the plaintiffs below, appellants in No. 72-1196, have appealed from that portion of the District Court's judgment, and here renew their contentions of constitutional infirmity in the foreign reporting regulations based upon the First, Fourth, and Fifth Amendments. The District Court invalidated the Bank Secrecy Act [Pub. L. 91-508, 1971-1 C.B. 523] insofar as it authorized the Secretary to promulgate regulations requiring banks to report domestic transactions involving their customers, and the Government in No. 72-1073 appeals from that portion of the District Court's judgment.

As noted above, the regulations issued by the Secretary under the authority of Title II contain two essential reporting requirements with respect to foreign financial transactions. Chapter 3 of Title II of the Act, 31 U. S. C. § 1101-1105, and the corresponding regulation, 31 CFR § 103.23, require individuals to report transportation of monetary instruments into or out of the United States, or receipts of such instruments in the United States from places outside the United States, if the instrument transported or received has a value in excess of $5,000. Chapter 4 of Title II of the Act, 31 U. S. C. § 1121-1122, and the corresponding regulation, 31 CFR § 103.24, generally require United States citizens, residents, and businessmen to file reports of their relationships with foreign financial institutions.

The domestic reporting provisions of the Act as implemented by the regulations, in contrast to the foreign reporting requirements, apply only to banks and financial institutions. In enacting the statute, Congress provided in section 221, 31 U. S. C. § 1081, that the Secretary might specify the types of currency transactions which should be reported:

"Transactions involving any domestic financial institution shall be reported to the Secretary at such time, in such manner, and in such detail as the Secretary may require if they involve the payment, receipt, or transfer of United States currency, or such other monetary instruments as the Secretary may specify, in such amounts, denominations, or both, or under such circumstances, as the Secretary shall by regulation prescribe."

Section 222 of the Act, 31 U. S. C. § 1082, authorizes the Secretary to require such reports from the domestic financial institution involved, from the parties to the transactions, or from both. In exercising his authority under these sections, the Secretary has promulgated regulations which require only that the financial institutions make the report to the Internal Revenue Service; he has not required any report from the individual parties to domestic financial transactions.[27] The applicable regulation, 31 CFR § 103.22, requires the financial institution to "file a report on each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to such financial institution, which involves a transaction in currency of more than $10,000." The regulation exempts several types of currency transactions from this reporting requirement, including transactions "within an established customer maintaining a deposit relationship with the bank, in amounts which the banks may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry or profession of the customer concerned." *Ibid.*

A. Fourth Amendment Challenge to the Foreign Reporting Requirements

The District Court, in differentiating for constitutional purposes between the foreign reporting requirements and the domestic reporting requirements imposed by the Secretary, relied upon our opinion in *United States* v. *United States District Court*, 407 U. S. 297 (1972), for the proposition that Government surveillance in the area of foreign relations is in some instances subject to less constitutional restraint than would be similar activity in domestic affairs. Our analysis does not take us over this ground.

The plenary authority of Congress to regulate foreign commerce, and to delegate significant portions of this power to the Executive, is well-established. *C & S Airlines* v. *Waterman Corp.*, 333 U. S. 103, 109 (1948); *Norwegian Nitrogen Products Co.* v.

[26] The ACLU contends that present injunctive relief is essential, since the banks might not notify it of the fact that their records have been subpoenaed, and might comply with the subpoena without giving the ACLU a chance to obtain judicial review. While noting that "most banks formally prohibit" it (citing American Banker, May 12, 1972, p. 1, cols. 3-4), the ACLU also contends that the "day-to-day practice of permitting 'informal' access to bank records is, unfortunately, widespread." Brief for Appellant ACLU in No. 72-1196, at 58-59.

The record contains no showing of any attempt by the Government, formal or informal, to compel the production of bank records containing information relating to the ACLU; we accordingly express no opinion whether notice would in such an instance be required by either the Act or the Constitution.

[27] See n. 29, *infra.*

United States, 288 U. S. 294 (1933). Plaintiffs contend that in exercising that authority to require reporting of previously described foreign financial transactions, Congress and the Secretary have abridged their Fourth Amendment rights.

The familiar language of the Fourth Amendment protects "the right of the people to be secure in their persons, houses, papers and effects against unreasonable searches and seizures. . . ." Since a statute requiring the filing and subsequent publication of a corporate tax return has been upheld against a Fourth Amendment challenge, *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 174-176 (1911), reporting requirements are by no means *per se* violations of the Fourth Amendment. Indeed, a contrary holding might well fly in the face of the settled sixty-year history of self-assessment of individual and corporate income taxes in the United States. This Court has on numerous occasions recognized the importance of the self-regulatory aspects of that system, and interests of the Congress in enforcing it:

"In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. This disclosure it requires him to make in his annual return. To insure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil. *Helvering* v. *Mitchell*, 303 U. S. 391, 399 (1938).

To the extent that the reporting requirements of the Bank Secrecy Act and the settled practices of the tax collection process are similar, this history must be overcome by those who argue that the reporting requirements are a violation of the Fourth Amendment. Plaintiffs contend, however, that *Boyd* v. *United States*, 116 U. S. 616 (1886), establishes the invalidity of the foreign reporting requirement under the Fourth Amendment, and that the particular requirements imposed are so indiscriminate in their nature that the regulations must be deemed to be the equivalent of a general warrant of the kind condemned as obnoxious to the Fourth Amendment in cases such as *Stanford* v. *Texas*, 379 U. S. 476 (1965). We do not think these cases would support plaintiffs even if their contentions were directed at the domestic reporting requirements; in light of the fact that the foreign reporting requirements deal with matters in foreign commerce, we think plaintiffs' reliance on the cases to challenge those requirements must fail.

Boyd v. *United States, supra,* is a case which has been the subject of repeated citation, discussion, and explanation since the time of its decision 88 years ago. In *Communist Party* v. *SACB,* 367 U. S. 1 (1961), the Court described the *Boyd* holding as follows:

"The *Boyd* case involved a statute providing that in proceedings other than criminal arising under the revenue laws, the Government could secure an order of the court requiring the production by an opposing claimant or defendant of any documents under his control which, the Government asserted, might tend to prove any of the Government's allegations. If production were not made, the allegations were to be taken as confessed. On the Government's motion, the District Court had entered such an order, requiring the claimants in a forfeiture proceeding to produce a specified invoice. Although the claimants objected that the order was improper and the statute unconstitutional in coercing self-incriminatory disclosures and permitting unreasonable searches and seizures, they did, under protest, produce the invoice, which was, again over their constitutional objection, admitted into evidence. This Court held that on such a record a judgment for the United States could not stand, and that the statute was invalid as repugnant to the Fourth and Fifth Amendments." 367 U. S. 1, 110.

But the *Boyd* Court recognized that the Fourth Amendment does not prohibit all requirements that information be made available to the Government:

"[T]he supervision authorized to be exercised by officers of the revenue over the manufacture or custody of excisable articles, and the entries thereof in books required by law to be kept for their inspection, are necessarily excepted out of the category of unreasonable searches and seizures." *Boyd* v. *United States, supra,* 116 U. S., at 623-624.

Stanford v. *Texas, supra,* involved a warrant issued by a state judge which described petitioner's home and authorized the search and seizure of "books, records, pamphlets, cards, receipts, lists, memoranda, pictures, recordings and other written instruments concerning the Communist Party of Texas." This Court found the warrant to be an unconstitutional general warrant, and invalidated the search and seizure conducted pursuant to it. Unlike the situation in *Stanford,* the Secretary's regulations do not authorize indiscriminate rummaging among the records of the plaintiffs, nor do the reports they require deal with literary material as in *Stanford;* the information sought is about commerce, not literature. The reports of foreign financial transactions required by the regulations must contain information as to a relatively limited group of financial transactions in foreign commerce, and are reasonably related to the statutory purpose of assisting in the enforcement of the laws of the United States.

Of primary importance, in addition, is the fact that the information required by the foreign reporting requirements pertains only to commercial transactions which take place across national boundaries. Chief Justice Taft, in his opinion for the Court in *Carroll* v. *United States*, 267 U. S. 132 (1925), observed:

"Travellers may be so stopped in crossing an international boundary because of national selfprotection reasonably requiring one entering the

country to identify himself as entitled to come in, and his belongings as effects which may be lawfully brought in." *Id.*, at 154.

This settled proposition has been reaffirmed as recently as last Term in *Almeida-Sanchez* v. *United States*, 413 U. S. 266, 272 (1973). If reporting of income may be required as an aid to enforcement of the federal revenue statutes, and if those entering and leaving the country may be examined as to their belongings and effects, all without violating the Fourth Amendment, we see no reason to invalidate the Secretary's regulations here. The statutory authorization for the regulations was based upon a conclusion by Congress that international currency transactions and foreign financial institutions were being used by residents of the United States to circumvent the enforcement of the laws of the United States. The regulations are sufficiently tailored so as to single out transactions found to have the greatest potential for such circumvention and which involve substantial amounts of money. They are therefore reasonable in the light of that statutory purpose, and consistent with the Fourth Amendment.

B. Fourth Amendment Challenge to The Domestic Reporting Requirements

The District Court examined the domestic reporting requirements imposed on plaintiffs by looking to the broad authorization of the Act itself, without specific reference to the regulations promulgated under its authority. The District Court observed:

"[A]lthough to date the Secretary has required reporting only by the financial institutions and then only of *currency* transactions over $10,000, he is empowered by the Act, as indicated above, to require, if he so decides, reporting not only by the financial institution, but also by other parties to or participants in transactions with the institutions and, further, that the Secretary may require reports, not only of currency transactions but of any transaction involving any monetary instrument—and in any amount —large or small." 347 F. Supp., at 1246.

The District Court went on to pose, as the question to be resolved, whether "these provisions, broadly authorizing an executive agency of government to require financial institutions and parties [thereto] to routinely report . . . the detail of almost every conceivable financial transaction . . . [are] such an invasion of a citizen's right of privacy as amounts to an unreasonable search and seizure within the meaning of the Fourth Amendment." *Ibid.*

Since, as we have observed earlier in this opinion, the statute is not self-executing, and were the Secretary to take no action whatever under his authority there would be no possibility of criminal or civil sanctions being imposed on anyone, the District Court was wrong in framing the question in this manner. The question is not what sort of reporting requirements *might* have been imposed by the Secretary under the broad authority given him in the Act, but rather what sort of reporting requirements did he *in fact* impose under that authority.

"Even where some of the provisions of a comprehensive legislative enactment are ripe for adjudication, portions of the enactment not immediately involved are not thereby thrown open for a judicial determination of constitutionality. 'Passing upon the possible significance of the manifold provisions of a broad statute in advance of efforts to apply the separate provisions is analogous to rendering an advisory opinion upon a statute or a declaratory judgment upon a hypothetical case.' *Watson* v. *Buck*, 313 U. S. 387, 402." *Communist Party* v. *SACB, supra*, 367 U. S., at 71.

The question for decision, therefore, is whether the regulations relating to the reporting of domestic transactions, violations of which could subject those required to report to civil or criminal penalties, invade any Fourth Amendment right of those required to report. To that question we now turn.

The regulations issued by the Secretary require the reporting of domestic financial transactions only by financial institutions. *United States* v. *Morton Salt Co.*, 338 U. S. 632 (1950), held that organizations engaged in commerce could be required by the Government to file reports dealing with particular phases of their activities. The language used by the Court in that case is instructive:

"It is unnecessary here to examine the question of whether a corporation is entitled to the protection of the Fourth Amendment. Cf. *Oklahoma Press Publishing Co.* v. *Walling*, 327 U. S. 186. Although the 'right to be let alone—the most comprehensive of rights and the right most valued by civilized men,' Brandeis, J., dissenting in *Olmstead* v. *United States*, 277 U. S. 438, 471, at 478, is not confined literally to searches and seizures as such, but extends as well to the orderly taking under compulsion of process, *Boyd* v. *United States*, 116 U. S. 616, *Hale* v. *Henkel*, 201 U. S. 43, 70, neither incorporated nor unincorporated associations can plead an unqualified right to conduct their affairs in secret. *Hale* v. *Henkel, supra; United States* v. *White*, 322 U. S. 694.

"While they may and should have protection from unlawful demands made in the name of public investigation, *cf. Federal Trade Comm'n* v. *American Tobacco Co.*, 264 U. S. 298, corporations can claim no equality with the individuals in the enjoyment of a right of privacy. *Cf. United States* v. *White, supra.* They are endowed with public attributes. They have a collective impact upon society, from which they derive the privilege of acting as artificial entities. The Federal Government allows them the privilege of engaging in interstate commerce. Favors from government often carry with them an enhanced measure of regulation. [Citations omitted.] Even if one were to regard the request for information in this

case as caused by nothing more than official curiosity, nevertheless law-enforcing agencies have a legitimate right to satisfy themselves that corporate behavior is consistent with the law and the public interest." 338 U. S. 632, 651-652.

We have no difficulty then in determining that the Secretary's requirements for the reporting of domestic financial transactions abridge no Fourth Amendment right of the banks themselves. The bank is not a mere stranger or bystander with respect to the transactions which it is required to record or report. The bank is itself a party to each of these transactions, earns portions of its income from conducting such transactions, and in the past may have kept records of similar transactions on a voluntary basis for its own purposes. See *United States* v. *Biswell*, 406 U. S. 311, 316 (1972). The regulations presently in effect governing the reporting of domestic currency transactions require information as to the personal and business identity of the person conducting the transaction and of the person or organization for whom it was conducted, as well as a summary description of the nature of the transaction. It is conceivable, and perhaps likely, that the bank might not of its own volition compile this amount of detail for its own purposes, and therefore to that extent the regulations put the bank in the position of seeking information from the customer in order to eventually report it to the Government. But as we have noted above, "neither incorporated nor unincorporated associations can plead an unqualified right to conduct their affairs in secret." *United States* v. *Morton Salt Co., supra,* at 652.

The regulations do not impose unreasonable reporting requirements on the banks. The regulations require the reporting of information with respect to abnormally large transactions in currency, much of which information the bank as a party to the transaction already possesses or would acquire in its own interest. To the extent that the regulations in connection with such transactions require the bank to obtain information from a customer simply because the Government wants it, the information is sufficiently described and limited in nature, and sufficiently related to a tenable congressional determination as to improper use of transactions of that type in interstate commerce, so as to withstand the Fourth Amendment challenge made by the bank plaintiffs. "[T]he inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant. 'The gist of the protection is in the requirement, expressed in terms, that the disclosure sought shall not be unreasonable.' " *United States* v. *Morton Salt Co., supra,* at 652-653, see *Okla. Press Pub. Co.* v. *Walling*, 327 U. S. 186, 208 (1946).

In addition to the Fourth Amendment challenge to the domestic reporting requirements made by the bank plaintiffs, we are faced with a similar challenge by the depositor plaintiffs, who contend that since the reports of domestic transactions which the bank is required to make will include transactions to which the depositors were parties, the requirement that the bank make a report of the transaction violates the Fourth Amendment rights of the depositor. The complaint filed in the District Court by the ACLU and the depositors contains no allegation by any of the individual depositors that they were engaged in the type of $10,000 domestic currency transaction which would necessitate that their bank report it to the Government. This is not a situation where there might have been a mere oversight in the specificity of the pleadings and where this Court could properly infer that participation in such a transaction was necessarily inferred from the fact that the individual plaintiffs allege that they are in fact "depositors." Such an inference can be made, for example, as to the recordkeeping provisions of Title I, which require the banks to keep various records of certain transactions by check; as our discussion of the challenges by the individual depositors to the recordkeeping provisions, *supra,* implicitly recognizes, the allegation that one is a depositor is sufficient to permit consideration of the challenges to the recordkeeping provisions, since any depositor would to some degree be affected by them. Here, however, we simply cannot assume that the mere fact that one is a depositor in a bank means that he has engaged or will engage in a transaction involving more than $10,000 in currency, which is the only type of domestic transaction which the Secretary's regulations require that the banks report. That being so, the depositor plaintiffs lack standing to challenge the domestic reporting regulations, since they do not show that their transactions are required to be reported.[28]

"Plaintiffs in the federal courts 'must allege some threatened or actual injury resulting from the putatively illegal action before a federal court may assume jurisdiction.' *Linda R. S.* v. *Richard D.*, 410 U. S. 614, 617 (1973). There must be a 'personal stake in the outcome' such as to 'assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions.' *Baker* v. *Carr*, 369 U. S. 186, 204 (1962). . . . Abstract injury is not enough. It must be alleged that the plaintiff 'has sustained or is immediately in danger of sustaining some direct injury' as the result of the challenged statute or official conduct. *Massachusetts* v. *Mellon*, 262 U. S. 447, 488 (1923). The injury or threat of injury must be both 'real and immediate,' not 'conjectural' or 'hypothetical.' *Golden*

[28] We hold here and in other parts of this opinion that certain of the plaintiffs did not make the requisite allegations in the District Court to give them standing to challenge the Act and the regulations issued pursuant to it. In so holding, we do not, of course, mean to imply that such claims would be meritorious if presented by a litigant who has standing.

v. *Zwickler*, 394 U. S. 103, 109-110 (1969); *Maryland Casualty Co.* v. *Pacific Coal & Oil Co.*, 312 U. S. 270, 273 (1941); *United Public Workers* v. *Mitchell*, 330 U. S. 75, 89-91 (1947)." *O'Shea* v. *Littleton*, 414 U. S. 488, at 493-494 (1974) (footnote omitted).

We therefore hold that the Fourth Amendment claims of the depositor plaintiffs may not be considered on the record before us. Nor do we think that the California Bankers Association or the Security National Bank can vicariously assert such Fourth Amendment claims on behalf of bank customers in general.

The regulations promulgated by the Secretary require that a report concerning a domestic currency transaction involving more than $10,000 be filed only by the financial institution which is a party to the transaction; the regulations do not require a report from the customer. 31 CFR § 103.22; see 31 U. S. C. § 1082. Both the bank and depositor plaintiffs here argue that the regulations are constitutionally defective because they do not require the financial institution to notify the customer that a report will be filed concerning the domestic currency transaction. Since we have held that the depositor plaintiffs have not made a sufficient showing of injury to make a constitutional challenge to the domestic reporting requirements, we do not address ourselves to the necessity of notice to those bank customers whose transactions must be reported. The fact that the regulations do not require the banks to notify the customer of the report violates no constitutional right of the banks, and the banks in any event are left free to adopt whatever customer notification procedures they desire.[29]

[29] Plaintiffs similarly contend that the Secretary's regulation requiring the reporting of domestic currency transactions *only* by the banks or financial institutions which are parties thereto, violates a specific requirement of the Act. Section 222 of the Act, 31 U. S. C. § 1082 [Pub. L. 91-508, 1971-1 C.B. 523, 527], provides in pertinent part:

"The report of any transaction required to be reported under this chapter shall be signed or otherwise made both by the domestic financial institution involved and by one or more of the other parties thereto or participants therein, as the Secretary may require." Plaintiffs contend that this language *requires* the Secretary to require either a signature on the report by the individual customer in the currency transaction, or a report from that customer. Since the Secretary has only required a report from the financial institution, plaintiffs urge, in addition, that there will not be notice to the individual customer of the report made by the financial institution.

In rebuttal, the Government urged in oral argument, Tr. of Oral Arg. 64-70, that not only does section 206 of the Act, 31 U. S. C. § 1055, give the Secretary broad authority to make exceptions to the requirements of the Act in promulgating the regulations, but that the House and Senate Reports on the bills considered by each house of the Congress, each of which contained a provision identical to the language of section 222, indicated that each chamber read that language differently. The Senate Committee believed that the language permitted the Secretary to require reports from the financial institution, the customer, *or* both, S. Rep. No. 91-1139, *supra*, at 15, while the House Committee felt that the language required reports to be filed by both the financial institution and the customer, H. R. Rep. No. 91-975, *supra*, at 22.

We similarly do not reach this claim as it relates to the depositor plaintiffs since they failed to allege sufficient injury below. Whatever the merits of such a contention vis-a-vis the depositors, the regulation clearly has no adverse effect on any constitutional right of the banks, since the statute indisputably authorizes the Secretary to requre a report from the bank.

C. Fifth Amendment Challenge to The Foreign and Domestic Reporting Requirements

The District Court rejected the depositor plaintiffs' claim that the foreign reporting requirements violated the depositors' Fifth Amendment privilege against compulsory self-incrimination, and found it unnecessary to consider the similarly based challenge to the domestic reporting requirements since the latter were found to be in violation of the Fourth Amendment. The appeal of the depositor plaintiffs in No. 72-1196 challenges the foreign reporting requirements under the Fifth Amendment, and their brief likewise challenges the domestic reporting requirements as violative of that Amendment. Since they are free to urge in this Court reasons for affirming the judgment of the District Court which may not have been relied upon by the District Court, we consider here the Fifth Amendment objections to both the foreign and the domestic reporting requirements.

As we noted above, the bank plaintiffs, being corporations, have no constitutional privilege against compulsory self-incrimination by virtue of the Fifth Amendment. *Hale* v. *Henkel, supra*. Their brief urges that they may vicariously assert Fifth Amendment claims on behalf of their depositors. But since we hold *infra* that those depositor plaintiffs who are actually parties to this action are premature in asserting any Fifth Amendment claims, we do not believe that the banks under these circumstances have standing to assert Fifth Amendment claims on behalf of customers in general.

The individual depositor plaintiffs below made various allegations in the complaint and affidavits filed in the District Court. Plaintiff Stark alleged that he was, in addition to being president of plaintiff Security National Bank, a customer of and depositor in the bank. Plaintiff Marson alleged that he was a customer of and depositor in the Bank of America. Plaintiff Lieberman alleged that he had repeatedly in the recent past transported or shipped one or more monetary instruments exceeding $5,000 in value from the United States to places outside the United States, and expected to do likewise in the near future. Plaintiffs Lieberman, Harwood, Bruer, and Durell each alleged that they maintained a financial interest in and signature authority over one or more bank accounts in foreign countries. This, so far as we can ascertain from the record, is the sum and substance of the depositors' allegations of fact upon which they seek to mount an attack on the reporting requirements of regulations of violative of the privilege against compulsory self-incrimi-

nation granted to each of them by the Fifth Amendment.

Considering first the challenge of the depositor plaintiffs to the foreign reporting requirements, we hold that such claims are premature. In *United States* v. *Sullivan*, 274 U. S. 259 (1927), this Court reviewed a judgment of the Circuit Court of Appeals for the Fourth Circuit, 15 F. 2d 809 (1926), which had held that the Fifth Amendment protected the respondent from being punished for failure to file an income tax return. This Court reversed the decision below, stating:

"As the defendant's income was taxed, the statute of course required a return. See *United States* v. *Sischo*, 262 U. S. 165. In the decision that this was contrary to the Constitution we are of opinion that the protection of the Fifth Amendment was pressed too far. If the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all. We are not called on to decide what, if anything, he might have withheld. Most of the items warranted no complaint. It would be an extreme if not an extravagant application of the Fifth Amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime. But if the defendant desired to test that or any other point he should have tested it in the return so that it could be passed upon. He could not draw a conjurer's circle around the whole matter by his own declaration that to write any word upon the government blank would bring him into danger of the law." 274 U. S., at 263-264.

Here the depositor plaintiffs allege that they intend to engage in foreign currency transactions or dealings with foreign banks which the Secretary's regulations will require them to report, but they make no additional allegation that any of the information required by the Secretary will tend to incriminate them. It will be time enough for us to determine what, if any, relief from the reporting requirement they may obtain in a judicial proceeding when they have properly and specifically raised a claim of privilege with respect to particular items of information required by the Secretary, and the Secretary has overruled their claim of privilege. The posture of plaintiffs' Fifth Amendment rights here is strikingly similar to those asserted in *Communist Party* v. *SACB, supra,* 367 U. S., at 105-110. The Party there sought to assert the Fifth Amendment claims of its officers as a defense to the registration requirement of the Subversive Activities Control Act, although the officers were not at that stage of the proceeding required by the Act to register, and had neither registered nor refused to register on the grounds that registration might incriminate them. The Court said:

"If a claim of privilege is made, it may or may not be honored by the Attorney General. We cannot, on the basis of supposition that privilege will be claimed and not honored, proceed now to adjudicate the constitutionality under the Fifth Amendment of the registration provisions. Whatever proceeding may be taken after and if the privilege is claimed will provide an adequate forum for litigation of that issue." 367 U. S., at 107.

Plaintiffs argue that cases such as *Albertson* v. *SACB,* 382 U. S. 70 (1965), have relaxed the requirements of earlier cases, but we do not find that contention supported by the language or holding of that case. There the Attorney General had petitioned for and obtained an order from the SACB compelling certain named members of the Communist Party to register their affiliation. In response to the Attorney General's petitions, both before the Board and in subsequent judicial proceedings, the Communist Party members had asserted the privilege against self-incrimination, and their claims had been rejected by the Attorney General. A previous decision of this Court had held that an affirmative answer to the inquiry as to membership in the Communist Party was an incriminating admission protected under the Fifth Amendment. *Blau* v. *United States,* 340 U. S. 159 (1950). The differences then between the posture of the depositor plaintiffs in this case and that of petitioner in *Albertson* v. *SACB, supra,* are evident.

We similarly think that the depositor plaintiffs' challenge to the domestic reporting requirements are premature. As we noted above, it is not apparent from the allegations of the complaints in these actions that any of the depositor plaintiffs would be engaged in $10,000 domestic transactions with the bank which the latter would be required to report under the Secretary's regulations pertaining to such domestic transactions. Not only is there no allegation that any depositor engaged in such transactions, but there is no allegation in the complaint that any report which such a bank was required to make would contain information incriminating any depositor. To what extent, if any, depositors may claim a privilege arising from the Fifth Amendment by reason of the obligation of the bank to report such a transaction may be left for resolution when the claim of privilege is properly asserted.

Depositor plaintiffs rely on *Marchetti* v. *United States,* 390 U. S. 39 (1968) [Ct. D. 1919, 1968-1 C.B. 500, *Grosso* v. *United States,* 390 U. S. 62 (1968) [Ct. D. 1918, 1968-1 C.B. 495], and *Haynes* v. *United States,* 390 U. S. 85 (1968) [Ct. D. 1920, 1968-1 C.B. 615], as supporting the merits of their Fifth Amendment claim. In each of those cases, however, a claim of privilege was asserted as a defense to the requirement of reporting particular information required by the law under challenge, and those decisions therefore in no way militate against our conclusion that depositor plaintiffs' efforts to litigate the Fifth Amendment issue at this time are premature.

D. Plaintiff ACLU's First Amendment Challenge to the Foreign and Domestic Reporting Requirements

The ACLU claims that the reporting requirements with respect to foreign and domestic transactions invade its associational interests protected by the First Amendment. We have earlier held a similar claim by this organization to be speculative and hypothetical when addressed to the recordkeeping requirements imposed by the Secretary. *Supra,* pp. ———. The requirement that particular transactions be reported to the Government, rather than records merely being kept to be available through normal legal process, removes part of the speculative quality of the claim. But the only allegation found in the complaints with respect to the financial activities of the ACLU states that it maintains accounts at one of the San Francisco offices of the Wells Fargo Bank and Trust Company. There is no allegation that the ACLU engages with any regularity in abnormally large domestic currency transactions, transports or receives monetary instruments from channels of foreign commerce, or maintains accounts in financial institutions in foreign countries. Until there is some showing that the reporting requirements contained in the Secretary's regulations would require the reporting of information with respect to the organization's financial activities, no concrete controversy is presented to this Court for adjudication. *O'Shea* v. *Littleton, supra,* 414 U.S., at 493-494.

V

All of the bank and depositor plaintiffs have stressed in their presentations to the District Court and to this Court that the recordkeeping and reporting requirements of the Bank Secrecy Act are focused in large part on the acquisition of information to assist in the enforcement of the criminal laws. While, as we have noted, Congress seems to have been equally concerned with civil liability which might go undetected by reason of transactions of the type required to be recorded or reported, concern for the enforcement of the criminal law was undoubtedly prominent in the minds of the legislators who considered the Act. We do not think it is strange or irrational that Congress, having its attention called to what appeared to be serious and organized efforts to avoid detection of criminal activity, should have legislated to rectify the situation. We have no doubt that Congress, in the sphere of its legislative authority, may just as properly address itself to the effective enforcement of criminal laws which it has previously enacted as to the enactment of those laws in the first instance. In so doing, it is of course subject to the strictures of the Bill of Rights, and may not transgress those strictures.[30] But the fact that a legislative enactment manifests a concern for the enforcement of the criminal law does not cast any generalized pall of constitutional suspicion over it. Having concluded that on the record in these appeals, plaintiffs have failed to state a claim for relief under the First, Fourth, and Fifth Amendments, and having concluded that the enactment in question was within the legislative authority of Congress, our inquiry is at an end.

On the appeal of the California Bankers Association in No. 72-985 from that portion of the judgment of the District Court upholding the recordkeeping requirements imposed by the Secretary pursuant to Title I, the judgment is affirmed. On the appeal of the bank and depositor plaintiffs in No. 72-1196 from that portion of the District Court's judgment upholding the recordkeeping requirements and regulations of Title I and the foreign reporting requirements imposed under the authority of Title II, the judgment is likewise affirmed. On the Government's appeal in No. 72-1073 from that portion of the District Court's judgment which held that the domestic reporting requirements imposed under Title II of the Act violated the Constitution, the judgment is reversed. The cause is remanded to the District Court for disposition consistent with this opinion.

So ordered.

[30] There have been recent hearings in Congress on various legislative proposals to amend the Bank Secrecy Act. Hearings before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs to amend the Bank Secrecy Act, 92d Cong., 2d Sess. (1972). See S. 3814 and S. 3828, 92d Cong., 2d Sess. (1972).

Delegation Order No. 42 (Rev. 4) (Effective April 22, 1974)

Authority to Execute Consents Fixing the Period of Limitations on Assessment of Collection Under Provisions of the 1939 and 1954 Internal Revenue Codes.

1. Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 120, dated July 31, 1950; Order No. 150-2, dated May 15, 1972; 26 CFR 301.6501(c)-1; 26 CFR 301.6502-1; 26 CFR 301.6901-1(d); and 26 CFR 301.7701-9; I hereby delegate authority to sign all consents fixing the period of limitations on assessment or collection to the following officials:

a. Assistant Regional Commissioners (Appellate)

b. Service Center Directors

c. District Directors

d. Director of International Operations

2. This authority may be redelegated but not below the following level for each activity:

a. Service Centers—Chief, Accounting Branch; Chief, Correspondence Audit Branch

b. Collection—Revenue Officer

c. Audit—Conferees and Reviewers, Grade GS-11, and Group Managers

d. Intelligence—Chief, Intelligence Division

e. Appellate—Appellate Conferee

f. Office of International Operations—Conferees and Reviewers, Grade GS-11; Group Managers; Representatives at foreign posts; and Revenue Agents, Tax Auditors and Special Agents on foreign assignments; and Revenue Officers

3. This Order supersedes Delegation Order No. 42 (Rev. 3) [1973-1 C.B. 379], issued March 7, 1973.

DONALD C. ALEXANDER,
Commissioner.

(Filed by the Office of the Federal Register on April 29, 1974, 8:45 a.m., and published in the issue of the Federal Register for April 30, 1974, 39 F.R. 15055)

Delegation Order No. 143 (Effective December 12, 1973)

Authority to Enforce the Currency and Foreign Transactions Reporting Act of 1970 (Titles I and II of Public Law 91-508 [1971-1 C.B. 523])

The authority and responsibilities vested in the Commissioner of Internal Revenue by 31 CFR 103.46(a)(8) and 26 CFR 301.7701-9(c), for assuring compliance with the requirements of 31 CFR 103 which are under the jurisdiction of the Internal Revenue Service, are delegated as follows:

Assistant Commissioner (Compliance)
Regional Commissioners
District Directors

The authority delegated herein may be redelegated by the officials specified in this Order and may not be further redelegated.

DONALD C. ALEXANDER,
Commissioner.

(Filed by the Office of the Federal Register on December 18, 1973, 8:45 a.m., and published in the issue of the Federal Register for December 19, 1973, 38 F.R. 34824)

Delegation Order No. 144 (Effective January 18, 1974)

Authority to Issue Transfer Certificates in Certain Estate Tax Cases

1. The authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7701-9 and 26 CFR 20.6325-1(c) to issue transfer certificates in certain estate tax cases is hereby delegated to District Directors, the Director of International Operations and the Director, Philadelphia Service Center.

2. The authority delegated herein may be redelegated only by the officials specified in this Order and may not be further redelegated.

DONALD C. ALEXANDER,
Commissioner.

(Filed by the Office of the Federal Register on January 23, 1974, 8:45 a.m., and published in the issue of the Federal Register for January 24, 1974, 39 F.R. 2777)

Executive Order 11760

Designating the European Space Research Organization (ESRO) as a Public International Organization Entitled To Enjoy Certain Privileges, Exemptions, and Immunities

By virtue of the authority vested in me by sections 1 and 11 of the International Organizations Immunities Act (59 Stat. 669; 22 U.S.C. 288) [Pub. L. 291, 1946-1 C.B. 323] as amended by Public Law 89-353 (80 Stat. 5), it is ordered as follows:

SECTION 1. I hereby designate the European Space Research Organization (ESRO) as a public international organization entitled to enjoy those privileges, exemptions, and immunities provided for by the International Organizations Immunities Act.

SEC. 2. Executive Order No. 11318 [1967-1 C.B. 431] of December 5, 1966 and Executive Order No. 11351 [1967-1 C.B. 432] of May 22, 1967 are hereby superseded.

RICHARD NIXON.

THE WHITE HOUSE,
January 17, 1974.

(Filed in the Office of the Federal Register on January 17, 1974, 3:11 p.m., and published in the issue of the Federal Register for January 21, 1974, 39 F.R. 2343.)

E. O. 11767

Designating the Organization of African Unity as a Public International Organization Entitled to Enjoy Certain Privileges, Exemptions, and Immunities

By virtue of the authority vested in me by sections 1 and 12 of the International Organizations Immunities Act (59 Stat. 669; 22 U.S.C. 288), as amended by Public Law 93-161 (87 Stat. 635) [page 377, this Bulletin], I hereby designate the Organization of African Unity (OAU) as a public international organization entitled to enjoy the privileges, exemptions, and immunities provided by the International Organizations Immunities Act.

RICHARD NIXON.

THE WHITE HOUSE,
February 19, 1974.

(Filed by the Office of the Federal Register on February 19, 1974; 3:05 p.m., and published in the issue of the Federal Register for February 21, 1974, 39 F.R. 6603)

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 482; 1.482-1)

Rev. Proc. 65-17, Amendment II

The provisions of Rev. Proc. 65-17, 1965-1 C.B. 833, as amended by Rev. Proc. 65-17, Amendment I, 1966-2 C.B. 1211, are available to a corporation that under State law is in existence for the purpose of winding up its affairs where such corporation, subsequent to its liquidation, was a corporation from or to which an allocation of income or deductions was made pursuant to section 482 of the Internal Revenue Code of 1954.

26 CFR 601.402: Sales taxes collected by return.
(Also Part I, Section 4063; 142.1-1)

Rev. Proc. 74-1[1]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth guidelines for

[1] Based on Technical Information Release 1287, dated April 16, 1974.

determining whether a bus is operated in "mass transportation service in urban areas" for purposes of the exemption from manufacturers excise tax provided by section 4063(a)(6) of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

.01 Section 4063(a)(6) of the Code provides that the tax imposed under section 4061(a) shall not apply in the case of automobile bus chassis or bodies which are to be used predominantly by the purchaser in mass transportation service in urban areas.

.02 Section 142.1-1(e) of the Temporary Excise Tax Regulations under the Revenue Act of 1971, Pub. L. 92-178, 1972-1 C.B. 443, provides that, for purposes of section 4063(a)(6) of the Code, a bus will be considered to be purchased for predominant use in mass transportation service in an urban area if the ultimate purchaser of the article intends to use the article in such service for more than 50 percent for each year of its estimated useful life based on both hours of use and mileage. This paragraph applies to buses which are to be operated in local, scheduled, common carrier public passenger service or chartered transportation service for commuters, on a continuing basis, along regular routes in cities and towns and the suburbs thereof. This paragraph does not apply to buses which are to be operated predominantly on intercity routes.

SEC. 3. GUIDELINES.

.01. The guidelines in this section will be used by the Internal Revenue Service in determining whether the predominant use (as defined in section 142.1-1(e) of the Temporary Regulations) of a bus will be in providing local, scheduled, common carrier public passenger service or chartered transportation service for commuters, on a continuing basis, along regular routes within an urban area.

.02. For purposes of the exemption provided by section 4063(a)(6) of the Code, an urban area is defined as an "urban center" and its "surrounding area." "Urban center" is defined as any city or town with a population in excess of 100,000 inhabitants. "Surrounding area" is defined as the area surrounding the urban center that is within (1) 30 miles of the boundary of the urban center if the center's population is in excess of 500,000, or (2) 20 miles of the center's boundary if its population is in excess of 100,000 but not greater than 500,000.

.03. Where a city or town with a population in excess of 100,000 has a common boundary with one or more other cities and towns having a population in excess of 100,000, these cities or towns shall in combination be considered a single urban center for purposes of this Procedure. The populations of these cities or towns shall be combined for purposes of determining the surrounding area for the single urban center.

.04. Where two or more cities or towns, each having a population in excess of 100,000, and not sharing any common boundary, are located on a single route, only the most heavily populated of these cities or towns on the route shall be considered the urban center on that route.

SEC. 4. PROCEDURE.

.01. A purchaser, by submitting the necessary information, may request a determination from the District Director as to whether a bus will be used predominantly in mass transportation service in urban areas under the guidelines set forth in Section 3 of this Procedure. When this determination cannot be made by the District Director, these requests will be referred to the National Office, in accordance with Section 8.01 of Rev. Proc. 72-3, 1972-1 C.B. 698.

.02. Even though a bus does not qualify under the guidelines set forth above as sold for predominant use in mass transportation service in urban areas it may otherwise qualify for such use. In such cases the National Office will make a determination upon submission of the following information for the route or routes on which the bus will be used:

1. Whether commutation tickets or rates are available.

2. The type of bus (local transit, suburban, or intercity).

3. The nature of the service the bus company is certified to provide on the route(s) by the licensing authorities.

4. The schedule structure (whether or not the number of runs is increased during normal commuting hours).

5. Whether the bus route(s) meet the passenger fare revenue test of section 6421(b) of the Code.

6. The length of the route(s) and a description of the area(s) through which they pass.

7. The density of the population in the area(s) through which the route(s) pass.

8. If available from a governmental traffic survey or other data, the percentage of population of the areas along the route(s) that travel in daily traffic to and from the city or town considered to be the urban area.

.03. It should be noted that the information requested in section 4.02 is not exclusive and that any additional information considered relevant should be submitted and will be considered by the National Office.

SEC. 5. INQUIRIES.

.01. Requests for rulings by the National Office should be addressed to the Commissioner of Internal Revenue, Attention: T:MS:EX, Washington, D. C. 20224.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 472; 1.472-3.)

Rev. Proc. 74-2

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth certain circumstances under which a taxpayer will

be considered to have made a valid election to use the last-in, first-out (LIFO) method of inventory valuation even though the requisite Form 970 (Application to Use LIFO Inventory Method) is not filed with the timely filed Federal income tax return for the taxable year as of the close of which the method is first to be used.

SEC. 2. BACKGROUND.

Section 1.472-3(a) of the Income Tax Regulations, as amended by T.D. 7295, page 123, this Bulletin, 38 F.R. 34203, dated December 12, 1973. provides that the LIFO inventory method may be adopted and used only if the taxpayer files with his income tax return for the taxable year as of the close of which the method is first to be used a statement of his election to use such inventory method. Such statement shall be made on Form 970 pursuant to the instructions printed with respect thereto and the requirements of this section, *or in such other manner as shall be acceptable to the Commissioner of Internal Revenue.* Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and the end of the taxable year for which the LIFO inventory method is proposed first to be used, and also as of the beginning of the prior taxable year.

Section 1.472-3(a) of the regulations also provides that, in the case of a manufacturer, the analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in size, style, shape, or use of the finished products.

SEC. 3. CIRCUMSTANCES.

In some instances returns have been filed containing all of the information required under section 1.472-3(a) of the regulations (including the information required in the instructions on Form 970) and the Federal income tax return reflected an election to use the LIFO method of inventory valuation. However, the requisite Form 970 was not filed with the return. Under such circumstances, the question arises whether the Commissioner will accept such election as valid even though Form 970 is not filed with the return.

SEC. 4. PROCEDURE.

.01 The Internal Revenue Service will consider a taxpayer's "election" to use the LIFO method of valuing inventories as acceptable, even though the requisite Form 970 is not filed with the Federal income tax return for the taxable year for which the "election" is made, if the taxpayer included all of the information required on, or to be filed with, Form 970 on his timely filed Federal income tax return for the taxable year as of the close of which the LIFO method is first to be used.

.02 The above does not affect the Commissioner's rights (1) under section 1.472-3(b) of the regulations, to request other detailed information, (2) under section 1.472-3(c), to require that LIFO be used with respect to goods other than those specified in the taxpayers statement of election, and (3) under 1.472-3(d), with respect to the propriety of all adjustments upon examination of the taxpayer's income tax returns.

SEC. 5. INQUIRIES.

Inquiries regarding this Revenue Procedure may be addressed to the Commissioner of Internal Revenue, Attention: T:I:C, 1111 Constitution Avenue, N.W., Washington, D. C. 20224.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Rev. Proc. 74-3[1]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide a procedure relative to the examination of claims for refund and the audit of returns involving the valuation and basis of shares of an open-end investment company, commonly called a "mutual fund", acquired from a decedent or by gift.

SEC. 2. BACKGROUND.

On April 9, 1974, proposed amendments to the Estate Tax Regulations under section 2031 of the Internal Revenue Code of 1954 and the Gift Tax Regulations under 2512 of the Code were published in the Federal Register. The proposed regulations would provide revised rules for determining the fair market value of the shares of an open-end investment company for estate and gift tax purposes. In general, under the revised rules, the value of such shares would be the "bid" or public redemption price of the shares. Presently, the regulations provide that shares of an open-end investment company are to be valued at the public offering, or "asked" price of the shares.

The proposed amendments would conform the estate tax valuation rules to the decision of the Supreme Court in *United States v. Cartwright*, 411 U.S. 546 (1973) [Ct. D. 1957, 1973-1 C.B. 400], which held that section 20.2031-8(b) of the Estate Tax Regulations was invalid. The proposed amendments would also make corresponding changes to the Gift Tax Regulations. The Federal estate and gift tax are in *pari materia* and must be construed together. *Burnet v. Guggenheim*, 288 U.S. 280, 286, [XII-1 C.B. 374 (1933)].

The revised valuation rules would apply with respect to estates of decedents dying after August 16, 1954, and to gifts made after December 31, 1954.

Generally, under section 1014 of the Code, the basis of property in the

[1] Also released as Technical Information Release No. 1284, dated April 9, 1974.

hands of a beneficiary acquiring the property from a decedent is the fair market value of the property at the applicable estate tax valuation date. Further, section 1015 of the Code provides, in general, that the basis of property in the hands of a donee is the same as the donor's basis (increased, but not above fair market value, by the amount of gift tax paid with respect to the gift) except that, for purposes of determining a loss, the donee's basis is the lower of the donor's basis or the fair market value of the property at the time of the gift.

Accordingly, the retroactive application of the revised estate and gift tax valuation rules, as proposed, may affect the amount reported, or to be reported, for income tax purposes with respect to a gain or loss attributable to a sale or exchange of mutual fund shares which have been acquired from a decedent or acquired by gift. Additionally, such retroactive application may affect the determination of income and deductions under other income tax provisions, *e.g.*, the deduction for estate tax attributable to income in respect of a decedent under section 691(c) of the Code.

With respect to the valuation of certain gifts for preceding calendar years and quarters for gift tax purposes, see section 2504(c) of the Code and the regulations thereunder.

SEC. 3. PROCEDURES.

These procedures apply with respect to the examination of claims for refund of overpayment of income tax and the audit of income tax returns which involve an item relating to the basis of the shares of an open-end investment company acquired (1) from a decedent dying before May 8, 1973, and with respect to whose estate an estate tax return is filed on or before the 10th day after the date final amended regulations under section 2031 of the Code, reflecting the United States Supreme Court decision in *Cartwright*, as proposed April 9, 1974, are published in the Federal Register; or (2) by a gift made before May 8, 1973, and with respect to which a gift tax return is filed on or before the 10th day after the date final amended regulations under section 2512 of the Code, reflecting the decision by the Court in *Cartwright* as proposed on April 9, 1974, are published in the Federal Register.

.01 The Service will not disturb a determination of the basis of the shares passing from a decedent which is consistent with the valuation of the shares at the public offering or asked price for estate tax purposes, provided a claim for refund for the overpayment of estate tax is not filed on grounds of an erroneous valuation of the shares at such price.

(a) If a claim for refund for the overpayment of estate tax is filed on grounds of an erroneous valuation of the shares at the public offering or asked price but is later withdrawn, the Service will not disturb a determination of the basis of the shares passing from the decedent which is consistent with the valuation of the shares at such price for estate tax purposes.

(b) If a claim for refund for the overpayment of estate tax is filed on grounds of an erroneous valuation of the shares at the public offering or asked price and is not withdrawn, the Service will require the basis of the shares passing from the decedent to be determined by reference to the public redemption or bid price of the shares at the applicable valuation date for estate tax purposes.

.02 The Service will not disturb a determination of the fair market value of the shares acquired by gift or an addition to basis, where appropriate, for gift taxes paid, which is consistent with the valuation of the shares at the public offering or asked price for gift tax purposes, provided a claim for refund for the overpayment of gift tax is not filed on the grounds of an erroneous valuation of the shares at such price.

(a) If a claim for refund for the overpayment of gift tax is filed on the grounds of an erroneous valuation of such shares at the public offering or asked price but is later withdrawn, the Service will not disturb a determination of the fair market value of such shares acquired by gift, or of an addition to basis, where appropriate, for gift taxes paid, which is consistent with the valuation of the shares at such price for gift tax purposes.

(b) If a claim for refund for the overpayment of gift tax is filed on the grounds of an erroneous valuation of such shares at the public offering or asked price and is not withdrawn, the Service will require the fair market value or other basis of such shares acquired by gift to be determined consistently by reference to the public redemption or bid price of the shares used for gift tax purposes.

.03 The procedures contained in paragraphs .01 and .02 will be applied to other sections of the Code similarly affected by the revised regulations, *e.g.*, section 691(c) (relating to deduction for estate tax).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Rev. Proc. 74-4

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the revision of district Audit Division conference procedures to provide settlement authority to district conference staffs in certain cases.

SEC. 2. SCOPE.

The revised district Audit Division conference procedures apply to unagreed field and office audit cases involving income, estate, gift, excise (other than excise taxes on alcohol, tobacco, narcotics, and firearms), and employment taxes.

SEC. 3. SETTLEMENT AUTHORITY IN DISPOSITION OF SMALL UNAGREED FIELD AND OFFICE AUDIT CASES.

.01 District conferees are authorized to consider and accept settlement pro-

posals by taxpayers, subject to approval of Chief, Conference Staff, Section Chief (Conference Staff), or Chief, Technical Branch (except in Manhattan District), as appropriate, in field and office audit cases when the total amount of proposed additional tax, proposed overassessment, or claimed refund does not exceed $2,500 for any year. This authority includes the right to settle issues on a basis favorable to the taxpayer even though contrary to non-acquiesced court decisions or interpretations of the Service as set forth in ruling letters issued to, or technical advice memorandums concerning, the taxpayer whose case is being considered by the district conferee, and revenue rulings.

.02 If any case such as described in subsection .01 of this section remains unagreed after a district conference the taxpayer will be entitled to an Appellate Division Conference.

.03 If in any case described in subsection .01 of this section, the district conferee accepts the taxpayer's proposal of settlement, or, in the absence of a proposal recommends favorable action to the taxpayer and said recommendation is disapproved in whole or in part, the taxpayer will be so advised and upon request shall be accorded a rehearing before the Chief, Conference Staff, Section Chief (Conference Staff), or Chief, Technical Branch, (except in Manhattan District), as appropriate. The District Conference Staff may disregard this rule where the interest of the Government would be injured by delay, as for example, a case involving the imminent expiration of the statute of limitations, etc.

.04 If the taxpayer does not elect an Appellate conference in a case that is unagreed after district conference, a Statutory Notice will be issued or other appropriate closing action taken.

.05 These procedures are not intended to provide a taxpayer a choice of the better of two settlement proposals. In an unagreed case after district conference, any settlement proposals or counterproposals made will be included in the report of the district conferee, however, such proposals or counterproposals of settlement are not binding on the Appellate conferee and the Appellate disposition of the case will be final.

SEC. 4. PRE-CONFERENCE PROCEDURES IN UNAGREED FIELD AUDIT CASES

.01 If, at the conclusion of an examination, the taxpayer does not agree with the adjustments proposed by the examining officer, the examining officer will prepare a complete examination report fully explaining all proposed adjustments.

.02 The taxpayer will receive a copy of the examination report and an invitation to a district conference under cover of a transmittal letter (commonly referred to as a "30-day letter"). This letter provides the taxpayer with a detailed explanation of the available appeal procedures and requests that the district be informed, ordinarily within 30 days of the choice of action.

.03 If the total amount of proposed additional tax, proposed over-assessment, or claimed refund does not exceed $2,500 for any year, the taxpayer will be granted a district Audit Division conference on request, but will not be required to file a protest. Nevertheless, if he desires, he may submit a written statement outlining the facts, law, or arguments on which he relies.

.04 If the amount of proposed additional tax, proposed overassessment or claimed refund exceeds $2,500 for any year the taxpayer, on request will be granted a district Audit Division conference, provided a written protest is filed setting forth the facts, law, and arguments upon which the taxpayer relies.

.05 Taxpayers are encouraged to avail themselves of district Audit Division conference procedures because such procedures permit a more expeditious disposition of unagreed cases. This applies to both cases in which settlement authority may be employed and the larger cases in which issues are relatively free of legal or other complexities beyond the functional responsibilities of District conferees.

.06 In cases involving proposed additional tax, proposed overassessment, or claimed refund in excess of $2,500 for any year, when the nature or complexity of the unagreed issues is such that original consideration by the Appellate Division would result in the more expeditious resolution of the case, taxpayers will be invited to request initial consideration by the regional Appellate Division.

SEC. 5. PRE-CONFERENCE PROCEDURES IN UNAGREED OFFICE INTERVIEW AUDIT CASES

.01 If, at the conclusion of an office interview audit, the taxpayer does not agree with the adjustments proposed, the examining officer will fully explain the adjustments and the available appeal procedures.

.02 If the taxpayer desires an immediate conference it will be granted, if practicable.

.03 If an immediate conference is not requested by the taxpayer the examination report will be mailed to him under cover of an appropriate transmittal letter. This letter provides him with a detailed explanation of the available appeal procedures and requests him to inform the district, within the specified time of his choice of action.

.04 The taxpayer will be granted a district Audit Division conference on request, and will not be required to file a protest. Nevertheless, if he so desires, he may submit a written statement outlining the facts, law or arguments on which he relies.

SEC. 6. CONFERENCE AND REPORTS PROCEDURES IN UNAGREED FIELD AND OFFICE AUDIT CASES.

.01 Ordinarily, the examining officer will not attend the district Audit Division conference.

.02 Changes made by the conference

staff to the proposals set forth in the examination report will be reflected in a Conference Audit Statement. This statement will be sent to the taxpayer to inform him of changes made and to serve as a supplement to the examination report.

.03 The conferee's determination will not be reviewed by the district review staff. However, it may be subject to review by the office of the Assistant Regional Commissioner (Audit).

SEC. 7. REQUESTS FOR TECHNICAL ADVICE.

.01 In any case described in Section 3.01, the district conferee, depending on the facts and circumstances of each case, may either request technical advice in accordance with published procedures for requesting technical advice or return the case to the examiner to request such advice. However, in exercising settlement authority under Section 3.01, the conferee is not bound by such advice.

SEC. 8. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Compliance), Attention: CP:A:C:T, Internal Revenue Service, Washington, D.C. 20224.

SEC. 9. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 68-30, 1968-2 C.B. 915, is superseded.

SEC. 10. EFFECTIVE DATE.

.01 This Revenue Procedure will become effective on April 1, 1974.

.02 All unagreed cases in conference status on April 1, 1974, will be processed under the new procedures.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, Section 7605; 301.7605-1.)

Rev. Proc. 74-5

SECTION 1. PURPOSE

The purpose of the Revenue Procedure is to restate and amplify the conditions under which a case closed after examination in the office of a District Director of Internal Revenue may be reopened to make an adjustment unfavorable to the taxpayer.

This procedure contains a listing of certain types of cases wherein reconsideration is not considered a reopening and makes clear that cases closed after examination by service centers require application of reopening procedures.

SEC. 2. SCOPE

This procedure pertains to all cases, regardless of type of tax, in which the prior audit and conference action, if any, did not extend beyond the jurisdiction of the office of the District Director. It does not apply to cases previously closed after consideration by Regional Appellate Offices of Regional Counsels.

SEC. 3. DEFINITIONS

.01 Closed Case:

1. A case agreed at the district level is considered closed when the taxpayer is notified in writing, after district conference, if any, of adjustments to tax liability or acceptance of his return without change.

2. An unagreed income, estate or gift tax case is considered closed when the period for filing a petition with the United States Tax Court specified in the statutory noice of deficiency issued by the District Director expires and no petition was filed.

3. An unagreed excise or employment tax case is considered closed when the period for filing protest and requesting consideration by the Appellate Division specified in the preliminary letter expires and no protest or request for Appellate consideration is filed.

.02 Examination and Reopening:

1. Contacts with taxpayers to verify or adjust items disclosed on information returns, including items of income distributable to taxpayers by partnerships, fiduciaries, or small business corporations, and contacts with taxpayers to correct mathematical errors are not examinations or reopenings.

2. Reconsideration of a case is not considered a reopening and therefore, requires no approval or issuance of form letter L-153 if it involves:

(a) Cases involving section 1311 of the Code.

(b) Cases involving the year of deduction of a net operating loss carryback or similar type of carryback under other provisions of the Code.

(c) Cases in which there have been involuntary conversions and the taxpayer has not recomputed his tax liability because he did not replace the property within the time provided by section 1033 of the Code.

(d) Cases involving an overpayment in excess of $100,000, subject to consideration by the Joint Committee on Internal Revenue Taxation under section 6405 of the Code.

SEC. 4. POLICY

.01 The Internal Revenue Service will not reopen any case closed after examination by a district office, service center or Office of International Operations to make an adjustment unfavorable to the taxpayer unless:

1. There is evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact; or

2. The prior closing involved a clearly defined substantial error based on an established Service position existing at the time of the previous examination; or

3. Other circumstances exist which indicate failure to reopen would be a serious administrative omission.

.02 All reopenings must be approved by the District Director or by the Director of International Operations for cases under his jurisdiction. If an additional inspection of the taxpayer's books of account is necessary, the notice to the taxpayer required by section 7605(b) of the Code must be signed by the District Director, or by the Director of International Operations for cases under his jurisdiction.

SEC. 5. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes Rev. Proc. 72-40, 1972-2 C.B. 819.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Section 2055; 20.2055-2.)

Rev. Proc. 74-6

SECTION 1. PURPOSE.

.01 The purpose of this Revenue Procedure is to supersede Revenue Procedure 73-9, 1973-1 C.B. 758, by setting forth additional specific procedures which, with existing procedures, relate to the allowance of the charitable deduction for Federal estate tax purposes in certain cases where, by reason of the nature of the administrative or investment powers granted to the trustee, there is substantial doubt as to whether the value of an interest in trust passing from the decedent is ascertainable. Provisions of Rev. Proc. 73-9 applicable to cases under the District Director's jurisdiction are unchanged by this Revenue Procedure, but the disposition of other cases is clarified.

.02 Sections 3.02 and 4.04 are revised, respectively, by substitution of the word "Service" for "District Director". This change makes it clear that the Revenue Procedure is not restricted to cases that are under the jurisdiction of the District Director.

.03 Sections 4.05 and 4.06 are added to the Procedure to set forth specific provisions for the disposition of docketed cases.

.04 The title of the Service official on the last signature line in Section 5 is changed in order to conform the sample agreement to the foregoing revisions.

SEC. 2. BACKGROUND.

.01 In the case of a charitable contribution of an income or remainder interest in a split-interest trust, the presence of certain administrative or investment powers exercisable by the trustee may render the value of the income or remainder interest unascertainable, with the result that no estate tax deduction is allowable. For instance, Rev. Rul. 60-385, 1960-2 C.B. 77, holds that the charitable deduction for a remainder interest in trust is not allowable where the trustee is permitted, under the trust instrument, to invest in mutual funds and treat capital gains distributions (ordinarily held to be corpus) as income. In Rev. Rul. 67-33, 1967-1 C.B. 62, the Internal Revenue Service extended that holding to cases where the power to allocate capital gains distributions to income is granted under applicable local law instead of the trust instrument. Similarly, Rev. Rul. 65-144, 1965-1 C.B. 442, holds that the charitable deduction for a remainder interest in trust is not allowable where the trust instrument granted the trustee the power to allocate stock, extraordinary and liquidating dividends, taxes, and other expenses between income and principal in his absolute discretion.

.02 Since the issuance of these Revenue Rulings, each of which illustrates a situation where the noncharitable beneficiary can be favored over the charitable beneficiary by the trustee's exercise of his administrative or investment powers, a number of cases have been litigated involving the allowance of the charitable deduction for an interest in a split-interest trust where the trustee is granted certain administrative or investment powers with respect to such matters as permissible investments or the characterization of receipts and disbursements. In many of these cases, the courts have concluded that in view of these powers the charitable interest could not be valued in a dollar amount and that the charitable deduction was, therefore, not allowable. These conclusions were based upon the finding by the courts that the trustee could shift substantial portions of the trust interests between charitable and noncharitable beneficiaries through exercise of the administrative or investment powers in a manner that would not be obviously inconsistent with the testamentary purpose of the decedent and that such exercise would not violate the standard of fairness and good faith to which a fiduciary is held. In other cases, the trustee's administrative or investment powers have been found to be strictly limited by an overriding duty of impartiality, thus enabling the value of the charitable interest to be ascertained.

.03 The Tax Reform Act of 1969, P.L. 91-172, 1969-3 C.B. 10, amended section 2055(e) of the Internal Revenue Code of 1954 to provide that no deduction will be allowed for a charitable contribution of an interest in a split-interest trust unless such interest is a remainder interest in a charitable remainder annuity trust (as described in section 664(d)(1) of the Code), a charitable remainder unitrust (as described in section 664(d)(2) and (3), or a pooled income fund (as described in section 642(c)(5)), or is a guaranteed annuity or a fixed percentage distributed yearly of the fair market value of the property (determined yearly). In general, this amendment applies to devises and bequests made after December 31, 1969.

.04 In order to provide guidelines for settling cases governed by the provisions of section 2055 of the Code in effect prior to the Tax Reform Act of 1969, the following procedure is established.

SEC. 3. INSTRUCTIONS TO TAXPAYERS AND SERVICE PERSONNEL.

.01 Unless the Service determines that it is not clear whether the discretion of the trustee would be strictly limited by a duty of impartiality, the charitable deduction will be allowed.

.02 In cases where the Service determines that it is not clear whether the discretion of the trustee would be strictly limited by a duty of impartiality, the Service shall notify the estate of such determination and the charitable deduction may nevertheless be allowed for the value of the

charitable bequest or transfer in trust if the appropriate parties enter into a prescribed agreement with the Service that the trustee of the trust will exercise enumerated administrative or investment powers in an impartial manner and will not favor the interests of noncharitable beneficiaries as against those of charitable beneficiaries.

.03 The appropriate parties to the agreement must include the fiduciary of the decedent's estate, the trustees of the trust, and all charitable and noncharitable beneficiaries (both vested and contingent).

.04 If any of the charitable beneficiaries are not ascertainable, then the attorney general for the State that is the situs of the trust must also be a party to the agreement. Any unascertained noncharitable beneficiaries must be made parties to, or otherwise bound by, the agreement through appropriate process under the local law.

.05 If the trustee and other necessary parties fail to enter into such an agreement, then it will be necessary to determine whether the trustee's discretion is sufficiently limited under local law.

.06 The execution and performance of the agreement described in this Revenue Procedure will not be considered to be a gift.

SEC. 4. SCOPE.

.01 The Service will not enter into such an agreement where section 2055 (e) of the Code, as amended by the Tax Reform Act of 1969, applies. See section 201(g)(4) of that Act for effective date provisions as applicable to amendments made by the Act to section 2055(e) of the Code.

.02 The Service will not enter into such an agreement where the dispositive instrument clearly states, or the surrounding circumstances establish, an intention that the noncharitable beneficiaries should be favored over the charitable beneficiaries. See, for example, *Joseph Sachter v. United States*, 312 F. Supp. 670 (S.D. N.Y. 1970).

.03 This Revenue Procedure relates only to the effect of administrative or investment powers on the allowance of a charitable deduction under section 2055 of the Code. It does not relate to administrative or investment powers for purposes of any other provision of the income, estate, and gift tax laws or to direct powers of invasion.

.04 *Cases pending with the Internal Revenue Service.* The agreement described in this Revenue Procedure will be effective for purposes of section 2055 of the Code if it is executed (1) within 30 days after the Service notifies the estate that there appears to be cause for denying the deduction unless such agreement is executed (or within such extension of the 30-day period as the Service may grant), or (2) before the expiration of the period of limitations on credits or refunds as prescribed by section 6511, whichever of the two dates occurs first.

.05 *Cases pending before the United States Tax Court.* If a case is pending before the Tax Court and there has been no final decision of the court, and if it is determined by the Service (through its Chief Counsel and with the concurrence of the Appellate Division, where appropriae) that the estate is eligible for the benefits of section 3.02, the parties may, upon execution by the appropriate parties (as defined in section 3.03) and by the Service (through an appropriate Appellate Division official) with the approval of its Chief Counsel of an agreement in substantially the form prescribed in section 5, stipulate or otherwise arrange with the court so that the final decision of the court will reflect allowance of the charitable deduction.

.06 *Cases within the jurisdiction of the Department of Justice.* If a case is pending within the jurisdiction of the Department of Justice and no final judgment has been entered therein, the estate may submit an agreement to the Department of Justice in substantially the form prescribed in section 5, executed by the appropriate parties (as defined in section 3.03). If it is deemed proper by the Department of Justice, after receiving the recommendation of the Chief Counsel, that the estate is eligible for the benefits of section 3.02, the agreement will be forwarded to the Chief Counsel for execution by the District Director, appropriate Appellate Division official, or Director of International Operations, as appropriate, and the Department of Justice will take such action in the case as may be necessary to reflect allowance of the charitable deduction.

SEC. 5. FORM OF AGREEMENT.

An agreement in substantially the following form satisfies the requirements of section 3:

In the event of the allowance by or on behalf of the Commissioner of Internal Revenue of a charitable deduction under section 2055 of the Internal Revenue Code of 1954 in the amount of $_____, for a transfer in trust for the benefit of _____, claimed in connection with the settlement of the Federal estate tax liability of the estate of _____ (decedent), and as part of the consideration for this settlement, it is hereby agreed that the powers listed below, that have been granted by said decedent, will be exercised in an impartial manner as between charitable and noncharitable beneficiaries and that such powers will not be used to favor the noncharitable beneficiaries at the expense of charitable beneficiaries or to divert the charitable interest to noncharitable beneficiaries.

(1) _____

(2) _____

(3) _____

_____

Trustee

_____

Executor of the Estate

Noncharitable Beneficiary

Charitable Beneficiary
(or Attorney General)

District Director, Appellate Division official, or Director of Office of International Operations, as appropriate

Approved (where appropriate):

Chief Counsel

SEC. 6. EFFECT ON OTHER DOCUMENTS.

Revenue Procedure 73-9 is superseded by this Revenue Procedure.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, Section 531; 1.531-1.)

Rev. Proc. 74-7

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to modify the position of the Internal Revenue Service regarding Rev. Proc. 72-11, 1972-1 C.B. 732, and Rev. Proc. 72-42, 1972-2 C.B. 823, relating to the application of the accumulated earnings tax imposed by section 531 of the Internal Revenue Code of 1954. These Revenue Procedures involve the effect of the guidelines for dividend payments, issued by the Committee on Interest and Dividends pursuant to Executive Order 11640, dated January 26, 1972, and Executive Order 11695, dated January 11, 1973, and any subsequent guidelines issued pursuant to Executive Orders, on the application of section 531.

SEC. 2. BACKGROUND.

.01 Rev. Proc. 72-11 was issued to provide guidance for corporate taxpayers as to the effect compliance with guidelines for dividend payments issued by the Committee on Interest and Dividends pursuant to Executive Order 11627, dated October 15, 1971, 36 F.R. 20139, would have on the imposition of accumulated earnings tax under section 531 of the Code.

.02 Rev. Proc. 72-42 was issued to provide guidance as to the application of Rev. Proc. 72-11, relating to the imposition of the accumulated earnings tax under section 531 of the Code, to those corporate taxpayers that distribute dividends in excess of the maximum amount permitted under the applicable guidelines issued by the Committee on Interest and Dividends.

.03 Rev. Proc. 73-33, 1973-2 C.B. 489, effective for taxable years ending after December 31, 1973, revoked Rev. Proc. 72-11 and Rev. Proc. 72-42 as to their application to those corporate taxpayers that are not subject to the dividend guidelines.

SEC. 3. PROCEDURE.

Where a corporate taxpayer with a taxable year ending on or after June 30, 1971, and before January 1, 1972, which has never paid a dividend and is exempt from the dividend guidelines, permits its earnings and profits to accumulate for that year beyond the reasonable needs of business in order to comply with the spirit of the dividend guidelines, such excess accumulations will not be subject to the accumulated earnings tax of section 531 of the Code *for that taxable year.*

SEC. 4. EFFECT ON OTHER DOCUMENTS.

Rev. Proc. 72-11 and Rev. Proc. 72-42 are modified to include corporations with taxable years ending on or after June 30, 1971, and before January 1, 1972, which have never paid a dividend and are exempt from the dividend guidelines.

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26 CFR 601.201: Rulings and determination letters. (Also Part I, Section 265; 1.265-2.)

Interest on tax-exempt obligations; clarification of terms in guidelines. Clarification of the terms "portfolio investment" and "active conduct of a trade or business" as used in guidelines for applying section 265(2) of the Code relating to interest on tax-exempt State and local obligations; Rev. Proc. 72-18 clarified.

Rev. Proc. 74-8

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to clarify the second paragraph of section 4.04 of Rev. Proc. 72-18, 1972-1 C.B. 740, concerning the terms "portfolio investment" and "active conduct of a trade or business" as used in Rev. Proc. 72-18.

SEC. 2. IMPLEMENTATION

The second paragraph of section 4.04 of Rev. Proc. 72-18 is clarified to read as follows:

Portfolio investment for the purposes of this Revenue Procedure includes transactions entered into for profit (including investment in real estate) which are not connected with the active conduct of a trade or business. The purchase and sale of securities shall not constitute the active conduct of a trade or business unless the taxpayer is a dealer in securities within the meaning of section 1.471-5 of the Income Tax Regulations. A substantial ownership interest in a corporation engaged in the active conduct of a trade or business will not be considered a portfolio investment. For example, where a taxpayer owns 80 percent of the voting stock of a corporation that is engaged in the active conduct of a trade or business, the investment in such controlling interest will not be considered to be a portfolio investment. However, any ownership in a corporation not engaged in the active conduct of a trade or business will be considered a portfolio investment.

Substantial ownership in a corporation is a question of fact which will be determined on a case-by-case basis.

SEC. 3. EFFECT ON OTHER DOCUMENTS

Section 4.04, paragraph 2 of Rev.

Proc. 72-18 is clarified to read as set forth in section 2.

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 446, 471; 1.446-1, 1.471-11.)

Rev. Proc. 74-9[1]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth guidelines to be used in determining whether or not there is a "pending issue" regarding inventory costing for the purpose of the special election which may be made by a taxpayer to change to the "full" absorption method of inventory costing described in section 1.471-11 (a) through (d) of the Income Tax Regulations.

SEC. 2. BACKGROUND.

.01 Income Tax Regulations relating to inventory costing were published in the Federal Register on September 19, 1973, as T.D. 7285, 38 F.R. 26184 (1973) [1973-2 C.B. 163]. Section 1.471-11(e)(1)(i) of the regulations requires that taxpayers not using the full absorption method of inventory costing must change to that method. Section 1.471-11(e)(1)(ii) provides for a special election under which a taxpayer may change to the full absorption method of inventory costing and adopt any of the transition methods prescribed in section 1.471-11(e)(3).

.02 Section 1.471-11(e)(1)(ii) of the regulations also provides that where a taxpayer's prior returns have been examined by the Internal Revenue Service prior to September 19, 1973, and there is a pending issue involving the taxpayer's method of inventory costing, the taxpayer may request the application of section 1.471-11. This is done by notifying the district director, within 90 days after September 19, 1973, of the taxpayer's intention to change to the full absorption method for the first taxable year beginning after September 19, 1973, and filing Form 3115 within the first 180 days of such taxable year of change.

.03 It has been brought to the attention of the Service that the phrase "pending issue" involving a taxpayer's method of inventory costing may be the subject of varying interpretations. Therefore, the guidelines set out in section 3, below, are to be used in determining whether there is a "pending issue" regarding inventory costing under section 1.471-11(e)(1)(ii) of the regulations.

SEC. 3. GUIDELINES.

.01 The issue involving inventory costing will be considered a "pending issue" prior to September 19, 1973, if:

(a) the taxpayer has been advised, orally or in writing, prior to September 19, 1973, by an examining officer or other Internal Revenue Service official that an issue has been raised regarding his method of inventory costing and the issue remains unresolved on September 19, 1973, or

(b) on September 19, 1973, the issue is being considered at an Internal Revenue Service appellate level or before any court of law.

.02 Solely for the purpose of determining whether an issue remains unresolved for the purpose of the special election, the signing of an agreement as to or including the inventory costing issue, such as Form 870 (Waiver of restriction on assessment and collection of deficiency in tax) or Form 875 (Acceptance of examining officer's findings by a partnership, fiduciary or small business corporation), prior to September 19, 1973, will be considered evidence that the issue is resolved.

.03 The issue involving inventory costing will not be considered a "pending issue" prior to September 19, 1973, where:

(a) the examining officer, before that date, had merely stated that the taxpayer's inventories would be examined but had not raised an inventory costing issue with the taxpayer or his representative, or

(b) the issue was raised in a prior examination but later dropped or otherwise not pursued since the issue was not present in an examination or appeal in process on September 19, 1973.

SEC. 4. INQUIRIES.

Inquiries regarding this Revenue Procedure should be addressed to the Commissioner of Internal Revenue, Attention T:I:C, Washington, D. C. 20224.

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26 CFR 601.601: Rules and regulations.
(Also Part I, Section 368; 1.368-1.)

Rev. Proc. 74-10

Rev. Proc. 73-15, 1973-2 C.B. 464, modifies Sec. 3.01 of Rev. Proc. 72-9, C.B. 1972-1 719, which lists the specific questions and problems with regard to which ruling or determination letters will not be issued, to include, under section 368 of the Internal Revenue Code of 1954 (reorganizations), the acquisition by a regulated investment company, a real estate investment trust, or another corporation whose assets consist primarily of investment property, of the assets or stock of another regulated investment company, a real estate investment trust, or another corporation whose assets consist primarily of investment property.

Rev. Proc. 73-15 is hereby withdrawn, and requests for rulings regarding transactions described in Rev. Proc. 73-15 will be considered.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, Sections 167, 446; 1.167(e)-1, 1.446-1.)

Change in method of depreciation accounting. Taxpayers may expeditiously obtain, under prescribed conditions, the Commissioner's consent to change certain methods of depreciation accounting to certain other methods by filing application on Form 3115, within the first 180 days of the taxable year the change is to be-

[1] Based upon Technical Information Release 1268 dated December 10, 1973.

come effective, with the Director of the Internal Revenue Service Center where the return will be filed; Rev. Procs. 67-40, 68-26, and 69-29 superseded.

Rev. Proc. 74-11

SECTION 1. PURPOSE.

.01 The purpose of this Revenue Procedure is to update Rev. Proc. 67-40, 1967-2 C.B. 674, as amplified by Rev. Proc. 68-26, 1968-2 C.B. 911 and Rev. Proc. 69-29, 1969-2 C.B. 311, which provides an administrative procedure whereby taxpayers may expeditiously obtain consent to change their methods of depreciation accounting to certain other methods for Federal income tax purposes.

.02 The changes in method of accounting described in Rev. Rul. 70-165, 1970-1 C.B. 43, and Rev. Rul. 70-166, 1970-1 C.B. 44, are consolidated in this Revenue Procedure. Also, section 7 of this Revenue Procedure includes additional situations of taxpayers not covered by Rev. Proc. 67-40, Rev. Proc. 68-26, and Rev. Proc. 69-29, and changes the 90-day period for timely filing of an Application for Change in Accounting Method to 180 days in accordance with section 1.446-1(e)(3) of the Income Tax Regulations. Taxpayers complying with the provisions hereof will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change their methods of depreciation accounting.

SEC. 2. BACKGROUND.

A taxpayer, before changing his method of depreciation accounting for Federal income tax purposes, generally is required to obtain the consent of the Commissioner under the provisions of section 1.446-1(e)(3) of the regulations and is required to file an application on Form 3115, Application for Change in Accounting Method, with the Commissioner within the first 180 days of the taxable year in which the change is to become effective.

SEC. 3. APPLICATION.

.01 Subject to the following conditions a taxpayer desiring to change his method of depreciation accounting set forth in section 4 of this Revenue Procedure may do so by filing an application on Form 3115 with the Director of the Internal Revenue Service Center where the return will be filed. Reference to this Revenue Procedure should be made a part of his application. The application shall be filed within the first 180 days of the taxable year in which the change is to become effective and shall include the following information with respect to the property which is the subject of the change:

(a) Date of acquisition;

(b) Whether or not the "original use" (the first use to which the property is put) of the property commenced with the taxpayer;

(c) General description of the location of the involved property (sufficient to identify and distinguish properties involved in the change from the properties of the taxpayer, if any, not involved in the change);

(d) Type or character of the property;

(e) Cost or other basis of the depreciable property and adjustments thereto, other than depreciation;

(f) Amounts recovered through depreciation and other allowances;

(g) Estimated salvage value; and

(h) Estimated remaining useful life of property to the taxpayer.

.02 Unless a letter is received by the taxpayer from the Director of the Internal Revenue Service Center denying permission because the Form 3115 is not timely filed, it may be assumed that the change has been granted provided the taxpayer has complied with all of the provisions of this Revenue Procedure.

.03 The application of the terms and conditions of this Revenue Procedure as well as the computations resulting from the change, are subject to verification by the District Director upon examination of the taxpayer's Federal income tax return.

SEC. 4. CHANGES IN METHOD COVERED BY THIS REVENUE PROCEDURE.

.01 The following changes in method of depreciation are covered by this Revenue Procedure. Taxpayers desiring to change their methods of depreciation accounting under circumstances other than those following must follow the procedures outlined in section 7.05, below:

(a) From the straight line method to the sum of years-digits, sinking fund, unit-of-production, or declining balance method using any proper percentage of the straight line rate.

(b) From the declining balance method using any percentage of the straight line rate to the sum of years-digits method or the sinking fund method.

(c) From the sum of years-digits method to the sinking fund method, to the declining balance method using any proper percentage of the straight line rate, or to the straight line method.

(d) From the unit-of-production method to the straight line method.

(e) From the sinking fund method to the straight line method, unit-of-production method, sum of years-digits method, or declining balance method using any proper percentage of the straight line rate.

(f) From the declining balance method using any percentage of the straight line rate to the declining balance method using a different proper percentage of the straight line rate or any change in the interest factor used in connection with a compound interest or sinking fund method.

(g) Any change in the treatment of salvage proceeds from retirement of assets as set forth in section 1.167(a)-8(e)(2) of the regulations. Such a change may be made under this Revenue Procedure only if the change is applied to all items in the account for which the change is being made.

(h) Any change in averaging con-

vention as set forth in section 1.167 (a)-10(b) of the regulations. However, as specifically provided in section 1.167(a)-10(b) of the regulations, in any year in which an averaging convention substantially distorts the depreciation allowance for the taxable year, it may not be used. See Rev. Rul. 73-202, 1973-1 C.B. 81.

(i) From the practice of crediting the depreciation reserve with the salvage proceeds realized on normal retirement sales to the practice of computing and recognizing gains and losses on such sales. See Rev. Rul. 70-165.

(j) From the practice of crediting ordinary income (including the combination method of crediting the depreciation reserve with estimated salvage value, or actual salvage proceeds if less, with any excess of salvage proceeds over estimated salvage value credited to ordinary income) with the salvage proceeds realized on normal retirement sales, to the practice of computing and recognizing gains and losses on such sales. See Rev. Rul. 70-166.

(k) From item accounting for specific assets to multiple asset accounting for the same assets or vice versa.

SEC. 5. CONDITIONS FOR EFFECTING THE CHANGE.

The following conditions must be adhered to, where appropriate, in order for the change to become effective:

.01 Any change from one method of depreciation to another method under this Revenue Procedure must result in a reasonable allowance for depreciation in accordance with the provisions, conditions, and limitations of section 167 of the Internal Revenue Code of 1954 and regulations thereunder.

.02 The basis for depreciation, as of the taxable year or period immediately preceding the taxable year of change, shall be the adjusted basis of the property determined under section 1016 of the Code and regulations thereunder.

.03 The rate of depreciation for property changed to the straight line or sum of years-digits method of depreciation shall be based on the remaining useful life of such property.

.04 For changes in method of depreciation to the declining balance method, the rate of depreciation applicable to the property shall be based on the useful life of such property from the date of acquisition, and not the expected remaining life from the date the change becomes effective.

.05 For changes in method of depreciation to the sum of years-digits or declining balance method, the property must meet the qualifications of sections 1.167(b)-0, 1.167(c)-1, or 1.167(j)-1 of the regulations, as appropriate.

.06 The effective year of change will be the taxable year or period within which the application for change is filed during the first 180 days in accordance with section 1.446-1(e)(3) of the regulations.

.07 The taxpayer must attach a copy of the application, Form 3115, to his income tax return filed for the taxable year of change.

SEC. 6. FACTUAL MATTERS SUBJECT TO REVIEW BY DISTRICT DIRECTOR.

The following factors involved in depreciation computations are matters of fact and subject to review and verification by the District Director upon examination of the taxpayer's income tax return.

(a) Useful life
(b) Salvage value
(c) Adjusted basis
(d) Interest factors under the sinking fund method
(e) Estimated reserves under the unit-of-production method.

SEC. 7. TAXPAYERS NOT COVERED BY THIS REVENUE PROCEDURE.

.01 This Revenue Procedure applies only to those changes in method of depreciation specifically covered in section 4 above.

.02 This Revenue Procedure does not apply to an account where a change in method of depreciation was made by a taxpayer to such account at any time within the ten taxable years immediately preceding the taxable year unless such change was made in applying the provisions of section 1.167(a)-12 of the regulations or such change was made previously in applying the provisions of Rev. Proc. 62-21, 1962-2 C.B. 418.

.03 This Revenue Procedure does not apply to depreciation allowance determinations made in accordance with section 1.167(a)-11 of the regulations relating to the Class Life Asset Depreciation Range System (ADR).

.04 This Revenue Procedure does not apply to depreciation allowance determinations under the authority of section 167(l) of the Code, relating to public utility property.

.05 For changes in method of depreciation to which this Revenue Procedure does not apply, other than changes expressly permitted or required under the Code and regulations provided procedures regarding those changes are expressly stated, permission of the Commissioner must be obtained by filing application on Form 3115 with the Commissioner of Internal Revenue, Attention T:I:E, Washington, D.C. 20224, within the first 180 days of the taxable year for which the change is desired.

SEC. 8. RECORDS.

Taxpayers must maintain records so that the District Director may verify the necessary data concerning the proposed change in method of depreciation accounting.

SEC. 9. COMPLIANCE WITH CONDITIONS.

Taxpayers making a change under this Revenue Procedure without complying with all the conditions herein will be deemed to have initiated the

change in method of accounting without having obtained the consent of the Commissioner.

SEC. 10. EFFECTIVE DATE.

This Revenue Procedure shall be effective on January 7, 1974.

SEC. 11. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention T:I:E, Washington, D.C. 20224.

SEC. 12. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Rev. Proc. 67-40, Rev. Proc. 68-26, and Rev. Proc. 69-29.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 1441, 1442, 1443, 1461, 1463, 1464, 1465, 6011; 1.1441-1, 1.1441-2, 1.1441-3, 1.1441-4, 1.1441-5, 1.1441-6, 1.1442-2, 1.1443-1, 1.1461-1, 1.1461-2, 1.1461-3, 1.1461-4, 1.1463-1, 1.1464-1, 1.1465-1, 1.6011-1.)

Rev. Proc. 74-12

PART "A"—GENERAL

SECTION 1. PURPOSE.

.01 The purpose of this Revenue Procedure is to state the requirements and conditions under which withholding agents, as defined in Section 1.02 below, can file Form 1042S information returns on magnetic tape beginning with TAX YEAR 1974 RETURNS.

.02 A Withholding agent is defined as any person or entity required to withhold U.S. tax on payments of income subject to withholding from sources within the United States as provided for in Chapter 3 of the Internal Revenue Code.

A withholding agent may be an individual, partnership, corporation, trust, estate, government agency (Federal, State or local), association, or a tax-exempt foundation or organization. For the purposes of this Revenue Procedure, the term "withholding agent" refers to any of the above.

.03 Wherever possible, the Service encourages all entities who must file information returns and who have the facility for submitting this information on magnetic tape to use this method of filing. Withholding agents filing Form 1042S information returns in the form of magnetic tape should also be aware of Rev. Proc. 73-13, 1973-1 C.B. 776, which allows payers, employers and nominees to file other types of annual information returns on magnetic tape instead of paper documents. Attention is also brought to Rev. Proc. 71-18, 1971-1 C.B. 684, which provides a single magnetic tape format covering quarterly earnings reports, Forms W-2, quarterly reports to state employment security agencies, and annual reports to state income tax agencies. Copies of the above mentioned Revenue Procedures are available from any Internal Revenue Service Center.

SEC. 2. APPLICATION FOR TAPE REPORTING.

.01 Form 1042S statements may be filed on magnetic tape by withholding agents or by their designated agents. Tape reporting is not restricted to withholding agents with the ability to submit all their information on magnetic tape; a combination of tape records and paper documents is acceptable so long as there is no duplication or omission of documents.

.02 Withholding agents or their designated agents who desire to file statements in the form of magnetic tape must first file a letter of application. This letter should be addressed to the Director of the Philadelphia Service Center, Internal Revenue Service, P.O. Box 245, Cornwell Heights, Pennsylvania 19020.

The letter of request must contain the following:

(a) Name, address and Employer Identification Number of person, organization or entity making the request.

(b) Name, Title and Telephone number of person to contact regarding the request.

(c) An estimate of the number of 1042S statements to be reported in tape format, and the number, if any, to be reported on paper forms.

(d) Type and nature of equipment to be used to prepare tape; i.e. manufacturer and model of main frame and tape drives, tape width (½", ¾", etc.), density (characters per inch) and recording code (BCD, Excess 3, Octal, etc.).

(e) List of withholding agents to be included in the file(s) if the requester is an agent designated to file for a group of withholding agents.

(f) Signature of official responsible for the preparation of tax reports or his authorized agent.

.03 The Service will act on applications and notify applicants of authorization or disapproval within 30 days of receipt of applications.

.04 Generally, withholding agents using equipment compatible with the Service's can presume that their application will be approved. Compatible tape characteristics are shown in PART "B", Section 1.01.

Where the capability to prepare several types of tapes exists, the Service prefers that compatible tapes be prepared.

.05 If withholding agents propose to submit convertible tapes, the Service will attempt to find conversion facilities. Generally, an application to file on magnetic tape will be disapproved only when the Service is unable to obtain facilities to convert a withholding agent's file to a compatible form.

.06 In general, once authorization to file on magnetic tape has been granted, such approval will continue in effect in succeeding years, providing that the requirements of this Revenue Procedure are met, and there are no equipment changes by the withholding agent. However, new applications are required:

(a) If users change from equipment producing compatible tapes to equipment producing convertible tapes.

(b) If the users submit tapes that are not listed as either compatible or convertible.

(c) If the users discontinue tape reporting for one or more years, then decide to resume this method of reporting.

SEC. 3. FILING OF TAPE REPORTS.

.01 Packaging, shipping and mailing instructions will be provided in the authorizing letter issued by the Service in response to an application for tape reporting.

.02 Withholding agents submitting a portion of their statements on magnetic tape and the remainder on paper forms, should file both magnetic tape records and paper documents at the Philadelphia Service Center, but in separate shipments.

.03 The withholding agent's Form 1042 tax return serves as the transmittal document for Forms 1042S statements, including those on paper and on magnetic tape. For designated agents filing statements for several withholding agents, Forms 1042 must be filed for each withholding agent included in the transmittal. Since the required Form 1042 is a tax return (with or without a remittance attached), it must be filed separately from the shipment of magnetic tape. If the entire transmittal consists only of magnetic tape, note on the separately filed Form 1042, "Magnetic Tape Filing." If only a portion of the statements are submitted on magnetic tape, the remaining paper documents should be submitted with the Form 1042 which should be noted, "Balance Filed on Magnetic Tape."

Any additional documents required to be submitted should accompany Form 1042. (See instructions for Form 1042, U.S. Annual Return of Income Tax To Be Paid at Source (under Chapter 3 Internal Revenue Code.) Note on the address side of the magnetic tape shipments, "DELIVER UNOPENED TO THE TAPE LIBRARY".

.04 The dates prescribed for filing paper documents with the Service will also apply to magnetic tape filing. Requests for extensions of time for filing and related matters should be made to the Philadelphia Service Center.

If an extension is granted by the Service a copy of the letter granting the extension should be attached to the Form 1042.

.05 The magnetic tape specifications contained in PART "B" of this Revenue Procedure must be strictly adhered to. Deviations will not be permitted under any circumstances.

SEC. 4. PROCESSING OF TAPE STATEMENTS.

.01 The Service will copy the information from the original tapes and will return the original tapes to the withholding agent. Normally, tapes will be returned by September 15 of the year in which submitted. However, if the tapes submitted are unprocessable, and must be returned for correction prior to processing, they will be returned within six months of receipt of acceptable tapes.

.02. The Service will prepare the appropriate statements for transmittal to Treaty countries.

SEC. 5. CORRECTED STATEMENTS.

.01 The appropriate paper forms will normally be used if it is necessary to correct Recipient "Q" records in the magnetic tape files. Since corrected statements supersede information previously supplied, all required data fields must be completed. Each such form must be annotated "Corrected" at the top. Corrected documents should be bundled separately from other paper documents. When correcting documents are shipped separately, an amended Form 1042 must also be filed, also suitably annotated.

.02 If it becomes necessary for the withholding agent to submit a large volume of corrected statements, the Service would prefer that corrected statements be provided on tape. If the withholding agent possesses the capability to provide such corrections on tape, he should contact the Philadelphia Service Center.

SEC. 6. EFFECT ON PAPER DOCUMENTS.

.01 Reports on magnetic tape for reporting to Internal Revenue Service would eliminate the need for submission of paper Forms 1042S to the Service. However, withholding agents must continue to provide recipients with requisite information, although this need not be on a copy of 1042S.

.02 If only a portion of the statements is reported on magnetic tape and the remainder is reported on paper forms, those paper statements must be filed on the prescribed forms.

SEC. 7. DATA ENTRIES.

.01 Since taxpayer identifying numbers are not required on all Forms 1042S (see Specific Instructions for Withholding Agents, Copy D of the official Form 1042S), the specifications in PART "B" of this Revenue Procedure permit omission of such identifying numbers.

.02 For statements on which recipient identifying numbers are required the Service must be able to identify the surname associated with the taxpayer identifying number (usually a social security number or an employer identification number) furnished on the statement. When statements are received in the form of paper documents, this is accomplished through a manual editing process. However, manual editing is precluded when statements are received on magnetic tape. Consequently, the specifications in PART "B" of this Revenue Procedure include a data field in the recipient "Q" records called "Name Control," in which the first four alphabetic characters of the recipient surname are to be entered by withholding agents.

.03 If withholding agents are unable to provide the first four charac-

ters of the recipient surname, the specifications permit the submission of statements on magnetic tape with the Name Control Field left blank. However, compliance with the following will facilitate the Service's computer programs required to generate the Name Control:

(a) The surname should be recorded on the first name line.

(b) In the case of a single recipient, a blank space should precede the surname unless the surname begins in the first position of the field.

(c) In case of multiple recipients, the name of the person whose identifying number has been provided should be placed before all other names.

.04 Sometimes the recipient identification recorded on the withholding agent's records is lengthy, and exceeds the 80 characters allotted on the magnetic tape records. This is most common in the case of trusts or other types of fiduciary accounts. The first 80 characters of the recipient identification normally provide sufficient descriptive data for the Service's purposes. The Service encourages all agents to make every possible attempt to truncate or abbreviate lengthy recipient descriptions.

SEC. 8. ADDITIONAL INFORMATION.

Requests for additional copies of this Revenue Procedure, or request for additional information on tape reporting, should be addressed to the Internal Revenue Service, Philadelphia Service Center, Post Office Box 245, Cornwell Heights, Pennsylvania 19020.

PART "B"—MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL.

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. Usually, the Service will be able to process, without translation, any compatible tape file. To be compatible, a tape file must meet all of the following:

Type of Tape—½ inch Mylar base, oxide coated
Recording Density—556 or 800 BPI
Parity—Even or Odd
Interrecord gap—¾ inch
Reading Code—7 channel binary coded decimal (BCD)

.02 Convertible tapes for which conversion facilities are currently available are:

(a) 9 Channel EBCDIC (Extended Binary Coded Decimal Interchange Code);

(1) Odd Parity
(2) 800, 1600 Densities

(b) 9 Channel ASC II (American Standard Coded Information Interchange);

(1) Odd Parity
(2) 800, 1600 Densities

(c) 200 Density

.03 An acceptable tape file for each withholding agent will contain the following:

(a) Single Reel:

(1) A Transmitter "T" Record,
(2) A Series of Recipient "Q" Records,
(3) An End of Withholding Agent "W" Record,
(4) An End of Transmission "Y" Record.

(b) Multiple Reels:

(1) A Transmitter "T" Record,
(2) A Series of Recipient "Q" Records,
(3) An End of Withholding Agent "W" Record,
(4) End of Transmission "Y" Record.

NOTE: See Section 8 (Tape Layouts) of this Procedure.

All records, including Headers and Trailers, must be written at the same density.

SEC. 2. CONVENTIONS AND DEFINITIONS.

.01 Certain conventions may be required by the programming system or equipment used by the withholding agent with respect to Header and Trailer labels, record marks and tape marks. Their use must adhere to the following:

Header Label	1. First four characters must be 1HDR or HDR1.
	2. Can only be the first record on a reel.
	3. Must consist of a maximum of 80 characters.
Trailer Label (Required)	1. First four characters must be 1EOR, 1EOF, EOR1 or EOF1.
	2. Can only be the last record on a reel.
	3. Must consist of a maximum of 80 characters.
Record Mark	1. Special character used to separate blocked records on tape.
	2. Can only be at the end of a record or block.
	3. Use BCD bit configuration 011010 ("A82" bits) in even parity: 111010 ("BA82" bits) in odd parity.

Tape Mark ---------- 1. Special character that is written on tape usually to signify the physical end of the recording on tape.

2. For compatibility with IRS equipment, use BCD bit configuration 001111 ("8421" bits) in even parity.

3. The tape mark may follow the header label and may precede and/or follow the trailer label.

.02 Definitions:

Element	Description
b	Denotes a blank position. For compatibility with IRS equipment, use BCD bit configuration 010000 ("A" bit only) in even parity, 001101 ("841" bits) in odd parity.
Special Character	Any character that is not a numeral, a letter or a blank.
Withholding Agent	Person or organization, including withholding agent, making payments. The withholding agent is responsible for the completeness, accuracy and timely submission of magnetic tape files.
Transmitter	Person or organization preparing magnetic tape files. May be withholding agent or his designated agent.
Recipient	Person(s) or organization(s) receiving payments from withholding agent.
Record	A group of related fields of information treated as a unit.
Blocked Records	Two or more records grouped together between interrecord gaps.
Unblocked Records	A single record which is written between interrecord gaps.
File	For the purpose of this Procedure, a file consists of all tape records submitted by a withholding agent or transmitter for Form 1042S.
Reel	A spool of magnetic tape.
EIN	Employer Identification Number which has been assigned by IRS to the withholding entity.
SSN	Social Security Number.

.03 Since the Service is not restricting magnetic tape reporting to withholding agents or transmitters with specific types of equipment, or prescribing the methods used to prepare the tape files, the Transmitter ("T" Record), End of Withholding Agent ("W" Record), and End of Transmission ("Y" Record) perform the functions normally assigned to Header and Trailer labels, and related conventions. The Transmitter Record serves the purpose of a Header Label, the End of Withholding Agent Record indicates that all Recipient Records ("Q" Records) for a Withholding Agent have been written on the reel and the End of Transmission Record indicates that the end of reporting has been reached. In addition to the functions stated above, the End of Withholding Agent Record is used to balance each reel or each withholding agent's records on a reel.

SEC. 3. RECORD LENGTH.

.01 Tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

(a) A block may not exceed 4,000 tape positions.

(b) If the use of blocked records would result in a short block, all remaining positions of the block may be filled with 9's, or a short block may be written.

(c) All records may be blocked, except Header and Trailer Labels.

(d) All records are of a fixed length of 365 characteres.

SEC. 4. TRANSMITTER "T" RECORD.

Identifies the Transmitter, by name and address, of the files. A Transmitter and a withholding agent may be the same. In this event it will be necessary to repeat certain identifying data as required in the Recipient "Q" Records. A Transmitter may include Recipient "Q" Records for more than one withholding agent on a tape reel;

however, each separate Withholding Agent's Recipient "Q" Records will not be preceded by a Transmitter "T" Record. The parameters under which the Transmitter "T" Record can be used is specified below.

A Header Label *must be present* as the first record of every reel. The Transmitter "T" Record must appear as the *second record of the first reel only* and will *not* be repeated on subsequent reels. Enter an *"X"* in position 6 of the Transmitter "T" Record to indicate that the reel sequence number is in the Header Label. Enter the high order position of the 3 position reel sequence number on the Header Label in positions 4 and 5 of the Transmitter "T" Record. Additionally, a trailer label must be the last record on each reel.

Example 1: If the reel sequence number is in positions 20 through 22 on the Header Label, enter 20 in positions 4 and 5 of the Transmitter "T" Record and "X" in position 6.

Example 2: If the reel sequence number is in positions 8 through 10 on the Header Label, enter 08 in positions 4 and 5 and an "X" in position 6.

Tape Position	Element Name	Entry or Definition
1	Record Type	Enter "T". Must be first character of each Transmitter "T" Record.
2–3	Reporting Year	Last two digits of the year for which payments are being reported.
4–6	Reel Number	Serial Number assigned by the Transmitter to each reel. Enter an "X" in position 6. Enter the high order position of the 3 position real sequence number from the Header Label in positions 4 and 5.
7–46	Transmitter's Name	Enter name of submitter of tape. Left justify and fill with blanks.
47–86	Street Address	Enter street address of Transmitter. Left justify and fill with blanks.
87–126	City and State	Enter city and state of Transmitter. Left justify and fill with blanks.
127–131	ZIP Code	Enter ZIP code of Transmitter.
132–365	Blank	Blank

SEC. 5. RECIPIENT "Q" RECORD.

Contains both withholding agent identification data and recipient identification data. Transmitter and withholding agent may be the same which would necessitate the repetition of certain identifying data in this record. This would permit each Recipient "Q" Record to be self-sufficient and facilitate the Service's processing of the record.

All of the Recipient "Q" Records for a particular withholding agent must be summarized by a single End of Withholding Agent "W" Record.

Since the Recipient "Q" Record represents a single type of income paid to a recipient, it will be necessary to write up to 19 "Q" records if a specific recipient was paid more than one different types of income. The Recipient "Q" Records of a particular withholding agent should be written prior to beginning another withholding agent's Recipient "Q" Records.

Records may be blocked or unblocked. A block may not exceed 4,000 tape positions. All records must be fixed length.

Tape Position	Element Name	Entry or Definition
1	Record Type	Enter "Q". Must be first character of each Recipient Record.
2–3	Payment Year	Last two digits of the year for which payments are being reported.
4–12	EIN of Withholding Agent	Enter 9 numeric characters of the Employer Identification Number. Do NOT include the hyphen.
13–52	Name of Withholding Agent	Enter name of withholding agent. Left justify and fill with blanks.
53–92	Street Address	Enter street address of withholding agent. Left justify and fill with blanks.
93–127	City and State	Enter city and state of withholding agent. Left justify and fill with blanks.
128–132	ZIP Code	Enter ZIP Code of withholding agent.

Tape Position	Element Name	Entry or Definition
133–136	Name Control	Enter the first four (4) letters of the Surname of the recipient. Last names of less than four (4) letters should be entered, filling the unused positions with blanks.
137	Type of Account	This field is used to identify the data in positions 138–146 as the Employer Identification Number, Social Security Number, or the reason no number is shown. 1) Enter "1" if the recipient is a U.S. business or organization entity. EIN *must* be present in positions 138–146. 2) Enter "2" if the recipient is a U.S. Citizen or resident alien. SSN *must* be present in positions 138–146. 3) Enter "3" if the recipient is a nonresident alien or a foreign recipient and is *not* required to have either an EIN or SSN. 4) Enter "4" if an EIN or SSN is required but not obtainable due to a *legitimate* cause; e.g., number applied for but not received.
138–146	SSN or EIN of Recipient	Enter Social Security Number or Employer Identification of recipient, as appropriate. When identifying number has been applied for and not received or any other legitimate cause for not having an identifying number, enter blanks.
147–156	Withholding Agent's Assigned Account Number	Enter account number assigned to recipient by withholding agent. This item is optional, but its presence may facilitate subsequent reference to a withholding agent's file(s) if questions arise regarding specific records in a file. Enter blanks if no account number.
157–158	Country Code	Enter two (2) positions alpha code which represents the country of which the recipient is a resident. (See Instructions for Form 1042S, Income Subject to Withholding under Chapter 3, Internal Revenue Code; countries not listed, enter "OC" for all other countries.) Must be present.
159–238	Name of Recipient	Enter name of recipient. Left justify and fill with blanks. Must be present.
239–278	Street Address	Enter street address of recipient. Left justify and fill with blanks. Should be present.
279–318	City and Country	Enter city and country. Left justify and fill with blanks.
319–320	Income Code	Enter two (2) digit numeric. (See instructions for Form 1042S, Income Subject to Withholding Under Chapter 3, Internal Revenue Code; for other types of income not listed, enter 99 for other income.) Must be present.
321–330	Gross Amount of Income Paid	Must be present.
331	Effectively Connected Code	Enter "1" if income paid is effectively connected with a trade or business conducted within the U.S. Enter zero if otherwise.
332	Exemption Code	This field is used to identify the type of forms accompanying Form 1042. 1) Enter "1" if Form 4224 is filed claiming an exemption. 2) Enter "2" if Form 1078 is filed claiming taxation under IRS laws applicable to residents of U.S. 3) Enter "3" if Form 1000 is filed. 4) Enter "4" if non-IRS statements claiming exemption is filed. 5) Enter "5" if any of the above are filed together claiming an exemption. 6) Enter "6" if none of the above forms are filed with Form 1042.

333–335	Rate of Tax	Enter three (3) numeric character tax rate. Examples: 4% should be written as 04b; 15% should be written as 15b; 27½% should be written as 275.
336–345	Amount of Tax Withheld	Must be present if Effectively Connected Code is zero or if income is not otherwise exempt from tax withholding.
346–355	Amount of Tax Released	May be present or zero.
356–365	Amount of Net Tax Withheld	May be present or zero.

SEC. 6. END OF WITHHOLDING AGENT "W" RECORD.

Write this record after the last Recipient "Q" Record submitted for a particular withholding agent. A tape reel will contain more than one (1) End of Withholding Agent "W" Record if the last Recipient "Q" Record for more than one withholding agent is reported on the same tape reel.

Each End of Withholding Agent "W" Record must contain a count of the total number of Recipient "Q" Records and totals of each payment amount reported for all Recipient "Q" Records immediately preceding the End of Withholding Agent "W" Record, regardless of the number of tape reels involved. The End of Withholding Agent "W" Record must be followed by a new Recipient "Q" Record for the next withholding agent, if any, or an End of Transmission "Y" Record.

The End of Withholding Agent "W" Record cannot be followed by a Tape Mark.

Tape Position	Element Name	Entry or Definition
1	Record Type	Enter "W". Must be first character of each End of Withholding Agent Record.
2–3	Payment Year	Last two digits of the year for which payments are being reported.
4–12	EIN of Withholding Agent	Enter 9 numeric characters of the Employer Identification Number. Do NOT include the hyphen.
13–52	Name of Withholding Agent	Enter name of withholding agent. Left justify and fill with blanks.
53–92	Street Address	Enter street address of withholding agent. Left justify and fill with blanks.
93–132	City and State	Enter city and state of withholding agent. Left justify and fill with blanks.
133–137	ZIP Code	Enter ZIP code of withholding agent.
138–145	Total Number of Records	Enter the total number of "Q" records submitted by this Withholding Agent on this tape reel and on the prior reel(s).
146–158	Total Gross Amount of Income Paid	Enter grand total of Amount of Income Paid by this withholding agent on this tape reel and on prior tape reel(s).
159–171	Total Amount of Tax Withheld	Enter grand total of Amount of Tax Withheld by this withholding agent on this tape reel and on prior tape reel(s).
172–184	Total Amount of Tax Released	Enter grand total of Amount of Tax Released by this Withholding Agent on this reel and on the prior reel(s).
185–197	Total Amount of Net Tax Withheld	Enter grand total of Amount of Net Tax Withheld by this withholding agent on this reel and on the prior reel(s).
198–365	Blank	Blank

SEC. 7. END OF TRANSMISSON "Y" RECORD.

Write this record after the last End of Withholding Agent "W" Record in the file. This record can be followed only by a Tape Mark or Tape Mark and Trailer Label (see Part "B", Section 2.01).

Tape Position	Element Name	Entry or Definition
1	Record Type	Enter "Y". Must be first character of the End of Transmission Record.
2–4	Number of Withholding Agents	Enter total number of Withholding Agents for this Transmission. Right justify and zero fill.
5–7	Number of Reels	Enter total number of reels in this Transmission. Right justify and zero fill.
8–365	Zeros	Enter Zeros.

SEC. 8. TAPE LAYOUTS (REEL SEQUENCE NUMBER IS IN THE HEADER LABEL).

Because the Header Label is the first record, the following chart shows, by type of file, the record types to be used in the 2nd and 3rd records and the last three records written on a tape reel prior to the Trailer Label.

TYPE OF FILE	1st record type after Header Label	2nd record type after Header Label	2nd from last record type	Next to last record type	Last record type
Single withholding agent, single transmitter, single reel	T[4]	Q	Q	W[1]	Y[5]
Single withholding agent, single transmitter, multiple reels:					
Reel 1	T[4]	Q	Q	Q	Q
Last Reel	Q	Q	Q	W[2]	Y[5]
Multiple withholding agents, single transmitter, single reel:					
Withholding agent 1	T[4]	Q	Q	Q	W[1]
Withholding agent 2	Q	Q	Q	Q	W[1]
Last Withholding agent	Q	Q	Q	W[1]	Y[5]
Multiple withholding agents, single transmitter, multiple reels: first withholding agent's records split between reel 1 and reel 2; second withholding agent's records split between reel 2 and reel 3:					
Reel 1: Withholding agent 1	T[4]	Q	Q	Q	Q
Reel 2:					
Withholding agent 1	Q	Q	Q	Q	W[3]
Withholding agent 2	Q	Q	Q	Q	Q
Reel 3:					
Withholding agent 2	Q	Q	Q	Q	W[3]
Withholding agents 3 and 4	Q	Q	Q	W[3]	Q
Reel 4: Withholding agent 4	Q	Q	Q	W[3]	Y[5]

[1] Must contain "Total Number of Records" and "Total Amounts . . ." summarizing all Recipient "Q" Records written for this withholding agent.
[2] Must contain "Total Number of Records" and "Total Amounts . . ." summarizing all Recipient "Q" Records written for this withholding agent on this reel and on prior reel(s).
[3] Must contain "Total Number of Records" and "Total Amounts . . ." summarizing all Recipient "Q" Records written for this reel and for this withholding agent on the prior reel(s).
[4] Must be present as the 1st record type after the Header Label on the 1st reel (only).
[5] Must contain "Number of Withholding Agents" and "Number of Reels".

SEC. 9. RECORD LAYOUTS.

The record layouts beginning on page 431, show the magnetic tape formats that may be followed in writing the required "T", "Q", "W", and "Y" records on a tape reel.

SEC. 10. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure modifies Revenue Procedure 70-13, 1970-1 C.B. 438.

RECORD LAYOUT 1

RECORD TITLE			
Transmitter Record "T" Record	Magnetic Tape Reporting	Form 1042S	Reference Part B Section 4

RT	RY	RN	Transmitter's Name	Street Address	City and State
T	n	n	x	v	v

City and State	ZIP Code	Fill with blanks to 365 characters
v	n	n

REFERENCES AND REMARKS

Record Layout 2

RECORD TITLE			
Recipient Record — "Q" Record	Magnetic Tape Reporting	Form 1042S	Reference Part "R" Section 5

RT	RV	Withholding Agent's EIN	Withholding Agent's Name	Street Address	City and State

City and State	ZIP Code	Name Control	TA	Recipient's SSN or EIN	Withholding Agent's Assigned Account Number	CC	Recipient's Name

Recipient's Name	Street Address	City and Country

City and Country	IC	Gross Amount Income Paid	ECC	EC	Rate of Tax	Amount of Tax Withheld	Amount of Tax Released	Amount of Net Tax Withheld	

Record Layout 3

RECORD TITLE					
End of Withholding Agent Record — "W" Record			Magnetic Tape Reporting	Form 1042S	Reference Part "B" Section 6

W	n	n	v	v
R T	P Y	EIN of Withholding Agent	Name of Withholding Agent	Street Address	City & State

v	v	n	n					
City & State	ZIP Code	Total Number of Records	Total Gross Amount of Income Paid	Total Amount of Tax Withheld	Total Amount of Tax Released	Total Amount of Net Tax Withheld	

Fill with blanks to 365 characters

Record Layout 4

RECORD TITLE			
End of Transmission Record — "Y" Record	Magnetic Tape Reporting	Form 1042S	Reference Part "B" Section 7

Y	No. of With. Agent	No. of Reels	
			Fill with blanks 865365acharacters

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 3201, 3211, 3221; 31.3201-1, 31.3211-1, 31.3221-1.)

Rev. Proc. 74-13

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide instructions for the computation of employer tax and employee tax to be reported on Form CT-1, Employer's Quarterly Railroad Retirement Tax Return—1974, and employee representative tax to be reported on Form CT-2, Employee Representative's Quarterly Railroad Retirement Tax Return—1974, under the Railroad Retirement Tax Act (chapter 22, subtitle C, Internal Revenue Code of 1954), with respect to compensation paid during 1974 for services rendered after 1968 and before 1973. (For services rendered before 1969 see Rev. Proc. 71-3, 1971-1 C.B. 659.)

SEC. 2. BACKGROUND.

The January 1974 revision of Form CT-1 and Form CT-2 will provide entry spaces and rates for computing tax with respect to compensation for services rendered after 1972. Because of the infrequency of payments of compensation for services rendered before 1973, the forms do not provide a schedule for computation of tax with respect to such compensation. Instead, a single entry line is provided for the reporting of such tax, which may be computed by reference to this Revenue Procedure. Forms CT-1 and CT-2 provide space for computation of the supplemental tax based on man-hours, for services rendered after October 31, 1966. Accordingly, no provision is made in this Revenue Procedure for the computation of the supplemental tax.

SEC. 3. MAXIMUM AMOUNT OF COMPENSATION EARNED IN A MONTH THAT IS SUBJECT TO TAX.

The employee tax, employer tax, and employee representative tax apply to compensation that does not exceed the amount shown below, for services rendered in a calendar month:

Period in which services were rendered	Maximum per calendar month
Calendar year 1972	$750
After Dec. 31, 1968, and before 1972	650

If an employee is paid total compensation by two or more employers for services rendered in a calendar month, and the total exceeds the maximum amount subject to tax for that month, the amount of compensation paid by each employer that is subject to tax should be computed in accordance with paragraph F or G of the instructions relating to Form CT-1 (except that the monthly maximum applicable to that month should be used in lieu of the amount stated in par. F or G).

If in any calendar month an individual renders services as an employee representative and as an employee, and if the total compensation paid to him for the services exceeds the monthly maximum, the measure of the employee representative tax is the monthly maximum minus the amount of compensation paid to him for services rendered during the month as an employee.

SEC. 4. COMPUTATION OF EMPLOYER TAX AND EMPLOYEE TAX.

The schedule shown below is provided as a guide for computing the employer tax and employee tax applicable to compensation paid during 1974 for services rendered after 1968 and before 1973.

1. Computation of employee tax on compensation for services rendered after 1968 and before 1973:

Period in which compensation, paid during quarter, was earned (a)	Compensation paid during quarter for such services, subject to employee tax (b)	Rate of employee tax on such compensation (percent) (c)	Amount of employee tax (col. (b) x col. (c)) (d)
Calendar year 1972	$_____	9.95_____	$_____
Calendar year 1971	_____	9.95_____	_____
Calendar year 1970	_____	9.55_____	_____
Calendar year 1969	_____	9.55_____	_____

2. Computation of employer tax on compensation for services rendered before 1973:

Period in which compensation, paid during quarter, was earned (e)	Compensation paid during quarter for such services, subject to employer tax (f)	Rate of employer tax on such compensation (percent) (g)	Amount of employer tax (col. (f) x col. (g)) (h)
Calendar year 1972	$_____	9.95_____	$_____
Calendar year 1971	_____	9.95_____	_____
Calendar year 1970	_____	9.55_____	_____
Calendar year 1969	_____	9.55_____	_____

3. Total employee tax (from col. (d)), above, $_____.

4. Total employer tax (from col. (h)), above, $_____.

5. Total taxes (line 3 plus line 4) (enter on Form CT-1 and attach explanation, in duplicate). $_____

Note: If the total of column (b) differs from the total in column (f), include in the explanation a statement of the computations that cause the amounts to be different.

SEC. 5. COMPUTATION OF EMPLOYEE REPRESENTATIVE TAX.

The rates shown below are applica-

ble to compensation paid during 1974 for services rendered after 1968 and before 1973 as an employee representative.

Period in which compensation, paid during quarter, was earned	Rate of employee representative tax (percent)
Calendar year 1972_____	19.9
Calendar year 1971_____	19.9
Calendar year 1970_____	19.1
Calendar year 1969_____	19.1

26 CFR 601.701: Publicity of information. (Also Part IV, T.D. 6122, 1955-1 C.B. 632; 503.1 and 1965-1 C.B. 360.)

Rev. Proc. 74-14

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the new German filing procedures to be followed by a resident, corporation, or other entity of the United States in order to obtain German treaty benefits under the dividend, interest, and royalty provisions of the Income Tax Convention between the United States and the Federal Republic of Germany, as modified by the Protocol of December 27, 1965. See 1955-1 C.B. 635 and 1966-1 C.B. 360.

SEC. 2. BACKGROUND.

.01 The Ministry of Economics and Finance of the Federal Republic of Germany has furnished the United States Internal Revenue Service the information set out below in section 3 concerning the address of the German tax authorities to whom claims may be filed by a resident, corporation, or other entity of the United States for exemption from, or refund or reduction of, withholding taxes under the dividend, interest, and royalty provisions of the Income Tax Convention between the United States and the Federal Republic of Germany, as modified.

.02 Previously, these claims were filed with a designated tax office (Finanzamt) of the "Land" (constituent State of the Federal Republic) in which the payer (issuer) had his head office, place of management or fiscal domicile. However, a redistribution of functions among the appropriate German tax authorities in the various States of the German Federal Republic has resulted in the partial centralization of the processing of claims filed on or after January 1, 1972, and in the complete centralization of such process of claims filed on or after January 1, 1973.

.03 The German Ministry of Economics and Finance has also advised that all claims received on or after January 1, 1972, by a tax office previously responsible for handling such claims will be transmitted to the appropriate tax office without disadvantage to the claimant.

SEC. 3. DIVIDENDS, INTEREST, AND ROYALTIES.

.01 Filing Procedure to Obtain Reduction by Refund on Dividends.

1 Article VI of the Convention, as modified, provides, in general, for a reduced German tax rate on dividends received by a resident or corporation or other entity of the United States from a German company. This reduced tax rate is normally granted by means of a refund from the German tax authorities of the excess amount collected. To obtain this dividend reduction by refund, the applicant must submit a claim, in duplicate, on a special German form entitled "Antrag auf Erstattung der Kapitalertragsteuer nach dem Doppelbesteuerungsabkommen mit den Vereinigten Staaten von Amerika" (Claim for refund of Capital Yields Tax under the Double Taxation Convention with the United States of America).

2 Previously, dividend claims were filed with the Finanzamt of the "Land" in which the payer had his head office, place of management or fiscal domicile. However, commencing on January 1, 1973, all claims for refund of German dividend withholding taxes are filed with the Bundesamt für Finanzen, D-53 Bonn-Bad Godesberg, Kennedy-Allee 22/24, Deutschland, regardless of whether or not they refer to income derived in taxable years prior to the year in which the claims are filed.

.02 Filing Procedure to Obtain Interest Exemption by Refund.

1 Article VII(2) of the Convention, as modified, provides, in general, that interest on bonds, notes, debentures, securities, or on any other form of indebtedness derived by a resident or corporation or other entity of the United States shall be exempt from tax by the German Federal Republic. This exemption is normally granted by means of a refund from the German tax authorities of the amount collected. To obtain the interest exemption by refund, the applicant must submit a claim, in duplicate, on a special German form entitled "Antrag auf Erstattung der Kapitalertragsteuer nach dem Doppelbesteuerungsabkommen mit den Vereinigten Staaten von Amerika" (Claim for refund of Capital Yields Tax under the Double Taxation Convention with the United States of America).

2 Previously, interest claims were filed with the Finanzamt of the "Land" in which the payer had his head office, place of management or fiscal domicile. However, commencing on January 1, 1973, all claims for refund of German interest withholding taxes are filed with the Bundesamt für Finanzen, D-53 Bonn-Bad Godesberg, Kennedy-Allee 22/24, Deutschland, regardless of whether or not they refer to income derived in taxable years prior to the year in which the claims are filed.

.03 Filing Procedure to Obtain Royalty Exemption at Source.

1 Article VIII(2) of the Convention, as modified, provides, in general, that royalties derived by a resident or corporation or other entity of the United States shall be exempt from tax by the German Federal Republic. This exemption is normally granted at source if the United States resident

files an application for a certificate of tax exemption with the German tax authorities. The application must be filed in duplicate on a special German form entitled "Antrag auf Ausstellung einer Bescheinigung über Steuerfreiheit von Lizenzgebühren und ähnlichen Vergütungen" (Application for a certificate of tax exemption in respect of royalties and similar amounts).

2 Previously, royalty claims were filed with the Finanzamt of the "Land" in which the payer had his head office, place of management or fiscal domicile. However, commencing on January 1, 1973, all claims for exemption from or refund of German royalty withholding taxes are filed with the Bundesamt für Finanzen, D-53 Bonn-Bad Godesberg, Kennedy-Allee 22/24, Deutschland, regardless of whether or not they refer to income derived in taxable years prior to the year in which the claims are filed.

SEC. 4. FORMS.

The German forms, "Claims for refund of Capital Yields Tax under the Double Taxation Convention with the United States of America" and "Application for a certificate of tax exemption in respect of royalties and similar amounts," may be obtained from either the German tax authorities, whose address is Bundesamt für Finanzen, D-53 Bonn-Bad Godesberg, Kennedy-Allee 22/24, Deutschland, or from the Office of International Operations, Internal Revenue Service, P.O. Box 19007, Washington, D.C. 20036; Attention: CP:IO:2.

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26 CFR 601.401: Employment taxes.
(Also Part I, Section 6051; 31.6051-1.)

Forms W-2 for 1974; suspension of 30-day requirement. Employers may defer issuance of 1974 Forms W-2 to employees whose employment is terminated during 1974 until 30 days after the announced availability date of such forms.

Rev. Proc. 74-15 [1] [2]

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to provide additional time for employers to furnish copies of the 1974 Form W-2, Wage and Tax Statement, to employees whose employment is terminated during 1974.

SEC. 2. BACKGROUND

Section 6051 of the Internal Revenue Code of 1954 provides that employers furnish statements to employees for remuneration paid during the calendar year showing, among other information, the total amount of wages paid subject to withholding of income tax, the total amount of wages paid subject to tax under the Federal Insurance Contributions Act (social security tax), the total amount of social security tax deducted and withheld, and the proportion of the total amount withheld as social security tax which is for financing the cost of hospital insurance benefits under the Social Security Act.

Forms W-2 are required to be furnished to employees on or before January 31 of the year succeeding the calendar year or, if employment is terminated before the close of the calendar year, within 30 days after the day on which the last payment of wages is made.

Form W-2 has not been issued for 1974 because the Congress is currently considering legislation which may affect information required to be shown on the form.

SEC. 3. PROCEDURE

The Internal Revenue Service will announce in the Internal Revenue Bulletin the date the Forms W-2 for 1974 are available. Employers may defer furnishing the 1974 Forms W-2 to employees whose employment is terminated during 1974 until 30 days after the announced date.

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[1] Also released as Technical Information Release 1274, dated January 29, 1974.

[2] The availability of Form W-2 for 1974 was announced on July 22, 1974, in 1974-29 I.R.B. 23.

26 CFR 601.104: Collection functions.
(Also Part I, Sections 3101, 3111, 3121, 6413; 31.3101-1, 31.3111-1, 31.3121(a)-1, 31.6413(c)-1.)

FICA tax for parent and subsidiary corporations; collection for prior years. Guidelines are set forth for the collection of the taxes imposed by the FICA for a prior year in cases involving a parent and its subsidiary corporations where the wage limitation of section 3121(a)(1) of the Code was exceeded in such prior year with respect to a particular employee who performed substantial services for more than one of the corporations although paid only by the parent.

Rev. Proc. 74-16

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to establish guidelines for the collection of the taxes imposed by the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) for a prior year in cases involving a parent and its subsidiary corporations, in the event that the wage limitation of section 3121(a)(1) of that Act was exceeded in the prior year with respect to a particular employee.

SEC. 2. BACKGROUND

Rev. Rul. 69-316, 1969-1 C.B. 263, relates to a case where certain executives, in addition to being officers of the parent corporation, are also officers of one or more of its subsidiaries, and perform substantial services as officers of more than one of the corporations although paid only by the parent. The Revenue Ruling holds that any payment made by the parent that represents remuneration of the individual as an officer (employee) of the subsidiary is remuneration paid by the subsidiary for purposes of the Federal Insurance Contributions Act.

Numerous problems have arisen in such cases when the parent organization fails to take account of the Federal Insurance Contributions Act taxes owed by the subsidiary, the parent

treating itself as the sole employer of the executives. Typically, the parent pays the employer tax imposed by section 3111 of the Act and deducts and pays the employee tax imposed by section 3101, until the maximum "wage" limitation set forth in section 3121(a)(1) is reached. The parent pays no additional Federal Insurance Contributions Act taxes on behalf of the subsidiary.

Were the provisions of Rev. Rul. 69-316 to be followed strictly, an assessment against the subsidiary would be made for both the employer's and the employee's shares of the Federal Insurance Contributions Act taxes on the portion of the wages attributable to the subsidiary. However, the employee, in turn, would be entitled to a refund under section 6413(c)(1) of the Code if (1) the employer and employee agree that the employer will pay the employee's share of Federal Insurance Contributions Act taxes without deduction from the employee's remuneration or without reimbursement from the employee, (2) the employee tax is actually deducted from the remuneration of the employee, or (3) the employee reimburses the employer. See Rev. Rul. 74-75, page 19, this Bulletin.

Accordingly, when the failure by the parent to take account of the Federal Insurance Contributions Act taxes owed by the subsidiary is discovered in a later year, the Internal Revenue Service, the employer, and the employee would be in the same position subsequent to the assessment of the employee tax as they were prior to its assessment.

SEC. 3. PROCEDURE

.01. A district director or director of a service center will, in the situation described above, assess only the employer tax imposed by section 3111 of the Federal Insurance Contributions Act for the prior year where the employee had already surpassed his maximum "wage" limitation for that year. He will not assess the employee tax imposed by section 3101 of the Act, since under the conditions outlined in Rev. Rul. 74-75, the employee could secure a refund of that tax under section 6413(c)(1) of the Code and, if so, all parties then would be in the same position they were in prior to the assessment. However, for a district director or service center director to waive assessment of the employee tax, he must first secure a waiver from the subsidiary of any right it might have to any deduction or reimbursement from the employee for the employee tax, in order to preclude the possibility of a later inconsistent position.

.02. With respect to the subsidiary's deduction for additional expenses, the additional employer tax liability under the Federal Insurance Contributions Act should be deducted by an accrual basis taxpayer in the year to which it relates, since that is the year in which all the events occurred giving rise to the liability. See Rev. Rul. 68-631, 1968-2 C.B. 198, and Rev. Rul. 69-336, 1969-1 C.B. 142.

.03. Any penalties or interest that may be applicable to the underpayment by the subsidiary of the employer tax imposed by section 3111 of the Act and the employee tax imposed by section 3101 of the Act will be asserted only on the underpayment of the employer tax where the employer tax is the only amount assessed by a district director or service center director.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 7701; 301.7701-3.)

Rev. Proc. 74-17 [1]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce certain conditions under which the Internal Revenue Service will not issue advance rulings or determination letters concerning classification of organizations which raise factual questions as to whether their principal purpose is the reduction of Federal taxes.

SEC. 2. BACKGROUND.

.01 In accordance with Rev. Proc. 72-3, 1972-1 C.B. 698, section 5, the Internal Revenue Service has the discretionary authority to issue rulings and determination letters. There are certain areas where, because of the inherently factual nature of the problem, or for other reasons, the Service will not issue, or ordinarily will not issue, rulings or determination letters. A list of these areas is set forth in Rev. Proc. 72-9, 1972-1 C.B. 719. This list is not all inclusive. Section 3.021 of Rev. Proc. 72-9 indicates that the Service will not rule where the transaction has as its principal purpose the reduction of Federal taxes.

.02 When requested by taxpayers or their authorized representatives, the Individual Income Tax Branch of the Income Tax Division, as part of its functions, issues advance ruling letters on the classification of organizations as partnerships under section 7701 of the Internal Revenue Code of 1954 and section 301.7701-3 of the Procedure and Administration Regulations.

.03 The Individual Income Tax Branch has developed certain operating rules for determining whether a ruling letter will be issued concerning organizations formed as limited partnerships and the conclusions that will be expressed in such ruling letters. Among such operating rules is Rev. Proc. 72-13, 1972-1 C.B. 735, relating to conditions under which the Service will issue a ruling letter on the classification of an organization as a limited partnership where a corporation is the sole general partner.

.04 The operating rules set forth in this Revenue Procedure are being published to make clear the circumstances in which advance rulings will not ordinarily be issued and thus to provide assistance to taxpayers and

[1] Also released as Technical Information Release No. 1290, dated May 3, 1974.

their representatives in preparing ruling requests, and to assist the Service in issuing advance ruling letters as promptly as practicable. These operating rules do not define, as a matter of law, whether the principal purpose of the organization is the reduction of Federal taxes, nor whether participants in an organization are partners or whether such an organization is a partnership, nor do they define any other terms used in the Internal Revenue Code, Income Tax Regulations, Procedure and Administration Regulations, or Revenue Rulings.

.05 A requested ruling that an organization which is to be formed and operated as a limited partnership is a partnership under section 7701 of the Code will ordinarily be issued if the operating rules set forth in section 3 of this Revenue Procedure are complied with and if all other pertinent provisions of the Internal Revenue Code and regulations thereunder, Revenue Rulings and Revenue Procedures are satisfied.

.06 If the operating rules of section 3 of this Revenue Procedure are not complied with, the Service will ordinarily decline to issue the requested ruling or determination letter.

SEC. 3. OPERATING RULES FOR THIS REVENUE PROCEDURE.

.01 The interests of all of the general partners, taken together, in each material item of partnership income, gain, loss, deduction or credit is equal to at least one percent of each such item at all times during the existence of the partnership. In determining the general partners' interests in such items, limited partnership interests owned by the general partners shall not be taken into account.

.02 The aggregate deductions to be claimed by the partners as their distributive shares of partnership losses for the first two years of operation of the limited partnership will not exceed the amount of equity capital invested in the limited partnership.

.03 A creditor who makes a nonrecourse loan to the limited partnership must not have or acquire, at any time as a result of making the loan, any direct or indirect interest in the profits, capital, or property of the limited partnership other than as a secured creditor.

.04 The rules set forth above must be contained in relevant documents furnished with the request for ruling or, in the absence thereof, by factual representations that such rules will be contained in all relevant documents when they are finalized.

SEC. 4. OTHER INSTRUCTIONS.

The general procedures of Rev. Proc. 72-3, relating to the issuance of rulings and determination letters are applicable to requests relating to classification of organizations formed as limited partnerships, as are the special procedures of Rev. Proc. 72-13, relating to conditions under which the Service will issue a ruling concerning classification of organizations formed as limited partnerships where a corporation is the sole general partner. Also applicable is Rev. Proc. 72-9, which indicates the areas in which the Service will not issue, or ordinarily will not issue, rulings or determination letters. The rules stated above are to be applied only in determining whether ruling and determination letters will be issued and are not intended as substantive rules for the determination of partnership status and are not to be applied as criteria for the audit of taxpayers' returns.

SEC. 5. EFFECTIVE DATE.

The provisions of this Revenue Procedure are effective immediately.

SEC. 6. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to its number and should be addressed to the Assistant Commissioner (Technical), Attention: T:I:I, Internal Revenue Service, Washington, D.C. 20224.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, Section 472; 1.472-1, 1.472-2.)

Rev. Proc. 74-18 [1]

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to set forth the procedure to be used by the Internal Revenue Service in the examination of Federal income tax returns involving the LIFO inventory requirements of section 472(e) of the Internal Revenue Code of 1954 for those taxpayers with respect to the fiscal year ended on or about January 31, 1974, who are required by the Securities and Exchange Commission (SEC) to disclose in news releases and annual reports the effect on earnings resulting from the inflationary cost of goods sold caused by the sharp unexpected increases in the Department Store Inventory Price Indexes (DSI) for January 1974 compiled by the Bureau of Labor Statistics (BLS).

SEC. 2. SCOPE.

.01 The scope of this Revenue Procedure is limited to taxpayers using the BLS index figures in valuing their LIFO inventories under the authority of section 1.472-8(e)(1) of the Income Tax Regulations. The scope is further limited to those taxpayers using DSI as determined at January 31, 1974, who are subject to the rules and regulations of the SEC to make the disclosures referred to in Section 1 of this Revenue Procedure.

.02 This Revenue Procedure shall have no effect on any disclosure of whatever type in news releases or annual reports for any past or future taxable years with respect to the LIFO method.

SEC. 3. BACKGROUND.

.01 Section 472(e) of the Code and the regulations thereunder provide, in effect, that a taxpayer may not use the LIFO inventory method unless he establishes to the satisfaction of the Secretary of the Treasury or

[1] Also released as Technical Information Release No. 1291, dated May 3, 1974.

his delegate that he has used no procedure other than the LIFO method for purposes of an annual report to shareholders, partners, other proprietors, beneficiaries, or for credit purposes. These provisions also provide that such requirements shall apply to the continued use of the LIFO method. Thus, where there is a variance between the LIFO procedures used for Federal income tax purposes and for financial accounting purposes, the Secretary or his delegate may terminate the LIFO election of a taxpayer for a violation of the above requirements.

.02 The SEC is charged with the responsibility of administering the disclosure and reporting requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934. The SEC requires that material information affecting a company's earnings and its earnings per share be disclosed to avoid giving public investors a misleading impression of such earnings and earnings per share.

.03 The unusually sharp increase in the BLS index figures for January 1974 has resulted in high cost of sales for those taxpayers using the LIFO inventory method and a fiscal year ended on or about January 31, 1974, as compared with prior taxable years.

SEC. 4. APPLICATION.

In the examination of returns, if a corporation using the LIFO inventory method in conjunction with the BLS index figures is required by the SEC to make the following type of disclosure statements in its annual report, news releases, or other published reports for its fiscal year ending on or about January 31, 1974, its LIFO election under section 472 of the Code will not be terminated solely because of the use of such statements in published reports:

.01 Type of disclosure statements to be used in portions of the annual reports, etc., other than in the financial statements section:

Inflation in the cost of goods sold reduced earnings by _____¢ per share in 1973 as compared with _____¢ per share in 1972. These amounts were calculated from the increase in the appropriate BLS index used in determining the value of our year-end LIFO inventory.

The LIFO (last in, first out) method, used by _____ and some other retailers, has the effect of eliminating inflationary effects from earnings and from inventory value. Thus, profits and balance sheet inventory values are stated on a conservative basis, both for financial and tax reporting purposes.

.02 Type of disclosure statements to be used as a footnote in the financial statements section of the annual reports, etc.:

Inflation in the cost of goods sold reduced net earnings by $_____ in 1973 and $_____ in 1972. These amounts were calculated from the increase in the appropriate BLS index used in determining the value of the year-end LIFO inventory.

Statement of Organization and Functions[1]

This material supersedes the statements on organization and functions published at 37 F.R. 20961-20990 [1972-2 C.B. 836], 38 F.R. 23341 and 23342 [1973-2 C.B. 503], and 38 F.R. 30011 and 30012 [1973-2 C.B. 504].

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

Dated March 25, 1974.

1100 Organization and Staffing

1110 Organization and Functions of the Internal Revenue Service

1111 Establishment of the Internal Revenue Service

1111.1 Mission

The mission of the Service is to encourage and achieve the highest possible degree of voluntary compliance with the tax laws and regulations and to maintain the highest degree of public confidence in the integrity and efficiency of the Service. This includes communicating the requirements of the law to the public, determining the extent of compliance and causes of non-compliance, and doing all things needful to a proper enforcement of the law.

1111.2 Organic Act

(1) The Office of the Commissioner of Internal Revenue was established by an act of Congress (12 Stat. 432) on July 1, 1862, and the first Commissioner of Internal Revenue took office on July 17, 1862.

(2) The act of July 1 provided:

". . . That, for the purpose of superintending the collection of internal duties, stamp duties, licenses, or taxes imposed by this Act, or which may be hereafter imposed, and of assessing the same, an office is hereby created in the Treasury Department to be called the Office of the Commissioner of the Internal Revenue; . . . Commissioner of Internal Revenue, . . . shall be charged, and hereby is charged, under the direction of the Secretary of the Treasury, with preparing all the instructions, regulations, directions, forms, blanks, stamps, and licenses, and distributing the same or any part thereof, and all other matters pertaining to the assessment and collection of the duties, stamp duties, licenses, and taxes, which may be necessary to carry this Act into effect, and with the general superintendence of his office, as aforesaid, and shall have authority, and hereby is authorized and required, to provide proper and sufficient stamps or dies for expressing and denoting the several stamp duties, or the amount thereof in the case of percentage duties, imposed by this Act, and to alter and renew or replace such stamps from time to time, as occasion shall require; . . ."

(3) By common parlance and understanding of the time, an office of the importance of the Office of Commissioner of Internal Revenue was a

[1] 39 F.R. 11572.

bureau. The Secretary of the Treasury in his report at the close of the calendar year 1862 stated that "The Bureau of Internal Revenue has been organized under the Act of the last session . . ." Also it can be seen that Congress had intended to establish a Bureau of Internal Revenue, or thought they had, from the act of March 3, 1863, in which provision was made for the President to appoint with Senate confirmation a Deputy Commissioner of Internal Revenue "who shall be charged with such duties in the bureau of internal revenue as may be prescribed by the Secretary of the Treasury, or as may be required by law, and who shall act as Commissioner of internal revenue in the absence of that officer, and exercise the privilege of franking all letters and documents pertaining to the office of internal revenue." In other words, "the office of internal revenue" was "the bureau of internal revenue," and the act of July 1, 1862 is the organic act of today's Internal Revenue Service.

1111.3 History

1111.31 Internal Taxation

Madison's Notes on the Constitutional Convention reveal clearly that the framers of the Constitution believed for some time that the principal, if not sole, support of the new Federal Government would be derived from customs duties and taxes connected with shipping and importations. Internal taxation would not be resorted to except infrequently, and for special reasons. The first resort to internal taxation, the enactment of internal revenue laws in 1791 and in the following 10 years, was occasioned by the exigencies of the public credit. These first laws were repealed in 1802. Internal revenue laws were reenacted for the period 1813-1817 when the effects of the war of 1812 caused Congress to resort to internal taxation. From 1818 to 1861, however, the United States had no internal revenue laws and the Federal Government was supported by the revenue from import duties and the proceeds from the sale of public lands. In 1862 Congress once more levied internal revenue taxes. This time the establishment of an internal revenue system, not exclusively dependent upon the supplies of foreign commerce, was permanent.

1111.32 Background and Evolution of Present Organization

(1) Before the establishment of the Office of Commissioner of Internal Revenue, taxes were collected by "Supervisors" of collection districts who were appointed by the President, subject to Senate confirmation. These Supervisors worked under the direct control of the Treasury Department. The Revenue Act of 1813 provided, for the first time, for a "Collector" and a "Principal Assessor" for each collection district, and for deputy collectors and assistant assessors. Collectors and Assessors appear to be the original forerunners of the twentieth century Collectors of Internal Revenue and Internal Revenue Agents in Charge.

(2) Since 1862, the Internal Revenue Service has undergone a period of steady growth as the means for financing Government operations shifted from the levying of import duties to internal taxation. Its expansion received considerable impetus in 1913 with the ratification of the Sixteenth Amendment to the Constitution under which Congress received constitutional authority to levy taxes on the income of individuals and corporations. With the enactment of income tax laws the work of the Revenue Service began to take on a highly technical character.

(3) From the World War I period through 1951, the basic organizational structure of the Internal Revenue Service remained essentially unchanged even though there were marked increases in the number of taxpayers serviced, revenue receipts, employees and the over-all workload. The Service was organized, in Washington and the field, on a program or "type-of-tax" basis, with jurisdictionally separate organizations, or "Units," charged with the administration of different types of taxes.

1111.4 Reorganization Plan No. 1 of 1952 and Other Changes

(1) On January 14, 1952, the President of the United States submitted to Congress Reorganization Plan No. 1 of 1952, calling for a comprehensive reorganization of the Internal Revenue Service. On March 13, 1952, the last motion to defeat the Plan was voted down in the Senate, and the Plan became effective on March 15, 1952.

(2) Reorganization Plan No. 1 of 1952 brought about four basic changes in the Internal Revenue Service:

(a) The organization of the Service along functional lines—i.e., operations, administration, technical, planning, and inspection;

(b) The abandonment of the system of political appointments to positions below the Commissioner;

(c) The integration of most field revenue programs under District Directors of Internal Revenue; and

(d) The establishment of a system of regional administration under Regional Commissioners of Internal Revenue.

(3) The Reorganization Plan provided authority for the establishment of 25 Offices of Regional Commissioners (referred to as "District Commissioners" in the Plan). By December 1, 1952, the Offices of 17 Regional Commissioners had been established. The major field programs, including alcohol and tobacco tax enforcement, were integrated under District Directors; the appellate program and the permissive alcohol and tobacco tax functions were placed in the Offices of Regional Commissioners; and, in

the National Office, all activities were placed under Assistant Commissioners for Inspection; Operations; and Technical; an Assistant to the Commissioner, and an Administrative Assistant to the Commissioner.

(4) In 1953, a number of organizational refinements were effected. The number of regions was reduced to 9; the field operations of Alcohol and Tobacco Tax were centralized at the regional level; and the delinquent accounts and returns program was transferred from the Audit Divisions in the Offices of District Directors to their Collection Divisions. In the National Office, the position of Deputy Commissioner was established and the Bureau of Internal Revenue was redesignated as the Internal Revenue Service.

(5) Other significant changes since 1953 include establishment of the Offices of Assistant Commissioners for Administration, Data Processing, and Planning and Research; redesignation of the Assistant Commissioner (Operations) as the Assistant Commissioner (Compliance); discontinuance of the Columbus and Toledo (Ohio) districts and consolidation of the Upper and Lower Manhattan districts, effective January 1, 1960; establishment of the Anchorage (Alaska) district on January 1, 1961; transfer on September 13, 1963 of the Director of Practice from the Internal Revenue Service to the Office of the Secretary of the Treasury to be under the immediate supervision of the General Counsel; effective January 1, 1964, reduction in the number of regions to 8 and discontinuance of the districts of Camden (New Jersey), Kansas City (Missouri), Scranton (Pennsylvania), and Syracuse (New York); and, effective January 4, 1965, reduction in the number of regions to 7. On December 19, 1968, Alcohol and Tobacco Tax Division was changed to Alcohol, Tobacco and Firearms Division. Effective July 1, 1971, the Office of Assistant Commissioner (Data Processing) was redesignated Office of Assistant Commissioner (Accounts, Collection, and Taxpayer Service). Effective November 14, 1971, the position of Assistant Commissioner (Stabilization) was established. Effective July 1, 1972, the Alcohol, Tobacco and Firearms activity was transferred from the Internal Revenue Service to be a separate bureau within the Department of the Treasury.

1112
Service Organization

(1) The Internal Revenue Service is a component part of the Treasury Department. The Service is headed by the Commissioner of Internal Revenue who serves under the direction of the Secretary of the Treasury.

(2) The Internal Revenue Service consists of a National Office in Washington, D.C., and a field organization. The latter consists of 7 Internal Revenue regions, each headed by a Regional Commissioner who reports to the Deputy Commissioner; 58 Internal Revenue districts, each headed by a District Director, and 10 service centers, each headed by a Director, who report to a Regional Commissioner; and a computer center and a data center under the direction of the Assistant Commissioner (Accounts, Collection, and Taxpayer Service) in the National Office. In addition, there are in the field 7 Regional Inspectors and 7 Regional Counsels, who report to the Assistant Commissioner (Inspection) and the Chief Counsel, respectively, in Washington, D.C.

(3) In administering the appellate functions direct from the regional office, the Regional Commissioner maintains and supervises branch offices headed by Chiefs, Appellate Branch Office, who report to the Assistant Regional Commissioner (Appellate) who also carries the title of Chief, Appellate Division. Chief, Appellate Branch Office, may also supervise suboffices administered by an Assistant Chief or local representative of the Chief.

(4) The Regional Counsels also maintain and supervise branch offices.

(5) In each Internal Revenue district there are offices in communities where concentration of workload in audit, collection, intelligence, or stabilization activities requires the assignment of personnel.

1113
National Office

1113.1
Mission

The mission of the National Office is to develop broad nationwide policies and programs for the administration of the internal revenue laws and related statutes, and to direct, guide, coordinate, and control the endeavors of the Internal Revenue Service.

1113.2
Basic Organization

The principal offices which form the National Office are: The Office of the Commissioner; the Office of the Assistant Commissioner (Administration); the Office of the Assistant Commissioner (Compliance); the Office of the Assistant Commissioner (Accounts, Collection, and Taxpayer Service); the Office of the Assistant Commissioner (Inspection); the Office of the Assistant Commissioner (Planning and Research); the Office of the Assistant Commissioner (Technical); the Office of the Assistant Commissioner (Stabilization); and the Office of the Chief Counsel.

1113.3
Office of the Commissioner

The Commissioner of Internal Revenue, in conformity with policies and delegations of authority made by the Secretary of the Treasury, establishes the policies and administers the activities of the Internal Revenue Service. The Office of the Commissioner includes the Deputy Commissioner, the Assistant to the Commissioner, Assistant to the Commissioner (Public Affairs) and the Tax Administration Advisory Staff.

1113.31
Deputy Commissioner

The Deputy Commissioner assists and acts for the Commissioner in planning, directing, coordinating and controlling the policies and programs and in giving executive leadership to the activities of the Internal Revenue Service. The Deputy Commissioner also supervises the Regional Commissioners of Internal Revenue, and makes allocations of funds and personnel to them.

1113.32
Assistant to the Commissioner

The Assistant to the Commissioner reviews and takes final action for the Commissioner on documents involving technical matters prepared for the Commissioner's signature, including regulations, reports on proposed legislation, rulings, correspondence, compromises and reports to the Joint Committee on Internal Revenue Taxation involving refunds or credits of any income, war profits, excess profits, estate, or gift taxes in excess of $100,000. The Assistant to the Commissioner makes independent studies for the Commissioner.

1113.33
Assistant to the Commissioner (Public Affairs)

The Assistant to the Commissioner (Public Affairs) counsels and advises the Commissioner, Deputy Commissioner and other levels of management on matters where public interest or response is involved in the determination of Service policies and the execution of Service programs. Plans, develops and coordinates the Service-wide policies and programs for providing information to the public through mass communication methods to help improve knowledge and understanding of Federal tax and related laws and their administration, for the primary purpose of encouraging and facilitating maximum voluntary compliance by the public. Conducts continuous studies of the Service's public affairs activities to identify and act on problems and opportunities for improvement. Maintains liaison with and provides functional supervision to regional and district offices in public affairs matters and carries out public affairs programs at the National Office and directs the activities of the Public Affairs Division. Evaluates for the Commissioner public response to Service policies and programs and recommends Service actions where indicated.

1113.331
Administrative Office

Provides administrative support for the public affairs function. Coordinates budget formulation and financial planning for the Division and assists in developing staffing, training, and personnel plans for field public affairs activities. Provides the necessary administrative support to the internal operation of the Division, maintaining liaison with Personnel, Training, Facilities Management, and Fiscal Management personnel. Provides library and reference services for public affairs personnel and a daily newspaper clipping service for top Service and Department officials. Services requests for inspection and copies of exempt organization returns, Abstracts and Statements for accepted offers in compromise. Maintains the Freedom of Information Reading Room and services requests for documents on deposit therein.

1113.332
Operations Branch

Responsible for the continuing relationships and day-to-day contacts with national media and Washington bureaus of media serving local communities, on all aspects of the IRS mission and operations. Media include the press, radio, television, news services, trade associations, and other organizations that provide information to large segments of the public. Seeks out and develops new media outlets. Maintains a knowledge of all significant Service objectives, activities and problems; and an awareness of public interest and news developments which affect the Service. Conducts information activities both in response to media requests and as initiated in response to Service-recognized needs. The activities include answering queries, arranging interviews, reviewing articles, arranging news conferences, organizing public appearances, preparing news releases, radio and television announcements, fact sheets, feature articles, and conducting other information efforts to further Service objectives and assist the media in serving their audiences or members. Responsibilities also encompass assisting field officials in relationships with local media in situations where immediate action is required. Compiles the Commissioner's Letter, National Office Notes and other communications to employees. Responds to public correspondence relating to national news stories.

1113.333
Programs Branch

Responsible for formulating nationwide public affairs programs and providing the information materials, program guidance, coordination, and assistance necessary to implement those programs. Consults with operating officials to determine Service objectives and priorities, develops supporting information themes and objectives, and plans specific information actions, timetables and materials. Develops public affairs audio-visual materials and written materials for distribution to media through IRS field offices. Advises field offices of National Office information programs and projects; provides training, procedural guidance, and program assistance; supervises field visits; analyzes reports and other indicators of program effectiveness; prepares program evaluations and initiates action to improve programs where necessary. Serves as primary point of contact with field Public Affairs Officers and assures

prompt National Office response to their inquiries, requests for disclosure guidance under Freedom of Information Act, and other needs. Compiles the Commissioner's Annual Report and the Service segment of the Secretary's Annual Report.

1113.34
Tax Administration Advisory Staff

The Tax Administration Advisory Staff provides leadership within the Service for the development and implementation of comprehensive programs of assistance in tax administration to developing nations, and on occasion, to the more developed nations, in line with the foreign policy of the United States and its commitments to the Organization of American States, the United Nations, and other international institutions. It is the central point of contact within the Service with foreign governments, the State Department and international organizations on all matters involving the exchange of technical assistance in tax administration. The Staff designs broad programs aimed at modernizing and strengthening tax administration in developing countries; it determines program requirements in terms of number and qualifications of advisors and selects, trains, and assigns such advisors. It provides technical leadership and direction, continually monitors, and periodically evaluates country programs to ensure maximum effectiveness of assistance efforts. The Staff develops and arranges study and observation programs in tax administration for foreign tax officials, which are conducted largely in the U.S. and occasionally at overseas sites. The Staff maintains close liaison with the Department of State and the Agency for International Development (AID), foreign governments, international organizations, and the Office of the Secretary on matters concerning the foreign tax assistance program, most of which is conducted cooperatively with AID. The Director, Tax Administration Advisory Staff, has been delegated authority to arrange for and authorize temporary assignment of personnel between the IRS and State and local governments and institutions of higher education. The Director is responsible for determining that requests for individual assignments or for projects of assistance involving several assignments are consistent with the intent of the Act and that the requirements for mutual benefit to the Service and the requesting organization are met. The Director is also authorized to set the amount of the financial support to be provided by the Service and to make such other determinations as are needed. The Staff will furnish or arrange for any necessary technical direction and support of employees on assignment to other organizations.

1113.4
Office of Assistant Commissioner (Administration)

The Assistant Commissioner (Administration) is the principal assistant to the Commissioner in planning and executive the Administration program of the Internal Revenue Service, which includes fiscal management, personnel, facilities management, training, employment policy, and management improvement. Jointly, with other Assistant Commissioners, he participates in the general management of the Service by coordinating Administration with other functions to accomplish the objectives of a comprehensive and well-integrated Revenue program. On general administrative matters represents the Commissioner in relationships with the Congress; the Department of the Treasury Office of the Secretary and other components of the Department of the Treasury; and such agencies as the Office of Management and Budget, the Civil Service Commission and General Services Administration. Supervises the activities of the Fiscal Management, Personnel, Facilities Management, and Training Divisions in the National Office, and is responsible for functional supervision of Administration activities in the field.

1113.41
Facilities Management Division—Office of the Director

Develops, directs, coordinates, and evaluates policies and programs for providing essential support activities for the operating divisions' primary programs and carries them out in the National Office. Its programs are designed to increase the effectiveness of the Internal Revenue Service, reduce its operating costs, and improve taxpayer relations by tailoring Internal Revenue Service physical facilities and by providing support services to best meet the Service's total needs. These programs include information and records systems, space, property, supply, transportation, and telecommunications management, procurement and contracting, printing and distribution, national emergency planning, safety, document and physical security, and the settlement of tort claims. Develops the standards and procedures necessary for effective performance of its functions. This Division consists of five branches: National Office Facilities, Information Systems, Protective Programs, Space and Property, and Publishing Services.

1113.411
National Office Facilities Branch

Develops, coordinates, directs, and evaluates the Contracting and Procurement Programs of the Internal Revenue Service. Develops procurement policy and procedures, and provides guidelines and consultative assistance for all Internal Revenue Service Procurement Programs. Appraises procurement programs through a systematic program of visits to field offices and through review and analysis of reports and accomplishments. In addition, develops, coordinates, directs and evaluates all Facilities Management programs and activities (except printing and distribution and National Office emergency relocation

planning) within the National Office, including the National Training Center and the National Computer Center, within the broad guidelines established by the Division Director. These activities include: Information and records systems, space management, transportation management, property and supply management, telecommunications management, protective programs, and contracting and procurement. Maintains liaison with National Office officials, other Government agencies, public utilities, contractors, private carriers, and other private and public organizations to coordinate and improve service in all of these activities.

1113.412
Information Systems Branch

Plans, develops, promotes, coordinates, and evaluates programs designed to increase the effectiveness of Servicewide operations in the following areas: Records Management—documentation standards; correspondence; and the management of records creation, retrieval, retention, and disposal; Information Systems Analysis—internal mail and files management; management of information and records handling equipment and supplies; studies of information utilization and flow, and of paperwork management; analysis, either singly, or in collaboration with the Systems Development Division of the information needs of management at various levels of the Service, and the development of reporting and management information systems to effectively and economically meet those needs; guidelines and standards for application of microphotography (excepting microphotographic publishing), and other information handling and word processing technology; Reports Management—development of Servicewide reports management policies, procedures, and standards; control, review and evaluation of National Office generated reporting and management information systems; maintenance of a Servicewide information inventory and of the National Office Reports Catalogue; Mail and Transportation Management—coordination and planning for those services provided by the U.S. Postal Service, or private shippers and service units of IRS, for physically transporting, controlling, delivering, sorting and distributing material in solid forms such as correspondence, documents, receipts, microfilm, or magnetic tape; Telecommunications Systems—services and facilities for transmitting and receiving data and information and the operation of telephone, telegraph, facsimile, and data communications systems, equipment and circuitry. The Branch determines the need for program emphasis and goals, develops the programs and promotes and coordinates their acceptance and implementation with other components of the Service; provides standardized techniques, guidelines, and consultative services needed in these areas by the Service. Collaborates with the Systems Development Division in matters involving communications and information storage and retrieval systems. Acts as liaison for the Service with other Federal agencies and industry in matters concerning Branch program activities.

1113.413
Protective Programs Branch

Develops, coordinates, administers, and evaluates Servicewide programs of civil defense and emergency planning which includes contingency plans for coping with demonstrations, civil disorder and bomb threats; accident prevention; physician and document security and identification. Ensures continuity of operations by preventing or minimizing loss through accident, employee injury, fire, theft, enemy attack, natural disaster, and civil disturbance, and breaches of security of facilities, equipment, and documents. Exercises the authority to settle claims arising out of the activities of the Internal Revenue Service under the Federal Tort Claims Act, the Military Personnel and Civilian Employees' Claims Act and the Claims Collection Act, and administers the program to ensure equitable settlement and payment of claims.

1113.414
Publishing Services Branch

Plans, develops, coordinates, administers, and evaluates the policies, systems, procedures and standards for the publishing needs of the Internal Revenue Service in consonance with the Congressional Joint Committee on Printing Regulations. Participates in agency-wide program planning and development. Responsible for the fiscal control, planning, analysis, graphic design, requirements determination, procurement, integrated scheduling, inventory maintenance, and distribution of all published material. Administers the Servicewide forms management program and the publishing systems for forms, publications and envelopes. Provides for comprehensive graphic presentation program assistance and services. Initiates, directs, and coordinates studies to develop or improve processes in the publishing and graphic arts fields including duplicating and printing equipment; office reproduction machines; electronic composition; visual media; inventory, storage, and mail and distribution systems for published material. Provides functional supervision and logistical support to field components for the management of printing (including procurement), forms, graphic design, and distribution. Represents IRS in liaison and negotiation with other governmental agencies, private industry groups, and the public on matters pertaining to IRS publishing activities.

1113.415
Space and Property Branch

Plans, develops, promotes, coordinates, and evaluates programs designed to increase the effectiveness of Servicewide operations in the follow-

ing areas: Space Management—planning requirements for IRS space, providing standards for environmental quality programs and for the acquisition, maintenance, utilization and disposal of space to ensure an effective, efficient, and appropriate physical working environment for all Service employees, and a pleasing environment for public visitors; Property and Supply Management—conducts utilization studies, establishes requirements, designs, disposes of and maintains furniture, furnishings, certain non-capitalized and capitalized equipment including data processing auxiliary and accessory equipment; manages property accountability and the IRS motor vehicle fleet management; Electronic Support Systems—provides support services for the requirements, procurement, installation and inspection of electronic data processing systems and other electronic, electromechanical, audiovisual and other computerized or automated devices, equipment and systems; analyzes and conducts power reliability studies for IRS buildings. The Branch determines the need for program emphasis and goals, develops the programs and promotes and coordinates their acceptance and implementation with other components of the Service; provides standardized techniques, guidelines, and consultative services needed in these areas by the Service. Confers and collaborates with the Systems Development Division and the Accounts and Data Processing Division in matters involving new systems and equipment related to branch functions, and with other government agencies and private industry to assure proper installation. Acts as liaison for the Service with other Federal agencies and industry in matters concerning Branch program activities.

1113.42
Fiscal Management Division

Develops, plans, coordinates and evaluates the financial management and budget policies and programs of the Internal Revenue Service. Develops and assists in the justification of the Service's budget; advises on its execution; establishes procedures covering the accounting system for appropriated funds; and directs the budget and fiscal activities carried out in the National Office. Counsels and advises the Commissioner, the Deputy Commissioner and all levels of management on matters concerning budget and the fiscal management of funds appropriated for the administration of the Service. The Division, under the direction of the Fiscal Management Officer, consists of two branches: Accounting Branch and Budget Branch.

1113.421
Accounting Branch

The Accounting Branch develops, prescribes, and installs the Service's financial accounting system to produce timely and accurate data for budgetary and fiscal management purposes. It also collaborates with Planning and Analysis and Facilities Management Divisions in developing and administering the financial reporting system, as it relates to IRS management information systems.

1113.422
Budget Branch

The Budget Branch develops the Service's budget in conformance with the established over-all program policies through consultation and cooperation with the responsible operating officials. It prescribes budget procedures and directs the preparation of budget estimates for the Service; participates in the development of standards for the measurement of work necessary in the justification of estimates or the evaluation of financial plans; prepares requests for the apportionment or reapportionment of appropriations; allots funds in accordance with the approved financial plan and properly authorized revisions thereof; establishes the procedures and records necessary to properly reflect the execution of the budget; and collaborates with the Planning and Analysis and Facilities Management Divisions in developing and administering a reporting system reflecting the status of the budget and financial plan, as it relates to IRS management information systems.

1113.43
Personnel Division—Office of the Director

Plans, directs and leads in the development, coordination and evaluation of the personnel policies and programs of the Service. Provides functional supervision over personnel operations throughout the Service and personnel programs in the regions, districts and service centers, including long-range planning, organization and staffing studies, staff development and program evaluation. Administers centralized personnel activities including those for employees of the National Office. Acts as appellate office for the Commissioner on adverse action and grievance appeals and designates hearing officers when requested. Through the Technical Advisor directs appropriate personnel activities to promote effective manpower utilization. Prepares certain Servicewide personnel reports for the Civil Service Commission and other agencies. Exercises line supervision over the Eastern and Western Assessment Centers in their activities involving evaluation of candidates for supervisory, managerial and executive positions. Reviews and approves Servicewide security clearances for non-critical sensitive positions.

1113.431
Union Relations Branch

Develops and coordinates policies, procedures and instructions in the areas of union-management relationships, employee conduct, disciplinary actions and appeal procedures. Serves as IRS functional specialist; reviews, evaluates, assists, interprets, disseminates information and exercises functional supervision over Service activi-

ties in these program areas. Acts as liaison between the Service and the Office of the Secretary, Treasury Department Bureaus, and Civil Service Commission and other Federal agencies and provides comments on legislation, for these program areas. Responsible for liaison, consultation and negotiation with unions.

1113.432 Employment Branch

Develops and coordinates policies, procedures, and program instructions including technical training programs for the employee programs of the Service such as: recruitment; selection; placement; appointment; career status; details; veteran's preference; orientation and placement follow-up; reduction-in-force equal employment; separations; awards and incentive programs; high quality increase; pay administration; employee benefits and services; fitness for duty; and recreation and fund-raising. Develops and coordinates redeployment programs and procedures; coordinates, as required, personnel programs affecting service center installations. Develops and coordinates policies and procedures pertaining to participation of the Interagency Boards. Reviews and advises on budgetary and staffing proposals relative to recruitment, selection and utilization of personnel. Exercises functional supervision over counterpart operations throughout the Service, and participates as functional specialists in evaluation of field programs. Provides staff expertise in personnel management techniques for the development and application of automated processes to personnel management. Administers the Personnel Reports Management System. Processes Section 6(c) retirement cases.

Develops and maintains automated personnel data specifications; coordinates these specifications with the IRS Data Center and submits them to the Data Center for implementation.

1113.433 National Office Branch

Develops and executes policies, programs and procedures relating to recruitment, selection, placement, employee relations, position classification, discipline, performance evaluation, promotion, manpower utilization, and other aspects of a complete personnel program for National Office and certain field positions with the exception of those requiring Treasury or Civil Service approval; reviews the budget for proposed position reallocations pertinent to the above positions. In addition, performs the following duties pertaining to Servicewide programs: renders support to the Tax Administration Advisory Staff; administers National Placement Program; reviews and processes regional employment cases for which authority has not been delegated to regions; processes proposals for Gallatin Awards; and answers general inquiries and other correspondence concerning applications for employment, reassignment, promotion, etc.

1113.434 Position Management Branch

Plans, develops and coordinates procedures and program instructions to enable line managers to most effectively establish and manage positions in their organization. Provides advice to managers as to job content, grade structure and organization design. Assists managers in assessing position management effectiveness in their organization. Working with functional representatives, develops occupational standards and guides, such as case classification guides, rating schedules, classification and qualification guides. Coordinates with the Office of the Secretary on all classification, position management and occupational standards questions requiring the Secretary's Office's consideration. Exercises Servicewide functional supervision for position management operations. Provides program advice and assistance to Regional Offices and National Office Branch and assesses their program effectiveness. Performs such centralized services as classification of positions for which authority has not been delegated to the field, development of standard position descriptions, and preparation of recommendations and justifications for classification of supergrade positions. Adjudicates classification appeals and administers Wage Grade Systems. In collaboration with the Training Division, formulates and provides functional classification training courses to maintain and improve the level of technical excellence in the execution of the Servicewide position management program; and develops, negotiates and administers Servicewide training agreements.

1113.435 Careers Branch

Develops and coordinates policies, procedures, and program instructions for the Service's technical, supervisory, managerial, and executive career programs. Develops techniques and criteria for evaluating supervisory, managerial, and executive potential; exercises functional personnel direction, over implementation and follow-through on career programs; performs essential personnel services for career programs for supervisory and managerial positions; provides staff assistance to the Executive Resources Board which selects and assigns executive personnel; and administers the employee performance evaluation and promotion programs. Provides staff expertise in personnel management techniques including the conduct and direction of studies requiring the use of psychological and other social science methodology; coordinates and administers the IRS testing program (noncompetitive written test).

1113.44 Training Division—Office of the Director

The Director formulates and recommends overall training policies of

the Internal Revenue Service and provides professional training leadership and guidance to Service Officials and personnel. Performs the following functions: Conducts research and special studies to determine the best methods of employee development for the Service, and provides expert advice and counsel on training techniques and methodology; in cooperation with IRS management, the Director identifies the need for, and administers Service training programs, approves and is responsible for development and preparation of training courses and program materials, and supports the Tax Administration Advisory Staff; determines program emphasis and goals, establishes standards and procedures for the effective and efficient administration of Service training programs, and evaluates training for effectiveness and economy; administers the Taxpayer Education Program and coordinates the efforts of the field and National Office divisions concerned; advises on and approves training costs estimates for all Servicewide training, and administers the special fiscal allotment (250) used to finance centralized training activities; carries out the training policies and programs of the Service in the National Office.

1113.441
Administrative Services Office

Provides administrative support for the Training function. Performs the following: Assists the Director in carrying out Servicewide administrative management responsibilities related to the Training function; coordinates and maintains overall Servicewide training budget formulation and execution, and work and financial plans; develops, coordinates, and maintains the Training Manual System; coordinates and develops intra-divisional projects such as budget formulation, work and financial plans, and PPBS updatings; conducts studies of intra-divisional activities; conducts special intra-divisional projects of an administrative nature; provides all necessary administrative support for internal operations of the Training Division.

1113.442
Compliance Training Branch

Provides professional training support for the Compliance technical training program (Audit; Intelligence; and Appellate). Jointly and in cooperation with appropriate Compliance officials, performs the following functions: Determines training priorities and goals of the Compliance technical training programs; identifies training needs, and defines and articulates training objectives; plans, designs, develops, coordinates and conducts Compliance technical training programs; evaluates the implementation and effectiveness of the total Compliance technical training program; supports, coordinates, and evaluates field Compliance technical course development. In addition: Monitors all pilot Compliance technical training projects and administers those conducted centrally; reviews and updates training methods, instructional techniques, materials, and supervisory practices as they relate to training; keeps Compliance technical training materials current; in cooperation with Compliance officials, establishes and maintains criteria for employee performance evaluation as it relates to effective training programs; with assistance of National Training Center and Compliance, develops Compliance technical training guidelines and standards, and conducts experimental projects.

1113.443
ACTS Training Branch

Provides professional training support for the Accounts, Collection and Taxpayer Service technical training program. Jointly and in cooperation with appropriate ACTS officials, performs the following functions: Determines training priorities and goals of the ACTS technical training program; identifies training needs, and defines and articulates training objectives; plans, designs, develops, coordinates and conducts ACTS technical training programs; evaluates the implementation and effectiveness of the total ACTS technical training program; supports, coordinates, and evaluates field ACTS technical course development; monitors all pilot ACTS technical training projects and administers those conducted centrally; reviews and updates training methods, instructional techniques, materials and supervisory practices as they relate to training, keeps ACTS technical training materials current; in cooperation with ACTS officials, establishes and maintains criteria for employee performance evaluation as it relates to effective training programs; in cooperation with Taxpayer Service officials, plans, designs, coodinates and evaluates appropriate and useful informational and educational materials for public use; with assistance of National Training Center and ACTS, develops ACTS training guidelines and standards, and conducts experimental projects.

1113.444
Management Training Branch

Provides professional training support for the Service in areas of organizational and career development; executive management, and supervision; cross-functional; and Career Education Awards. Performs the following functions: In cooperation with key Service officials, determines general and functional supervisory, management, and executive training goals of the Service, identifies training needs and, in cooperation with the appropriate Service activities and functions, defines supervisory, management and executive training objectives; plans, designs, develops, coordinates and conducts supervisory, management and executive training programs; evaluates the implementation and effectiveness of total supervisory, management and executive training programs; supports, coordinates and eval-

uates field supervisory and management course development; monitors all pilot supervisory and management training projects and administers those conducted centrally; reviews and updates supervisory, management, and executive training methods, instructional techniques and materials; in cooperation with appropriate IRS officials, establishes and maintains criteria for employee performance evaluation as it relates to effective training programs; reviews, coordinates and evaluates Service's Organizational Development and Career Development Programs; establishes guidelines, coordinates and evaluates Servicewide Administration and Equal Employment Opportunity Training Programs; develops guidelines for and administers Career Education Awards; supports Tax Administration Advisory Staff in determining training needs of foreign tax officials and developing training programs to meet these needs; in cooperation with appropriate organizations, develops and conducts communications and cross-functional training programs.

1113.445
National Office Training Branch

Provides professional training support for the National Office, Inspection, Chief Counsel, National Computer Center and the Data Center. Performs the following functions: In cooperation with key National Office officials, determines clerical, technical, supervisory, and managerial training goals for National Office personnel; identifies training needs and, in cooperation with National Office officials, defines training objectives and establishes training priorities; plans, designs, develops, coordinates, conducts and evaluates all National Office intra-functional training programs, plus appropriate cross-functional training programs (e.g., supervisory, communications, instructor training, clerical skills); in cooperation with appropriate officials, determines training priorities, goals, and objectives for Inspection, Chief Counsel, National Computer Center and Data Center; plans, designs, develops, coordinates, conducts and evaluates Inspection Chief Counsel, National Computer Center and Data Center training programs; administers, reviews and monitors pilot training projects; keeps National Office, Inspection, Chief Counsel, National Computer Center and Data Center training materials current; reviews and updates training methods, instructional techniques and materials; administers training facilities in the National Office.

1113.446
National Training Center

Provides the educational research and development and specialized techniques input to the Training Division. Performs the following functions: Conducts research in training methodology and techniques; monitors and conducts experimental projects utilizing advance training technology; evaluates and determines feasibility of experimental projects becoming operational training programs; establishes Servicewide standards in training methodology, techniques and equipment, and develops materials requiring specialized training staffs support; develops Servicewide guidelines for instructor and course-developer training; establishes standards for Servicewide staff development in specialized skills of training profession, and coordinates training staff development; establishes the standards for and coordinates the administration of the Regional Training Center network; maintains library at NTC; coordinates development and production of Servicewide materials requiring specialized staff support (e.g., videotape, film strip); maintains control and oversees distribution of Servicewide printed materials; administers the National Training Center facility.

1113.5
Office of Assistant Commissioner (Compliance)

The Assistant Commissioner (Compliance) is the principal assistant to the Commissioner on all matters pertaining to the compliance and appellate programs of the Service, in encouraging and achieving the highest possible degree of voluntary compliance by taxpayers, and in providing effective functional supervision of those activities in the field. These include audit and investigation of returns; criminal fraud investigations; the administrative system of tax appeals; administration of laws relating to alcohol, alcoholic beverages, tobacco, firearms, and explosives; and the receipt and processing of wagering, narcotics, alcohol and tobacco tax, and firearms returns and applications. Through the Disclosure Staff, in the immediate Office of the Assistant Commissioner, administers the disclosure provisions of the law and regulations concerning inspection of returns and other matters of official record; administers the Freedom of Information Act and regulations; administers the regulations governing testimony of Service employees in non-tax matters; administers the tax check program involving high level Federal employees; and certifies documents under the Treasury Department seal, furnishing copies where appropriate. The Assistant Commissioner (Compliance) directs, coordinates and evaluates the work of the Appellate Division, the Audit Division, the Intelligence Division, and the Office of International Operations.

1113.51
(Reserved)

1113.52
Appellate Division—Office of the Director

Accomplishes the Appellate mission of resolving tax controversies without litigation, on a basis which is fair and impartial to both the Government and the taxpayer by developing and supervising (functional supervision) nationwide programs for final appeal consideration, within the Service, of cases involving income, profits,

estate, gift, employment and excise taxes (other than alcohol, tobacco, narcotics, firearms, and wagering), offers-in-compromise, refund claims and overassessments, in which the taxpayer protests the decision of the District Director, and of cases docketed in the United States Tax Court (with concurrence of Regional Counsel and prior to the opening date of the Tax Court session concerned). Develops nationwide Appellate budget estimates and long-range plans; evaluates financial plans and budget execution of regional Appellate Divisions. Conducts Appellate Reports and Information Retrieval Activity (ARIRA) programs and nationwide Appellate reporting system. Collaborates with Planning and Research, Accounts, Collection, and Taxpayer Service; and other segments of the Service in a research effort to create a comprehensive information storage and retrieval system. Furnishes administrative services for the operation of the Appellate Division of the National Office. Also directs or performs certain centralized Appellate functions.

1113.521 Coordination and Management Staff

Assists in developing and recommending policies, plans, programs, and basic procedures and provides top-level managerial assistance through the following principal functions: Develops and recommends operations policies, plans, programs, and basic procedures relating to the Appellate function. Assists and advises regional Appellate offices on technical and administrative problems to enable them more effectively to accomplish their objectives. Establishes and conducts a field visitation program, and maintains continuous field liaison to assure that established policies, programs, plans, and instructions are carried out in a uniform, effective manner. Evaluates adequacy of staffing and managerial performance in regional Appellate offices. Performs coordination functions across regional lines and with other Service elements. Supervises task forces working on special projects such as training, position descriptions, offices systems, and management improvement. Represents the Director in meetings of National Office and regional officials, and staff members serve on various committees as designated. Analyzes and interprets program status and progress in accomplishing the overall Appellate mission. Originates statistical analyses and graphic presentations with explanations and interpretations to disclose program status and progress with trends and deviations highlighted. These analyses serve as the basis for program direction and long-range program planning for the Appellate activity.

1113.522 Programs and Procedures Branch

Conducts program and procedural studies concerning Appellate activity and recommends methods to efficiently accomplish Appellate mission. Reviews and analyzes operational reports, field issuances and compiled data (such as ARIRA tables) to identify significant trends, procedural problems, etc., and submits recommendations to Director, where appropriate. Provides procedural instructions and procedural advice to Appellate field organization to effectively implement policies, plans, and programs relating to Appellate function. Maintains Part VIII of the Internal Revenue Manual and related Handbooks and coordinates Appellate procedures with other functions concerned. Provides material for inclusion in Statement of Procedural Rules concerning Appellate activity. Supervises task forces working on special projects relating to Appellate programs and procedures. Develops and coordinates training programs to improve skills of Appellate personnel. Provides forms and form letters for use in Appellate operation. Considers and processes employee suggestions submitted under the Incentive Awards Program relating to Appellate and implements those that are adopted.

1113.523 Special Services Branch

Advises and assists in cases involving controversies as to valuation through the following principal functions: Participates in the development of Service position and procedures in complex valuation matters. Helps to maintain uniformity of treatment of valuation issues throughout the regional Appellate Divisions by furnishing advice, and conducting training sessions. Furnishes expert advice and assistance to the National Office, regional Appellate Division, and Regional Counsel on difficult valuation problems. Provides expert witnesses to testify at trials involving complex valuation issues. Develops programs and techniques aimed at eliminating, to the greatest extent possible, the need for time consuming trials of valuation issues in the Tax Court or other courts. Provides regional Appellate Divisions with technical assistance of the general nature through the following principal functions: Analyzes and processes requests for technical information and digests technical information and other technical communications for dissemination to Regional Offices when information is of general Appellate interest. Maintains liaison on matters relating to cases requiring submission to the Congressional Joint Committee on Internal Revenue Taxation. Develops and aids in formulation and presentation of Appellate technical seminar programs. Recognizes need for specialized technical workshops and prepares program materials for them. Post-reviews closing agreements approved by regional Appellate officials. Also reviews closing agreements prior to submission to the Assistant Commissioner (Compliance) for approval. Identifies troublesome technical or qualitative areas and trends; and recommends solutions to help Regional Offices meet their objectives. Conducts special studies (such as prime issues) to assist the Director and the Assistant Regional Commissioners (Appellate) in their programming and long-range plan-

ning. Administers a continuing program for evaluating and analyzing regional post-review effectiveness.

1113.53
Audit Division—Office of the Director

Accomplishes the Audit mission of encouraging and achieving the highest possible degree of voluntary compliance by taxpayers and tax exempt organizations with the tax laws. This is accomplished through developing and functionally supervising well designed and executed examination programs which utilize appropriated resources effectively and through plans for optimum audit programs in the future. These programs and plans provide for determining types and degrees of noncompliance and taking effective action to increase compliance. Also supervises the performance of certain centralized audit functions.

1113.531
Office Services Staff

Furnishes services in support of the Audit Division. Maintains liaison with the Office of the Assistant Commissioner (Administration) on fiscal, personnel, training, and facilities matters. Provides centralized mail, files, distribution, messenger, and library services for the Division.

1113.532
Programs Branch

Plans, implements, and evaluates nationwide programs for the examination of income, excise, employment, and estate and gift tax returns. Responsible for the development, implementation, and monitoring of Audit Division's portion of other enforcement programs. Provides assistance to field components in the conduct of their returns examination programs. Develops long-range plans and strategies for the accomplishment of its portion of the Audit mission. Issues IRM and other procedural material required for the execution of examination programs. Participates with other Compliance activities, Technical, and ACTS in the development and implementation of examination programs. Participates in planning and is responsible for implementing the returns classification program. Prepares replies to correspondence relating to income, excise, employment, and estate and gift tax matters.

1113.533
Exempt Organization Examination Branch

Plans, implements, and evaluates nationwide programs for the examination of exempt organization returns and records. Responsible for the development, implementation, and monitoring of the Audit Division's portion of the pension trust program. Plans and implements the program for issuance of exemption determination letters. Develops long-range plans and strategies for the accomplishment of its portion of the Audit mission. Maintains close communication and liaison with the Office of the Assistant Commissioner (Technical) on both exempt organization and pension trust matters. Reviews or post reviews revenue agent reports for quality and uniformity of exempt organization examinations. Issues IRM and other procedural material required for the execution of exempt organization and pension trust examinations. Determines uses to be made of the Exempt Organization Master File (EOMF) data and works with other Service activities in fulfilling their needs from the EOMF. Also determines uses for the Employees' Plans Master File (EPMF) and coordinates with the office of the Assistant Commissioner (ACTS) in such matters. Prepares replies to correspondence relating to exempt organization matters.

1113.534
Centralized Activities Branch

Provides technical coordination on complex Audit matters with other Compliance activities, Assistant Commissioner (Technical), and the Chief Counsel. Plans, implements, and monitors nationwide programs for Joint Committee, conference and review programs. Monitors and reports on cases docketed for Tax Court and assists Chief Counsel and Department of Justice in trial and settlement of cases. Performs centralized activities relating to qualification for enrollment and practice. Monitors the providing of necessary management services for the Audit activity and serves as liaison with the Office of the Assistant Commissioner (Administration) on administrative matters affecting the entire Audit activity.

Provides liaison with the Office of the Assistant Commissioner (Technical) and the Tax Forms Coordinating Committee on Audit matters. Conducts economic studies pertinent to Section 482 allocations and post reviews and provides expert testimony concerning such allocations. Issues IRM and other procedural material required for the execution of the branch's programs. Prepares answers to correspondence deemed to be nationally significant concerning field Audit operations (with the exception of exempt organization and pension trust matters).

1113.535
Resources and Analysis Branch

Responsible for integrating the program planning and evaluation activities, such as budget, PPB and NORP support for the Audit activity. Regulates all program research activities for the Division including TCMP, DIF development, and other special analytical studies. Responsible for providing the Director and the other Audit branches with timely analyses of overall program effectiveness with regard to both resource expenditure and results achieved. Prepares Division submissions for PFP and budget requests. Plans, implements, and monitors programs to provide management information such as SCRIP. Provides functional direction to the Audit Service activity. Plans the Audit classifica-

tion of returns program. Issues IRM and other procedural material required to carry out the branch's programs. Provides coordination support for the Audit activity in respect to services provided by the ACTS organization.

1113.54
(Reserved)

1113.55
Intelligence Division—Office of the Director

Accomplishes the Intelligence mission with reference to enforcement of the criminal statutes applicable to income, estate, gift, employment, and certain excise tax laws by developing and supervising (functional supervision—which includes evaluation) nationwide programs for the investigation of suspected criminal violations of such laws and the recommendation of prosecution and/or assertion of the 50% ad valorem addition to the tax, when warranted, development of information concerning the extent of criminal violations of all Federal tax laws (except those relating to alcohol, tobacco, narcotics, and firearms), and measurement of the effectiveness of the investigation process. The Division also conducts, coordinates, and directs the investigation of cases which have been centralized, and performs certain other centralized Intelligence functions.

1113.551
Administrative Office

Is responsible for furnishing administrative services for the operation of the Intelligence Division of the National Office by: developing and preparing budget requests and financial plans as well as supervising budget execution, providing for the administrative needs of the Division (such as providing and maintaining investigative and administrative central filing systems and processing mail), and maintaining liaison with the Office of Assistant Commissioner (Administration) on all National Office Intelligence Division matters (including fiscal management, personnel, training, and facilities management matters); developing and preparing projections of personnel costs and staffing charts; collaborating with Administration in the procurement of investigative equipment for field and National Office use, and maintaining inventory and current records as to location of Intelligence Division investigative equipment; and conducting special studies relating to personnel, space, budget and equipment.

1113.552
Staff Assistance (Visitation)

Is responsible for: planning and conducting a visitation program for on-site evaluation, guidance, and assistance; coordinating with, and maintaining close liaison with each of the several branches of the Division for the purpose of inquiring into specific field activities of special interest to each of the branches and keeping each fully apprised of conditions and developments in the field.

1113.553
Operations Branch

Is responsible for: providing the field with operational assistance, and conducting, directing, and coordinating the investigation of centralized cases by: interviewing informants, maintaining liaison with Committees of Congress, representatives of the Service and other Government agencies in order to obtain, develop, and disseminate to the field pertinent information relating to tax evasion; coordinating, conducting, or directing investigations which are interregional in scope, of a sensitive nature, or of national interest; responding to communications on matters pertaining to operations; keeping Service and Treasury officials informed of significant developments in sensitive cases and those of national interest; identifying operational and management deficiencies in investigations coordinated, conducted, or directed by the National Office and initiating corrective action or referring identified deficiencies to the appropriate branch; and maintaining a program for case research and development including establishment of criteria for use in the automatic processing of returns to aid in identification of returns having criminal potential; and participating, as directed, in field visits.

1113.554
Program Branch

Is responsible for: providing effective management and technical programs, plans, and procedures for accomplishment of the Intelligence mission and identifying as well as correcting deficiencies in programming, planning, and procedural guidelines, including the Manual and the investigative handbook, through statistical analyses and studies, review of policies, management reparts, reports of field visits and other issuances, and through consultation and coordination with other Service elements. Consulting and coordinating with other Service elements on such matters as the findings in internal audit reports, legislative proposals, development of organizational and staffing standards and personnel classification standards; collaborating with the Planning and Analysis Division in developing the Intelligence Division's long-term program objectives and resource requirements within the Service's Long Range Planning System; collaborating with the Fiscal Management Division in the evaluation of field financial proposals; submitting recommendations for the allocation of Intelligence personnel and funds; collaborating with the Information Systems Branch for the report of management and investigative accomplishments; consolidating, evaluating, and disseminating information reflecting accomplishments of programs and plans; preparing the Intelligence portion of the Cost Reduction—Management Improvement Report and the Commissioners Annual Report; and participating, as directed, in field visits.

1113.555
Technical Development Branch

Is responsible for: developing and maintaining professional skills of special agents, developing investigative techniques and performing certain support functions in the accomplishment of the Intelligence mission by: conducting studies and developing Intelligence training programs in collaboration with the Training Division; directing and conducting centralized Intelligence training programs; instructing at, and collaborating in the program development and conduct of the Criminal Investigators School; maintaining liaison and providing technical guidance on the participation in course development and instruction which is carried out at the National Training Center for the Intelligence Division; coordinating and evaluating field training; identifying deficiencies in training programs and materials and initiating corrective action or referring identified deficiencies to the appropriate branch; developing Intelligence investigative equipment standards and allocating investigative equipment and automobiles to the field; keeping abreast of developments in the use of automatic data processing equipment by taxpayers and third parties, such as banks, brokerage houses, and insurance companies to determine the type and extent of training needed by special agents to obtain necessary financial information where automatic data processing equipment is used; cooperating with the Personnel Division in the development of guidelines and standards for recruitment, selection, and career development of Intelligence personnel; preparing final Intelligence recommendations in cases unresolved at regional level; evaluating and recommending disposition of Incentive Awards suggestions; maintaining a current record of special skills of individual special agents; disseminating information on current developments, such as legal decisions, unique defenses, and unusual investigative approaches, through the issuance, monthly, of the Intelligence Digest; collaborating with the Public Affairs Division in the preparation of news releases regarding closed cases; collaborating with the Tax Administration Advisory Staff and the National Training Center in orientation of enforcement officials of other Federal agencies and of State and foreign governments concerning Intelligence techniques, procedures and practices, and participating, as directed, in field visits.

1113.56
Office of International Operations —Director of International Operations

The Office of International Operations administers the Internal Revenue laws and related statutes (except those relating to alcohol, tobacco, narcotics and firearms) as they relate to citizen taxpayers residing or doing business abroad, foreign taxpayers deriving income from sources within the United States, and taxpayers who are required to withhold tax on income flowing abroad to nonresident aliens and foreign corporations; acts as staff advisor to the Assistant Commissioner (Compliance) in the international area on all compliance functions, and as the international specialist provides assistance and guidance to the Compliance Divisions and makes recommendations on all aspects of the international enforcement program to the Assistant Commissioner (Compliance) and the Division Directors concerned; acts as competent authority in administering the operating provisions of tax conventions; performs and coordinates for the Service all foreign investigations and requests for information (other than those relating to rulings, regulations or assistance in the field of foreign tax administration) from foreign countries and United States possessions. Also computes and collects taxes due from the Alien Property Custodian, administers the provisions of the Internal Revenue Code authorizing the acceptance of foreign currency in payment of United States tax liabilities, coordinates foreign travel of Service personnel, and maintains foreign posts.

1113.561
Administrative Office

Responsible for the personnel, training, budget and fiscal and general administrative services, including procurement and supply, printing and communication services and other administrative services necessary to the effective operation and management of the Office of International Operations, including Foreign Posts and the Puerto Rico Office. Coordinates and develops the management improvement and incentive awards programs and special projects. Initiates and administers the security, safety and records management program. Develops the financial plan and budget estimates, fiscal programs, cost estimates, and is responsible for control of funds, report on budget execution and International Transaction estimates. Coordinates in conjunction with the Facilities Management Division the printing requirements and distribution of special publications, documents and tax forms required by the Office of International Operations, and the distribution of all tax forms to the United States Embassies and Consulates.

1113.562
Collection and Taxpayer Service Division

The Collection and Taxpayer Service Division is responsible for the receipt and transmittal of tax returns and documents received in the Office of International Operations; filed by nonresident aliens, foreign corporations, nonresident alien estates, withholding agents (Forms 1042), information returns with respect to foreign corporations (Forms 959), and information returns with respect to foreign personal holding companies (Forms 957 and 958); the deposit to

the credit of the Service Center Director of tax remittances received in OIO. Authorizes extensions of time for filing; provides year round taxpayer service to citizens and aliens; administers the automatic exchange of information and reciprocal collection provisions of tax treaties with foreign countries. Is responsible for the collection of delinquent accounts through distraint, seizure, levy and other means; the securing of delinquent returns; examination of officers in compromise based on doubt as to collectibility of taxes (except alcohol, tobacco and firearm taxes), offers in compromise of statutory additions based on doubt as to liability (except alcohol, tobacco, firearms, employment and withholding taxes and specific penalties), and all offers in compromise of 100% penalties. The Division receives, acts on, and processes information pertinent to bankruptcies, receiverships, assignments, reorganizations, probate proceedings, foreclosures and redemptions after civil foreclosure, bulk sales, gifts and prizes, and dissolutions and initiates investigations for securing delinquent returns where necessary. The Division maintains files or control records of payments received in insolvency, bankruptcy, and decedent cases and of surety bonds and other collateral posted as security for tax liability. It also maintains files and control records of property seized under distraint authority and takes appropriate action with respect to seized property to ensure that proper legal action may be timely taken.

1113.5621
Special Procedures Staff

The Special Procedures Staff is responsible for furnishing advisory assistance on technical delinquent collection and returns matters to the Chief, Collection and Taxpayer Service Division, Chief, Field Branch, Chief, Office Branch and Group Supervisors; providing liaison for the Director of International Operations with the Department of Justice, including the U.S. Attorneys, the Chief Counsel and Regional Counsel on all collection matters; ascertaining tax liability and filing of proof of claims in insolvency and decedent's estate proceedings; recommending civil suits to enforce collection or to protect the Government's interests; processing civil suits against the United States or the Office of International Operations, examining, reviewing and processing seizure and sale reports; processing applications for discharge of property from the effect of Federal tax liens and for certificates of nonattachment of Federal tax liens and certificates of subordination of the Federal tax lien; processing filed notices of Federal tax liens and certificates of release; processing and maintaining executed collection waivers; analyzing and determining the sufficiency of various forms of collateral offered as security for release of lien or postponement of collection action; furnishing technical advice and assistance and recommendations for or against entry into suitable escrow agreements for the collection of delinquent accounts; reviewing recommendations for and holding conferences on 100% penalty and transferee assessments; post reviewing of accounts reported as uncollectible; reviewing recommendations and holding conferences on offers in compromise cases based on inability to pay; and maintaining files and control records on all the above type cases to ensure that proper legal and other collection actions are taken timely.

1113.5622
Office Branch

The Office Branch effects the collection of delinquent accounts and secures delinquent returns through demands made by correspondence, telephone or office interviews. It safeguards the Government's interest by causing the filing of notices of tax liens and serving or causing the service of notices of levies. It transfers to Revenue Officer groups those assignments which require field investigations or can be more efficiently completed by field Revenue Officers. The Branch carries out the Division's responsibility for district-wide execution of the year-round taxpayer service program. It provides taxpayer service to citizens and aliens, including responses to correspondence requests of tax information, and provides functional supervision of taxpayer service at other posts of duty. The Branch screens and assigns cases and maintains assignment files. It prepares periodic reports of collection and taxpayer service activities. It receives and deposits to the credit of the Service Center Director remittances received in the Office of International Operations. It receives and transmits other returns and documents received in the Office of International Operations.

1113.5623
Field Branch I (Headquarters)

Field Branch I is responsible for the management and control of Revenue Officer groups in Headquarters. Within the assigned area, the Branch makes collections of delinquent accounts and conducts a continuing program for the security of delinquent returns. It safeguards the Government's interest through the filing of notices of tax liens, and enforces collection by the serving of levies, and seizure and sale of real and personal property. It recommends jeopardy assessment when deemed necessary to protect revenue, civil actions to secure payments, suits to enforce penalty for failure to honor levies, and penalty assessments as a means of collection or as a method of obtaining compliance with existing laws and regulations. The Branch recommends the issuance of certificates of discharge of property from the effects of tax liens, recommends issuances of certificates of subordination of Federal tax liens, and conducts the investigations necessary to support such recommendations. The Branch examines offers in

compromise based on doubt as to collectibility of taxes (except alcohol, tobacco, and firearms taxes), offers in compromise of statutory additions based on doubt as to liability (except alcohol, tobacco, firearms, employment and withholding taxes and specific penalties), and all offers in compromise of 100% penalties.

1113.5624
Field Branch II (Puerto Rico)

Field Branch II is responsible for the management and control of both Revenue Officer groups and an Office Group in Puerto Rico. Within the assigned area, the Branch makes collections of delinquent accounts and conducts a continuing program for the security of delinquent returns. It safeguards the Government's interest through the filing of notices of tax liens, and enforces collection by the serving of levies, and seizure and sale of real and personal property. It recommends jeopardy assessment when deemed necessary to protect revenue, civil actions to secure payments, suits to enforce penalty for failure to honor levies, and penalty assessments as a means of collection or as a method of obtaining compliance with existing laws and regulations. The Branch recommends the issuance of certificates of discharge of property from the effects of tax liens, recommends issuances of certificates of subordination of Federal tax liens, and conducts the investigations necessary to support such recommendations. The Branch examines offers in compromise based on doubt as to collectibility of taxes (except alcohol, tobacco, and firearms taxes), offers in compromise of statutory additions based on doubt as to collectibility of taxes (except alcohol, tobacco, and firearms taxes), offers in compromise of statutory additions based on doubt as to liability (except alcohol, tobacco, firearms, employment and withholding taxes and specific penalties), and all offers in compromise of 100% penalties.

1113.563
Audit Division

The Audit Division administers an international audit program involving the selection and examination of all types of Federal Tax returns filed with the Office of International Operations (except alcohol, tobacco, and firearms). Is responsible for the examination of certain offers in compromise, informants' claims for reward and related activities including the examination and approval of pension trusts and the issuance of determination letters. The audit program involves the classification of returns for field and office audits, the conduct of district conferences in unagreed cases, participation with special agents in the conduct of tax fraud investigations, and is responsible for providing manpower for the annual overseas taxpayer compliance program. Provides advice and guidance on audit work performed by the foreign posts and reviews for technical and procedural accuracy all reports of audit examinations prepared by these offices. Directs programs for the exchange of estate and gift tax data with foreign governments under the tax conventions. Performs audit functions relating to the Alien Property Custodian activity. Makes certain that Internal Revenue Agents' manpower will be applied to the most significant civil enforcement cases in the international area. Is responsible for the maintenance of good relationship with region and districts and is responsive to their requirements for assistance in the foreign area. The Audit Division consists of the Examination Branch, Service Branch, Review Staff, Conference Staff and Classification.

1113.5631
Conference Staff

The Conference Staff attains, to the maximum extent possible, the primary objective of the Conference Function—to give taxpayers ample opportunity to reach early agreement on disputed issues arising from audit examinations. Has responsibility for all OIO conference cases. Assigns, controls, coordinates, and reviews Office of International Operations jurisdictional conference cases including those in Puerto Rico, and foreign posts of duty. Holds conferences; provides direction and furnishes technical advice to other conferees; performs final district review of field audit conference reports; reviews and evaluates statistics and other records to strengthen conference function operations; and screens taxpayer protests which request Appellate hearings. Authorizes settlements in "pattern settlement cases;" reviews primary statistical forms in conference cases; coordinates and discusses with Chief, Review Staff, conference cases in which Review Staff has taken legal interpretative positions at variance with conference positions; reviews and answers dissents to conference determinations; reviews Appellate Division closings for guidance to conferees; and is responsible for protecting the statute of limitations for cases under his control. Undertakes special assignments received from Division and Office Superiors to the extent time permits.

1113.5632
Review Staff

Is responsible for reviewing for technical accuracy and policy and procedural adherence, reports of examination on income, estate, gift, and miscellaneous taxes, and offers in compromise. Prepares and issues preliminary letters and statutory notices. Grants extension of time for filing protests, and closes out statutory notices by sending the case file to the Appellate Division if a petition is filed or closing out for assessment if the time period expires on default. Receives taxpayer protests, refers protests to the Chief, Conference Staff, and closes protested cases to the Appellate Division upon recommendation of the Chief, Conference Staff. Furnishes technical advice to foreign and Puerto

Rico posts and all examination personnel. Considers special problems relating to specific cases and prepares recommendations thereon. Prepares replies to technical inquiries from taxpayers from all over the world and issues determination letters as required. Considers applications for exemption from tax from foreign organizations, and issues determination letters or refers the case to the Assistant Commissioner (Technical), as appropriate. Prepares statistical reports and analyzes information on specific cases as required. Controls and reviews all forms used by the Audit Division. Controls and processes all informant's claims. Prepares requests for technical advice to the National Office on specific cases under examination.

1113.5633
Chief Classifying Officer

Is responsible for planning and executing the audit classification program including the selection of returns to be examined and the determination of the organizational units where the returns can best be examined. Is responsible for the planning and execution of procedures involving the classification of other documents used in connection with examinations such as transferred cases from other districts, information reports, etc.

1113.5634
Service Branch

Controls all income, estate and gift, and miscellaneous tax returns received for audit or investigation by the OIO Washington Office, Puerto Rico Office and the Foreign Programs and Research Division. Routes works to appropriate units; reproduces completed reports; provides typing service for the Audit Division; effects closing action on examined cases transmitting returns to the Collection and Taxpayer Service Division; assembles audit production and statistical data and maintains controls on statutory expirations for the entire Audit Division as well as the Foreign Programs and Research Division.

1113.5635
Examination Branch

Conducts field and office examinations relative to all types of taxes (except alcohol, tobacco, and firearms) to determine correct liabilities of citizen taxpayers residing or doing business abroad, foreign taxpayers deriving income from sources within the United States and taxpayers who are required to withhold tax on certain payments to non-resident aliens and foreign corporations. Conducts examinations of estate tax returns of U.S. citizens who died while residing abroad or non-resident aliens with substantial property or income in the U.S. and gift tax returns filed by non-resident aliens or U.S. citizens residing abroad. It also conducts examinations of offers in compromise based on doubt as to liability for taxes or for both taxes and statutory additions (except alcohol, tobacco, and firearms taxes), claims for refund, credit or abatement, and special examinations as requested including joint examinations with special agents where tax evasions may exist. Obtains information on suspected delinquent taxpayers and other tax information while in overseas areas. It furnishes technical advice and assistance on pension trust plans, processes informants' claims for reward, and recommends jeopardy assessments. Prepares memoranda to accompany closing agreements and closing letters and releases in estate and gift tax cases, and administers the program for exchange of estate and gift tax data with foreign governments under tax conventions. Audits employment tax returns of Puerto Rico residents and income tax returns of United States Government employees and Puerto Rico residents deriving income from sources outside Puerto Rico. Audits books and records of Puerto Rican affiliates of domestic taxpayers to secure information requested by districts. Examines Virgin Island corporations to determine correct subsidy allowances. Coordinates examination program on resident foreign corporations and other cases, where appropriate, with National and Regional enforcement programs. On assignment holds conferences with taxpayers and their representatives. Prepares tax returns for, and audits books of, foreign corporations and alien individuals whose property is controlled by the Alien Property Custodian and conducts conferences on these matters.

1113.564
Foreign Programs and Research Division

Plans, develops and coordinates the work programs and other activities of the foreign posts. Conducts the intelligence function with respect to taxpayers under jurisdiction of the Office of International Operations. Coordinates, directs and/or conducts all functions performed overseas by Appellate, Audit, Collection and Taxpayer Service, Intelligence and International Operations personnel. Coordinates all audit, collection and intelligence functions between the foreign posts and the Divisions of the Office of International Operations, other Service components and other Government agencies. Assists in the performance of functions under the treaties principally involving nonautomatic exchange of information. It is the focal point for all contacts with foreign governments either directly or through the foreign posts. Coordinates the foreign travel of personnel of the Internal Revenue Service. Maintains liaison with the Treasury, State, Defense, Commerce and Interior Departments concerning overseas operating matters. Plans coordinates and directs the Annual Taxpayer Compliance Audit and Collection Programs abroad. Plans and coordinates, in conjunction with the military service, the Annual Military Assistance School Program. Provides research and technical assistance and prepares guidance

memoranda for other OIO Divisions. Assists the Director in performance of the Competent Authority functions. Maintains a continuing appraisal of the operation of the income and estate tax treaties for the purpose of identifying areas for renegotiation. Considers administrative and operational feasibility of proposed tax conventions regulations. Conducts analytical studies with the purpose of achieving effective tax compliance. Prepares recommendations for remedial legislation or regulatory amendments. Reviews or prepares suggested public use or internal forms and documents. Disseminates information regarding United States business activity abroad and foreign business activity in the United States. Determines the amount of administrative relief [offset] to be allowed under Revenue Procedures 64-54 and 69-13. Submits recommendations with respect to proposed changes in legislation regulations, revenue procedures, treaty provisions and other aspects of the international enforcement program.

1113.5641
Foreign Posts

Takes necessary action under division programs to establish and maintain satisfactory levels of voluntary compliance. Develops information indicating possible tax evasion, delinquency or non-compliance. Conducts audits of income, estate and gift tax returns of a type justifying field investigation or contact abroad and conducts investigations on tax evasion cases. Effects collection of delinquent taxes when personal contact or investigation abroad is required. Obtains information on audit, intelligence and collection matters for other service components on collateral requests. Holds taxpayer conferences and effects settlements in income, estate and gift tax cases, claims, offers in compromise, etc., including those referred abroad by International Operations headquarters for such purposes. Under specific direction assists in the exercise of the Competent Authority provisions of tax treaties by holding discussions with foreign government representatives. Maintains close liaison with foreign governments in tax treaty, enforcement, exchange of information, technical and other matters. Maintains close liaison with U.S. military authorities and taxpayer groups in the area. Develops and implements enforcement, taxpayer assistance and school programs, taxpayer-education releases, and similar measures designed to assure a high level of compliance. Is responsible for the development and maintenance of desirable public relations, initiating appropriate taxpayer-education programs in the area. Furnishes technical assistance to taxpayers on all tax matters.

1113.5642
Research and Technical Branch

Accumulates and analyzes data concerning foreign tax laws, U.S. Tax Treaties, U.S. law changes, revenue rulings and statements of Service policy in the international area. Prepares, coordinates and reviews guidance memoranda within the Office of International Operations. Assists in the performance of the Competent Authority functions. As directed, represents the United States Government at conferences with foreign Competent Authorities. Reviews drafts of proposed tax conventions and regulations thereunder regarding the administrative and operational feasibility of the convention and regulations. Seeks out operational and administrative problems in the tax treaty area. Prepares analytical studies of technical problems and tax avoidance schemes in the international area. Prepares plans and programs to combat tax avoidance and evasion in the international area. Reviews or prepares suggested tax forms and other material. Coordinates technical matters regarding proposed legislation and similar matters with the various Divisions of the National Office and other Government agencies. Accumulates data on the extent, nature, location of U.S. taxpayer business and trust interest outside of United States and similar data on foreign business entities doing business in the United States. Accumulates data on other foreign business operations of concern to U.S. Determines the amount of administrative relief (offset) to be allowed under Revenue Procedures 64-54 and 69-13 and, where appropriate, prepares closing agreements. Submits recommendations on proposed changes in legislation, regulations, revenue procedures, treaty provisions and other aspects of the international enforcement program. Provides data on foreign tax laws to technical field personnel responsible for determining correct Subparts F and G income and earnings and profits of controlled foreign corporations under the 1962 Revenue Act. Prepares periodic reports of the progress and activity in the international area.

1113.5643
Foreign Programs Branch

Provides functional supervision of the work programs and other activities of the foreign posts. Conducts the intelligence function with respect to taxpayers under jurisdiction of the Office of International Operations. Coordinates all functions performed overseas by Appellate, Audit, Collection and Taxpayer Service, Intelligence and Intenational Operations personnel. Coordinates all audit collection, and intelligence functions between the foreign posts and the Divisions of the Office of International Operations other Service components and other Government agencies. Evaluates foreign programs. Provides point of contact for foreign governments either directly or through the foreign posts. Coordinates the foreign travel of personnel of the Internal Revenue Service. Maintains liaison with the Treasury, State, Defense, Commerce and Interior Departments concerning overseas operating mat-

ters. Plans and coordinates, in conjunction with the military services, the Annual Military Assistance and School Program.

1113.6
Office of Assistant Commissioner (Accounts, Collection, and Taxpayer Service)

The Assistant Commissioner (Accounts, Collection, and Taxpayer Service), is the principal assistant to the Commissioner on all matters pertaining to the development of programs, systems, methods and procedures for implementation and operation of the Internal Revenue Service Automatic Data Processing Plan, the accounting for the internal revenue, the receipt and integrated processing of tax returns and other documents, the review and coordination of all reports, the collection of delinquent accounts, obtaining delinquent returns, and providing responsive services to taxpayers. He exercises line supervision over the activities performed in the various Divisions in the National Office which are within his jurisdiction and the National Computer Center and the Internal Revenue Service Data Center, and is functionally responsible for ACTS activities in Regional Offices, District Offices and Service Centers. Confers and collaborates with officials of other Government agencies and private industry to ensure compatibility of data which will be integrated into the ADP system of each.

1113.61
Administrative Service Office

Plans, organizes, coordinates, and directs the administrative management activities of the Office of Assistant Commissioner (Accounts, Collection, and Taxpayer Service) at the National level, assisting and collaborating with Division Directors and the National Computer Center Director in providing budget, personnel, records and reports management, space management, duplication, supply, and other administrative services necessary for the internal administration, management, operation and functioning of the Office.

1113.62
Program Review and Analytical Services Staff

The Program Review and Analytical Services Staff provides the Assistant Commissioner (ACTS) with: in-depth evaluations of Service Center, Data Center and Regional Office operations, programs and effectiveness in the ACTS areas to meet his needs for NORP participation as well as for his day-to-day management appraisals and decisions; independent centralized and integrated analyses of all ACTS programs, including the identification of actual, emerging, and potential problems to management particularly as they impact on two or more ACTS Divisions or other IRS organizations; assessments of program accomplishments, trends, or developments of specific interest to the Assistant Commissioner; and design and the undertaking of advanced analytical research programs and projects (in conjunction with other ACTS Divisions and IRS offices) to improve operational effectiveness and/or to shed insight on program alternatives.

Provides analytical service support and assistance, including specialized statistical services, to the individual Directors of the Accounts and Data Processing, Collection, and Taxpayer Service Divisions and the Director of the Data Center by identifying, evaluating, interpreting, reporting, and assisting in reporting progress towards accomplishment of their respective missions and program objectives. Provides specialist and consultant services and assistance in analytical methods to these officials as well as to Regional personnel in understanding and utilizing techniques and data resulting from integrated analyses of relevant internal and external data.

Coordinates the need for, and advises individual ACTS Divisions on, information system requirements for data, reports and information systems design, reports management activities. Also, in conjunction with ACTS Divisions, develops input for the Annual Internal Audit Program to obtain additional data for valuation of ACTS program management. Coordinates with Divisions and Internal Audit preparation of the Monthly Informal Report to the Commissioner on significant findings pertaining to ACTS activities.

1113.63
Planning Staff

The Planning Staff is the principal advisor to the Assistant Commissioner (ACTS) for insuring the optimal use of ACTS resources for the Service in both tax and non-tax related applications. Develops and administers, in cooperation with all other offices, long-range goals; identifies a budgeting and control system as it relates to goal setting; recommends policy or program decisions on the basis of feasibility or operations research studies; systematizes requests for ACTS services; prepares final ACTS PPBS documents; and performs general staff work on all high-level planning and resource allocations as directed by the Assistant Commissioner (ACTS).

Develops and consolidates long-range goals for the ACTS organization, recommends priorities of work and alternatives, insures that all facets of major work projects are recognized, and identifies the impacts of recommended or proposed actions. Monitors the resources expended in the attainment of established goals and participates in the final system acceptance.

Systematizes the activities relating to requests for ACTS services by: identifying, controlling and monitoring major requirements, requesting and assisting in cost/benefit analysis, presenting the recommendations and priority assignments to the resource allocation boards (ADP Review Board, Data Center Committee) and the appropriate Assistant Commissioners. Independently reconciles and evaluates

the cost/manpower/computer accomplishments of ACTS.

Consolidates and finalizes the preparation and submission of PPBS documents to insure consistency with long-range plans and resource requirements commensurate with the objectives and goals of the Assistant Commissioner (ACTS) and top line officials of the Service.

1113.64 Accounts and Data Processing Division—Office of the Director

Plans, coordinates and directs the development of returns processing programs and revenue accounting functions. Directs the operation of the present tax administration system in service centers, the National Computer Center, and district offices, and will operate the new, integrated tax administration systems. This responsibility encompasses: The development of major tax administration programs and issuance of detailed systems requirements, forms, procedures, and computer programs for the receipt and processing of tax returns and related documents or data (except alcohol and tobacco tax and firearms returns and applications); accounting for revenue collections and tax deposits; fulfilling the related requirements of other Service activities and the Department of the Treasury; maintenance of taxpayer master file and non-master file accounts; required financial and operating reports; design of master file related management and data control systems; systems acceptability testing of manual procedures, machine instructions, computer inputs, processes and outputs before implementation; and the maintenance of all operational ADP master files and related systems. Functional supervision—including determining the effectiveness of on-going programs, procedures, systems to achieve Service objectives; and providing leadership in the installation or modifications of assigned tax administration programs and processing systems; prompt identification of and follow-up with regional management and coordination with Director, Program Review and Analytical Services Staff, ACTS, on significant operational problems which could impair attaining Service goals and objectives—over accounts and data processing activities in the regional offices, service centers, and district offices. Line supervision over the National Computer Center and liaison between the Center and other organizational units of the Service.

1113.641 National Computer Center

Plans, directs, and coordinates the master file operations of the totally integrated tax administration system. Functions include: establishment, maintenance, and updating of the individual, business, employee plans and exempt organizations master files through around-the-clock operation of a large-scale computer system complex. Provides reciprocal controls with service centers of the receipt, processing, and shipment of tax account data. Produces output data for use in issuing refunds, bills or notices, answering inquiries, conducting delinquency checks, detecting fraudulent refund claims, classifying returns for audit purposes, preparing reports, and other matters concerned with processing and enforcement activities of the Service. Provides line supervision over National Office Computer Facility which is principally responsible for computer testing support for the totally integrated tax administration system. Responsible for scheduling and coordinating with Service Centers on production matters and receipts, control and servicing of file searches for Disclosure Staff, Intelligence, Internal Audit and other Service offices. Responsible for financial planning, recruitment, and training, and other administrative matters of the National Computer Center.

1113.642 Office of the Executive Assistant

Responsible for providing assistance to the Director in the general overall management and evaluation of Accounts and Data Processing operations both within the Division and functional areas in the field. Coordinates and monitors Division program plans in the areas of organization, personnel, training, security, space and furniture acquisition, financial planning and funding. Finalizes financial and Program-Planning and Budgeting System documents for Division programs covering field operations and the National Office. Coordinates with Internal Audit on program reviews and follows up on findings and corrective action pertaining to the programs and mission of Accounts and Data Processing. Coordinates the Division reports management program. Manages the Division internal Work Planning and Control System. Prepares speeches and other required papers on Division activities. Represents the Division in the orientation of foreign tax officials and other dignitaries. Provides office management and directives management for the Accounts and Data Processing Division.

1113.643 Associate Director (Accounts and Services)

Directs the data processing program management for the present tax administration system and will direct the program management of the new, integrated tax administration systems. Develops programs for approval; and designs, implements, and evaluates systems and procedures for data processing applications. Functions include: participates in developing new systems or revision of existing systems, including a cost/benefit analysis; plans and coordinates resource requirements for accomplishments of programs (collaborates with involved client organizations); prepares, issues, and monitors program requirement packages (PRP's) and ADP Handbook procecedures; participates in systems acceptability testing with approval authority for proprietary programs; eval-

uates program effectiveness through feedback from on-site review, field office communications, customers, and Internal Audit, promptly resolving program problems; develops management information and quality review systems applicable to activities in service centers and NCC; responsible for development and coordination of service center and master file requirements relating to special studies and other research activities; provides analyses and recommendations of action required by tax legislation; and coordinates participation of ACTS in the data exchange programs, e.g., requests from Federal, State, and municipal entities for non-report and non-statistical formatted data from the master file.

1113.6431 Compliance and Special Programs Branch

Manages data processing programs relating to Compliance and other Service components, and external customers for the totally integrated tax administration system. Develops programs for approval; and designs, implements and evaluates systems and procedures for data processing applications. Develops new systems or revises existing systems in area of responsibility, including a cost/benefit analysis. In collaboration with client organization, responsible for aggregate planning and coordination of resource requirements for accomplishment of programs; prepares, issues, and monitors program requirement packages (PRP's) and ADP Handbook procedures for area of responsibility. Participates in system acceptability testing for those systems related to its program area with final approval authority for proprietary programs. Evaluates program effectiveness through feedback from on-site review, field office communications, customers, and Internal Audit, promptly resolving program problems. Develops management information systems applicable to activities in service centers, district offices, and NCC. Responsible for development and coordination for service center and master file requirements relating to special studies and other research activities. Coordinates participation of ACTS in the data exchange programs, e.g., requests from Federal, State, and municipal entities for non-report and non-statistical formatted data from the master file.

1113.6432 Revenue Accounting and Processing Branch

Manages data processing programs relating to processing of tax returns and related documents from receipt through posting to the master file, including service center and district office deposit activities for the totally integrated tax administration system. Develops programs for approval; and designs, implements, and evaluates systems and procedures for data processing applications. Develops new systems or revises existing systems in area of responsibility, including a cost/benefit analysis. Responsible for aggregate planning and coordination of resource requirement packages (PRP's) and ADP Handbook procedures for area of responsibility. Participates in systems acceptability testing for those systems related to its program area with final approval authority for proprietary programs. Evaluates program effectiveness through feedback from on-site review, field office communications, customers, and Internal Audit, promptly resolving program problems.

1113.6433 Taxpayer Accounts Services Branch

Manages data processing programs of service center and district office activities relating directly with taxpayer's accounts occurring subsequent to master file posting of the return for the totally integrated tax administration system. Develops programs for approval; and designs, implements and evaluates systems and procedures for data processing applications. Programs include activities such as correspondence, adjustments, notice review, payment tracers and other IDRS related activities. Develops new systems or revises existing systems in area of responsibility, including a cost/benefit analysis. Responsible for aggregate planning and coordination of resource requirements for accomplishment of programs. Prepares, issues, and monitors program requirement packages (PRP's) and ADP Handbook procedures for area of responsibility. Develops quality review systems applicable to activities in Service Centers and NCC. Participates in systems acceptability testing for those systems related to its program area with final approval authority for proprietary programs. Evaluates program effectiveness through feedback from on-site review, field office communications, customers, and Internal Audit, promptly resolving program problems.

1113.6434 Accounting Operations Branch

Assures that accounting operations in Service Centers are performed in accordance with prescribed procedures and provides assistance in account balancing or other problems through field visitations, phone calls and correspondence. Provides Division Management with information gathered through field contact relating to the accounting function.

Suggests revisions to the Revenue Accounting System and assists in preparation of field instructions; engages in consultation and preparation of special accounting related projects such as those involved in new service center activation and apportionment of accountability. Also prepares specifications for the maintenance of the centralized accounting function which accounts for monies to be transferred to U.S. territories such as Puerto Rico, Guam and the Virgin Islands. Prepares annual financial statements and maintains accounting data necessary for the proper planning of receipts and cash flow by the Department of the Treasury.

Prepares reports of revenue receipts

and refunds paid for management and various IRS publications. Reviews revenue and refunds paid data prepared by the National Computer Center and Service Centers and prepares quarterly certifications of trust fund collections, refunds and credits such as those for the Highway, Land and Water Conservation, Airport and Airway, and Railroad Retirement Trust Funds. Maintains administrative control over Joint Committee refund cases from time of receipt, through processing, to time of final dispatch to service center for preparation of refund check. Reviews pending and enacted legislation, government and other publications to keep current with all actions affecting the revenue. Acts as liaison with other agencies in the Department of the Treasury, Railroad Retirement Board, Joint Committee on Internal Revenue Taxation, Office of Business Economics, and other agencies, industries, individuals and associations involved in the Nation's revenue.

1113.644
Associate Director (Computer Systems)

Directs and coordinates the operations of computer systems and processing programs for the present tax administration system and will operate the new, integrated tax administration systems, commensurate with established ACTS goals and recommends determination of supporting computer hardware, as well as auxiliary and accessory equipment, and software requirements for service centers, district offices and the National Computer Center. In addition, includes: participation in studies of proposed computer systems, including telecommunications and real time processing applications; develops and maintains computer software support; evaluates computer systems utilization and is responsible for outside agency computer systems reporting; coordinates installation of computer systems, evaluating planned operational effectiveness; develops standards and guidelines for uniformity by all programmers; develops application and scientific computer programs; participates in systems acceptability testing of all procedures and computer programs before system implementation; provides functional supervision of Resident Programmer Analysts located at service centers and the National Computer Center; provides technical advice and consulting services to other Service offices on computer systems problems; coordinates participation of ACTS in the Government-wide ADP Sharing program; and develops and coordinates the recruitment and training of programmer trainees.

1113.6441
Master File Programming Branch

Develops, documents, and maintains computer systems and processing programs to establish, update, analyze and produce required outputs from Master Files of taxpayer accounts and related data files at the National Computer Center for the totally integrated tax administration system. Analyzes new or revised computer-oriented systems requirements to develop required run schematics, detailed logic and block diagrams, machine coding and run tests, documentation and instructions for National Computer Center input, Master Files processing and output programs, including data controls and files extracts. Coordinates with Accounts and Services, and the Service Center Programming, Data Retrieval Programming and Systems Support Branches to ensure compatibility with computer input/output programs in the Internal Revenue Service Centers. Assists the Systems Testing Branch in conducting tests of computer programs and instructions prior to operational use. Identifies operational programming problems, recommends recovery action, if practicable, and makes required program changes. Participates in the review and analysis of proposed computer systems requirements to determine feasibility, completeness, and compatibility with related IRS systems. Provides functional supervision over Resident Programmer Analysts located at the National Computer Center.

1113.6442
Service Center Programming Branch

Develops, documents, and maintains computer systems and processing programs and related off-line equipment instructions for tax return and all related data transcription and processing operations including residual master files and data controls in the Internal Revenue Service Centers for the totally integrated tax administration system. Analyzes new or revised computer-oriented systems requirements to develop required run schematics, detailed logic and block diagrams, machine coding and run tests, documentation and instructions for Service Center computer input/output programs, data controls and related processes. Coordinates with the Accounts and Services, and the Master File Programming, Data Retrieval Programming and Systems Support Branches to ensure compatibility with all IRS computer processes particularly at the National Computer Center. Assists the Systems Testing Branch in conducting tests of computer programs and instructions prior to operational use. Identifies operational programming problems, recommends recovery action if practicable and makes required program changes. Participates in the review and analysis of proposed computer systems requirements to determine feasibility, completeness, and compatibility with related IRS systems. Develops and maintains computer programs to fulfill requirements for management information systems integrated or related with the tax processing system. Provides functional supervision of Resident Programmer Analysts located at the Service Centers.

1113.6443
Data Retrieval Programming Branch

Develops, documents, and maintains

computer systems and processing programs for the Service Centers and district and local offices that are required for the Integrated Data Retrieval System (IDRS). Designs file structure and determines the need for individual computer runs and the relationship of these runs for IDRS. Requirements of the system are received from the branches under Associate Director, Accounts and Services and are coordinated for clarity and programming feasibility. The computer system is diagrammed; file content and format is determined; individual program logic is designed, coded and tested. Complete program documentation is prepared for distribution to all Service Centers and district and local offices including detailed operating instructions. Programs are all prepared to operate synchronously with the individual, business, and residual master files, and other automated and manual systems for the totally integrated tax administration system. Programming activities include real time processing of terminal inquires and update action plus a large number of multiprogrammed batch runs. The batch processing, which also has related real time processing, includes such items as: updating the Account Data files on a daily and weekly basis with data from the National Computer Center and data from all of the various stages of processing in the Service Center; analysis of accounts notice output; maintenance of adjustment and correspondence case inventories; and various audit and collection related activities. Some principal subsystems that are a part of IDRS processing are: Correspondex System, Document Request System, Unidentified Remittance System, On-Line Adjustment System, System for Direct Deposit of Receipts. Participates in the review and analysis of proposed computer systems requirements to determine feasibility, completeness, and compatibility with related IRS system. Coordinates with the Master File Programming and Service Center Programming Branches in the functional supervision over Resident Programmer Analysts located at the service centers and the National Computer Center.

1113.6444
Systems Testing Branch

Plans, develops, schedules and conducts acceptability tests simulating live operation of new or revised systems, procedures, forms, instructions, and computer programs designed to process tax returns, related documents and data in the district offices, service centers, or National Computer Center, including accounting, document and other internal controls over such operations for the totally integrated tax administration system. Coordinates with other ACTS operating and user organizations in testing the system as acceptable for implementation, analyzes total system requirements, develops appropriate test documents and data, and establishes predetermined control and output results. Tests all manual procedures, machine processes and computer programs, under predetermined controls as planned, to determine readiness of the system to produce records and outputs meeting all requirements. Identifies any deficiencies of problem areas, recommends evident modification or clarification, and tests any changes. Recommends acceptability to the client organization for their certification.

1113.6445
Systems Support Branch

Develops, maintains and modifies all software products, required for the Service's totally integrated tax administration system as a service function to the programming branches within the Division. Studies and evaluates proprietary software packages for application on any IRS system. Provides technical advice and consulting services to other Service offices including development of scientific computer programs. Provides a systems "debug" service to application programmers within the Division. Maintains the variety of skills and knowledge necessary to support the several different computer systems and programming languages utilized in the Service. Maintains a current knowledge of computer equipment, including auxiliary and related equipment, software technology, and telecommunication and real time processing applications. Participates in determining immediate or long-range computer systems equipment requirements for data processing; develops plans and schedules for meeting those requirements, and recommends acceptance, modification, or rejection of suppliers proposals. Coordinates installation of computer systems and evaluates effectiveness compared with contract requirements. Evaluates computer systems utilization and is responsible for outside agency computer systems reporting. Responsible for computer operation support functions (e.g., tape library, computer scheduling), including related procedures and programming, for the Service Centers, National Computer Center, and the National Office. Develops and issues standards and techniques for uniform guidance and use by all programmers; coordinates participation of ACTS in the Government-wide ADP Sharing Program. In coordination with Training Division, assists in developing and conducting data processing functional training seminars for Service personnel and specialized training courses for programmer trainees.

1113.65
Collection Division—Office of the Director

Accomplishes the Collection mission with reference to the filing and payment requirements of the internal revenue laws by providing and supervising (functional supervision) nationwide programs for issuance of Certificates of Compliance to departing aliens, disposition of certain offers in compromise, collection of unpaid accounts, determination and analysis of why accounts become delinquent, and prevention of accounts from becoming

delinquent; obtaining of delinquent returns, measurement of the types and degrees of non-filing, determination and analysis of the reasons for non-filing and reduction of non-filing.

1113.651
Special Projects Branch

Exercises responsibility over projects and activities not directly identified with a program management branch or the Special Service Staff. Exercises continuing responsibility for the coordination of management processes which apply to all programs and activities of the Division by performing the following functions: Monitors, coordinates and integrates the planning activities of the Division, including the preparation of program planning document, PPBS Program Memoranda and Program and Financial Plan, Work Plans and budget and financial documents. Maintains Work Planning and Control System (including maintenance of the Operations List) current and compatible with procedural issuances and coordinates the establishment of work priorities within the System. Monitors, studies, coordinates and integrates field collection (DAR activities), organization functions, position responsibilities, staffing and related personnel matters. Serves as Division consultant on these matters. Collaborates and maintains liaison with the Office of the Assistant Commissioner (ACTS) on information system requirements for data and data processing, reports and information systems design, other reports management activities, and on information storage and retrieval matters (also collaborating and maintaining liaison with the Office of Assistant Commissioner (Planning and Research) on information storage and retrieval), and coordinates and maintains management surveillance over all these matters within the Collection Division. Collaborates and maintains liaison with the Office of Assistant Commissioner (Administration) in determining field Collection training needs, evaluating and administering Collection training programs, and providing Collection functional guidance and review for development of training materials at the National Training Center. Conducts general management and other special studies and performs other assignments, which are not within the specific jurisdiction of the program management branches, when authorized by the Director or Assistant Director. Assists Director in determining permanent functional assignments within the Division where such assignments are not clearly covered within the established functional responsibilities. Coordinates internal audit matters related to the Collection Division, and is responsible for completed action on internal audit reports, keeping branches informed on these matters. Responsible, on a continuing basis, for management improvement, work simplification, better utilization of resources, etc., with reference to assigned programs.

1113.652
Delinquent Accounts Branch

Exercises program management responsibility for Collection Division's functional supervision of the payment requirements of the Internal Revenue laws through the Delinquent Accounts Program (collection of unpaid accounts, determination and analysis of why accounts become delinquent, and prevention of accounts from becoming delinquent) and of the functional supervision of offers in compromise based on doubt as to collectibility of taxes (except alcohol, tobacco and firearms taxes), offers in compromise of statutory additions based on doubt as to liability or doubt as to collectibility (except alcohol, tobacco, firearms, employment, withholding and excise taxes and specific penalties), and all offers in compromise of 100% penalties, by performing the following functions with reference to the Delinquent Accounts and Offer in Compromise Programs: Formulates and recommends policies. Develops short, intermediate and long-range program content and activities. Relates these to program planning documents, preliminary work plans and budget and financial plans. Develops, reviews and revises as necessary, systems, procedures, methods and other instructions for Collection field personnel, including the development of techniques. Analyzes, evaluates and reports to Division Director on status, progress and trends with reference to assigned programs and takes appropriate action required. Evaluates and reports to Division Director on status and trends of Field Operations involving assigned programs. Collaborates with Office of Assistant Commissioner (ACTS) on substantive program and systems matters pertaining to assigned programs. Identifies the need for and seeks improvement (in collaboration with the Special Projects Branch of reports and information systems and training guides). Identifies need for and seeks improvement of records and internal forms in collaboration with Facilities Management Division. Recommends appropriate action on Incentive Awards suggestions referred by the Administrative Services Office and on internal audit reports referred by the Special Projects Branch. Conducts studies required for problem identification, problem solving, planning, assistance to the regions, and engages in "trouble-shooting" for assigned programs. Makes a performance evaluation of offers in compromise in certain district acceptance cases. Reviews offers in compromise within functional jurisdiction requiring the Commissioner's approval. Participates in Division visits to field offices and conducts special purpose visits as required. Serves as taxpayer liaison office for the Division by the performance of the following principal functions: Responds to inquiries (personal visits, correspondence and telephone) from sources external to the Internal Revenue Service (e.g. taxpayers, members of Congress, Treasury Department and other Departments and Agencies) on matters

pertaining to Collection Programs, activities and functions. Conducts correspondence and engages in conferences with taxpayers, officials of the Service, States, other Federal Agencies, members of Congress and Congressional Committees on Collection Division activities and functions. Monitors the Division's sensitive case program. Responsible on a continuing basis, for management improvement, work simplification, better utilization of resources, etc., with reference to assigned programs.

1113.653
Returns Compliance Branch

Exercises program management responsibility for Collection Division's functional supervision of the filing requirements of the Internal Revenue laws through the Returns Compliance and Delinquent Returns Programs (obtaining of delinquent returns, measurement of the types and degrees of non-filing, determination and analysis of the reasons for non-filing and reduction of non-filing) by performance of the following functions with reference to the Returns Compliance and Delinquent Returns Program. Formulates and recommends policies. Develops short, intermediate and long-range program content and activities. Relates these to program planning documents, preliminary work plans and budget and financial plans. Develops, reviews and revises as necessary: systems, procedures, methods and other instructions for Collection field personnel, including the development of techniques. Analyzes, evaluates and reports to Division Director on status, progress and trends with reference to assigned programs and takes appropriate action required. Evaluates and reports to Division Director on status and trends of field operations involving assigned programs. Collaborates with Office of Assistant Commissioner (ACTS) on substantive program and systems matters pertaining to assigned programs. Identifies the need for and seeks improvement (in collaboration with the Special Projects Branch) of reports and information systems and training guides. Identifies need for and seeks improvement of records and internal forms in collaboration with Facilities Management Division. Recommends appropriate action on Incentive Award suggestions referred by the Administrative Services Office and on internal audit reports referred by the Special Projects Branch. Conducts studies required for problem identification, problem solving, planning assistance to the regions, and engages in "troubleshooting" for assigned programs. Participates in Division visits to field offices and conducts special purpose visits as required. Responsible, on a continuing basis, for management improvement, work simplification, better utilization of resources, etc., with reference to assigned programs.

1113.66
Taxpayer Service Division—Office of the Director

Plans, develops and directs a comprehensive Servicewide Taxpayer Service Program which recognizes that taxpayers must have the ability as well as the willingness to comply with Federal tax law. Ensures a consistent and uniform policy of service to all taxpayers.

Responsible for coordinating and integrating all field Taxpayer Service related activities (other than those requesting technical determinations), regardless of organizational boundaries. In this regard ensures that prompt, accurate, and responsive replies are made to taxpayer inquiries and that appropriate and useful informational and educational materials for public use are prepared and distributed. Participates in the formulation of policies affecting the taxpaying public. Assists (utilizing internal audits to the extent practical) in determining the effectiveness of taxpayer service activities in all areas and at all organizational levels. In this regard, recommends how procedures might be changed and resources increased, decreased, or shifted to provide better overall service to the taxpayer. Exercises functional supervision over regional and district taxpayer service activities. Conducts research on assessing and improving the effectiveness of various Taxpayer Service activities.

1113.661
Operations Branch

Exercises general program management responsibility to ensure prompt, accurate and responsive replies to taxpayer inquiries directed to district offices and service centers. This includes prompt replies to correspondence received from taxpayers, members of Congress, tax practitioners, and others regarding operations aspects of the ACTS organization.

Develops, reviews and modifies, as necessary, procedures, methods and other instructions to assist field managers and employees in the accomplishment of Program objectives.

Reviews selected correspondence to identify problem areas within the Taxpayer Service Division or to have the matter referred so the appropriate activity may take necessary remedial action. Provides liaison between district office taxpayer service operations and service center data processing operations as they related to Service-generated output or taxpayer-initiated actions.

Provides input to the Planning and Development Branch for Program Management guidelines, PPBS materials, work plans, estimates of staff and budget requirements to meet Program goals and objectives.

In conjunction with the Training Division, develops or reviews materials for field and National Office training programs for Taxpayer Service personnel. Issues up-to-date tax information, e.g., handbooks, guidelines, TAXNEWS, and the like to ensure dissemination of accurate tax information to the public by TSR's.

Provides guidance and assistance in the implementation of a comprehen-

sive Servicewide Taxpayer Service Program; and participates in the evaluation of its operational effectiveness. Responsible, on a continuing basis, for submitting recommendations for initiating studies and conducting field operational studies to improve the effectiveness of field operations, management improvement, work simplification and the like.

1113.662
Planning and Development Branch

Develops long-range plans and objectives for a comprehensive Taxpayer Service and Assistance Program and coordinates these plans with other activities assigned responsibility for various programs related to Taxpayer Service. Prepares, coordinates, and integrates the planning activities of the Division, including the preparation of Program Planning documents, PPBS materials, Programs and Financial plan, Work Plans, and budget documents. Assists in the determination of staff requirements to meet program objectives and long-range plans.

Assesses taxpayer needs, conducts in-depth research studies to measure effectiveness of selected methods of providing taxpayer service as well as measure various related programs, and recommends effective and economical methods of informing and educating taxpayers in their rights and responsibilities. Related programs to be measured include telephone assistance, filing, period publicity, taxpayer education, taxpayer publications, and the like, to determine how to most effectively meet taxpayer needs.

Represents both taxpayers and the Assistant Commissioner (ACTS) on the Forms Committee; and suggests alternative solutions to meet Service objectives with minimum inconvenience to taxpayers. Assures that the needs of taxpayers are considered in the design of tax forms and other Service publications; and that instructions are issued which make compliance simpler or more understandable for the public.

Identifies subject matter areas giving taxpayers problems and endeavors to alleviate these by coordinating with other National Office Divisions in the preparation of appropriate technical publications, news releases, institute training materials, et cetera. Reviews forms, form letters, computer notices, and other issuances to ensure that information or instructions contained therein are understandable to the public.

Provides assistance in personnel management activities and program evaluation. Collects and presents statistical data in an organized and readily usable form in measuring accomplishments against objectives. Prepares materials designed to aid field personnel in achieving the highest Program goals at a minimum cost. Serves as Taxpayer Service Division representative in TCMP matters. Develops and coordinates the issuance of Revenue Procedures on the use of "substitute" tax forms and schedules. Coordinates internal audit matters related to the Taxpayer Service Division and has responsibility for completing action on such reports and for collaboration with the Field Operations Branch on these matters.

1113.67
IRS Data Center

Responsible for the performance of Non-Master File data processing operations for the Service. This includes: design of manually and electronically oriented processing systems; detail design of computer programming requirements and instructions; writing of computer programs; testing and debugging of computer routines; systems acceptability testing; installation of new systems; and maintenance of systems after they become operational. Such systems provide for the preparation of Department of the Treasury payrolls; fiscal reports; statistics of income; Taxpayer Compliance Measurement Programs, including both work progress reports and special studies; special tax research; personnel analysis reports; work planning and control reports; data for PPBS and other purposes; special tabulations and comparisons for States and other Federal agencies; and statistical information for management control by National and Regional Office officials; and other special applications not included in the Business and Individual Master File systems.

1113.7
Office of Assistant Commissioner (Inspection)

The Assistant Commissioner (Inspection) acts as the principal assistant to the Commissioner in planning and carrying out the inspection program of the Internal Revenue Service. This includes the independent review and appraisal of all Internal Revenue Service activities as a basis for protective and constructive service to management, and the carrying out of a program for assisting management to maintain the highest standards of honesty and integrity among its employees. The Assistant Commissioner (Inspection) plans and directs the inspection program at both the national and regional levels. At the National Office level he supervises two divisions: the Internal Audit Division and the Internal Security Division; and at the regional level he supervises the Regional Inspectors.

1113.71
Internal Audit Division—Office of the Director

The Internal Audit Division has responsibility for conducting a program providing for an independent review and appraisal of the operations of the Internal Revenue Service. This review provides information on the condition of all the functional activities of the Service at the National, regional and district levels and is sufficient in scope to provide a basis for constructive management action by the Service officials responsible for the activities involved. The Division is also responsible for a systematic verification and analysis of

financial transactions and a review and appraisal of the protective measures and controls established at all operating levels. The organizational structure for program operations consists of the National Office Internal Audit Division, and the regional Internal Audit staffs which are headquartered in the same location as the Regional Inspectors. The Director of the Internal Audit Division, under the general supervision of the Assistant Commissioner (Inspection), is responsible for the development and execution of the Division's program.

1113.711 Operations Branch

The Operations Branch has responsibility for ensuring a continuing effective internal audit of the Service's Administration, Appellate, Audit, Counsel, Intelligence, Technical, Office of International Operations, and Economic Stabilization Program activities by developing guidelines for the annual internal audit plans; by reviewing and making recommendations on regional internal audit plans; by conducting National Office and coordinated nationwide audits; by carrying out special surveys, examinations, and projects as assigned by higher authority, such as audits of the Tax Division of the U.S. Virgin Islands Government, and the Treasury Department's Exchange Stabilization Fund and Alcohol, Tobacco and Firearms activities; by coordinating, evaluating, and reviewing and following through on audit findings; and by bringing significant audit disclosures to the attention of top National Office management officials including the Commissioner. Participates in the program of staff guidance, review and evaluation of the auditing activities of regional Internal Audit staffs. Consults with top officials in the Offices of the Assistant Commissioners and the Office of Chief Counsel on recommendations for improving procedures and controls. Carries out special assignments in cooperation with the Internal Security Division on cases requiring the specialized knowledge and training of personnel of the Internal Audit Division. Exercises continuing direction and control over all Internal Audit aspects of Inspection integrity assignments conducted nationwide, including on-job visitations. Maintains liaison with National Office Internal Security Division on Security cases pending in the regional offices. Analyzes and summarizes Internal Audit Division's annual accomplishments and prepares required internal and external reports.

1113.712 Program Development Branch

The Program Development Branch has responsibility for developing the Division's policy and procedural instructions and internal audit program guidelines for the continuing effective internal audit of all activities in the Revenue Service's field offices. Also has responsibility for developing and carrying out career development programs for Internal Audit staff members nationwide to increase staff management capability and professional auditing proficiency, including conducting basic and advanced Internal Audit training programs. Keeps abreast of new developments in Service programs to determine their effect on Internal Audit's responsibilities in the auditing of field operations. Coordinates with other functional areas of the Office of Assistant Commissioner (Inspection) as necessary, including participation in a program of on-site review and evaluation of the activities of the regional Internal Audit staffs. Maintains liaison with Officers of Assistant Commissioners and Chief Counsel, to determine operating problems or developments that should be given internal audit program attention. Keeps abreast of latest professional management auditing techniques and methods to ensure timely adaptation to the Service's internal audit program. Maintains the division's program of continuing review of special long-range Service projects, e.g., Taxpayer Compliance Measurement Program.

1113.713 Data Processing Activities Branch

The Data Processing Activities Branch has responsibility for ensuring a continuing effective internal audit of the Service's Accounting, Data Processing, Collection and Taxpayer Service activities by developing guidelines for the annual internal audit plans; by reviewing and making recommendations on regional internal audit plans; by conducting National Office and coordinated nationwide audits; by carrying out special surveys, examinations, and projects as assigned by higher authority; by coordinating, evaluating, and reviewing and following through on audit findings; and by bringing significant audit disclosures to the attention of top National Office management officials including the Commissioner. Participates with management during the development stages of new or improved ADP systems to ensure the incorporation of effective management controls. Develops systems and procedures to utilize automatic data processing in carrying out principal segments of the Internal Audit Division's program. Participates in the program of staff guidance, review and evaluation of the auditing activities of regional Internal Audit staffs. Consults with top officials in the Offices of the Assistant Commissioners and the Office of Chief Counsel on recommendations for improving procedures and controls; keeps abreast of current data processing developments, including technological changes, so that proper consideration can be given to carrying out the Internal Audit Division's program. Coordinates with other functional areas of the Office of Assistant Commissioner (Inspection) in order to obtain data processing services requested by them or provide other information pertinent to the mission of these functions. Analyzes and summarizes In-

ternal Audit Division's annual accomplishments and prepares required internal and external reports.

1113.72 Internal Security Division

The Internal Security Division plans, develops, and controls the Internal Security program for the Internal Revenue Service so as to assist management in assuring the highest standards of honesty, integrity and security among Service employees and maintain public confidence in the integrity of the Service. The program includes personnel background investigations and investigations of complaints or allegations of misconduct or irregularities, including criminal, concerning Service employees; also investigations of non-Service persons when their actions may affect the integrity of the Service or safety of Service personnel, including attempts to bribe or otherwise corrupt Service personnel; this authority includes investigation of attempts to interfere with administration of Internal Revenue laws through threats, assaults or forcible interference, and also the unauthorized disclosure of Federal tax information. The program also includes background investigations of certain applicants for enrollment to practice before the Internal Revenue Service, investigations of charges against tax practitioners, formal investigations of accidents involving Service employees or property, investigations of complaints alleging discrimination because of race, creed, color or national origin; and the maintenance of records and case files relating to investigations conducted. The Division also conducts such special investigations, studies, and inquiries as required for the Commissioner, Office of the Secretary, or other components of the Treasury Department. The Division is composed of three branches: Field Coordination Branch, Investigations Branch, Planning and Programming Branch.

1113.721 Field Coordination Branch

The Field Coordination Branch controls and coordinates on a nationwide basis *all* investigations conducted by the Internal Security function. These investigations cover alleged violations of Federal criminal statutes and of the regulations and rules governing the conduct of Service personnel; actions of non-Service persons that may affect the integrity of the Service, including attempts to bribe or otherwise corrupt Service personnel; charges against persons enrolled or entitled to practice before the Internal Revenue Service; the investigation of the character and background of applicants for, or incumbents of, positions in the Service; enrollee applicant cases; formal investigations under the Federal Tort Claims Act; and other investigations as required for the Commissioner and other components of the Treasury Department. The Branch maintains a continuing review and control of all investigations to: assure that proper priorities are established and that the investigation workload is accomplished in an effective and efficient manner on an overall regional, as well as an individual Inspector basis; assure that the scope of the investigations and the facts and evidence are sufficient to provide a basis for conclusions by management, the Department of Justice or other authority; assure that established policies, procedures and techniques are being followed properly and uniformly; assure effective investigation accomplishments, uniformity in investigative coverage, and that there is proper form and quality of reports, as well as administrative and criminal dispositions; develops data and recommendations for improvement, simplification, and standardization of investigative operations, many of which are passed along for use by management in connection with directing program execution as well as planning and programming Internal Security activities; and directs the maintenance of records and case files relating to investigations conducted by the Internal Security function. The Branch maintains liaison on criminal and other investigative matters with the Office of the Chief Counsel, other law enforcement and security segments of the Treasury Department and the Internal Revenue Service, Department of Justice, Federal Bureau of Investigation and other Federal law enforcement agencies.

1113.722 Investigations Branch

The Investigations Branch, operating on a nationwide basis, is responsible for conducting extremely confidential investigations of complaints and allegations of misconduct or irregularities concerning high level officials of the Service and other special investigations which by reason of their complexity or sensitivity, or because of their potential effect on the maintenance of public confidence in the integrity of the Service, demand special handling. The Branch, as the investigative branch of the Internal Security Division for National Office personnel, is responsible for conducting background investigations of applicants for, or incumbents of, positions in the Service, certain applicants for enrollment to practice before the Internal Revenue Service, and for applicants for positions with certain other components of the Treasury Department. In addition the Branch conducts investigations of alleged violations of Federal criminal statutes and rules and regulations governing the conduct of Service personnel; actions of non-Service persons that may affect the integrity of the Service, including attempts to bribe or otherwise corrupt Service personnel; charges against persons enrolled to practice before the Internal Revenue Service; formal investigations under the Federal Tort Claims Act; investigations of alleged discrimination because of race, creed, color or national origin; and other special investigations as may be required for the Commissioner and other components of the Treasury Depart-

ment. The Branch maintains liaison with the Regional Inspectors and Assistant Regional Inspectors (Internal Security) to coordinate joint activities and in special situations to render assistance in the handling of difficult investigations.

1113.723
Planning and Programming Branch

The Planning and Programming Branch is responsible for providing staff assistance to the Division Director in planning and programming the Internal Security Division program. This includes formulating policies; developing technical and administrative procedural instructions, including manual issuances and investigative handbooks; conducting inspections of the management and operation of the regional Internal Security Divisions; conducting special surveys of National Office Internal Security activities; developing and coordinating training programs for the Division; providing technical and staff assistance to the Treasury Law Enforcement Officer Training School; compiling and analyzing reports of operational costs, workload data, and statistics concerning criminal and administrative actions resulting from Internal Security investigations; evaluating manual issuances or proposals originating outside Inspection which are pertinent to Internal Security functions; conducting special staff studies; and maintaining liaison with other branches of the Internal Security Division, the Internal Audit Division, and other offices of the Service.

1113.8
Office of Assistant Commissioner (Planning and Research)

The Assistant Commissioner (Planning and Research) acts as the principal assistant to the Commissioner and the Deputy Commissioner in the development and administration of the Long-Range Plan, related objectives and policies, and in the analysis of all Service programs for the purpose of promoting maximum effectiveness in the administration of the Internal Revenue Code with the most efficient and economical expenditure of resources; provides leadership and coordination in Federal-State cooperative tax administration; provides liaison with the States on administrative matters related to Federal collection of State individual income taxes; and is responsible for research, statistics, and systems development. The Assistant Commissioner (Planning and Research) represents the Commissioner on these matters in relations with the Department of the Treasury, the Congress, other Government agencies and outside organizations. He discharges these primary responsibilities in cooperation with the appropriate Assistant Commissioners (or other principal officials), each of whom exercises related responsibilities within his own functional area. The Assistant Commissioner (Planning and Research) is responsible for and supervises the activities of the Planning and Analysis Division, Research Division, Statistics Division, Systems Development Division, Tax Systems Redesign Divison, and Internal Management Documents Division.

1113.81
Planning and Analysis Division

The Planning and Analysis Division develops and administers the systems for producing a comprehensive multiyear Long-Range Plan, for coordinating and integrating program objectives of the Service, and for analyzing all Service programs—with the aim of optimizing the collection of internal revenue taxes. To these ends, in cooperation with responsible offices, it develops the Service's Long-Range Plan; through Special Studies, approved by the Deputy Commissioner, evaluates the desirability and costs of existing and proposed plans, organizations, and program objectives; and develops criteria and presentations to measure accomplishments. It coordinates the preparation of the annual Program Memoranda analyzing the objectives, costs and benefits of the Long-Range Plan. The Division, in cooperation with other responsible offices, determines the scope of operating data needed for performance reporting and for marginal productivity and other kinds of operations research analyses in connection with the Long-Range Plan, Program Memoranda, and Special Studies.

1113.82
Research Division

The Research Division conducts advanced research (independently or in conjunction with other offices) into the Federal tax system to develop new approaches to improve the Service's operations and to reduce the compliance burden on the taxpayer; directs such research, within the framework of tax policy determined by the Office of the Secretary of the Treasury; furnishes leadership and coordination for the program of Federal-State cooperation in the field of tax administration; and serves as the liaison office for administrative matters with the States in connection with the Federal collection of State individual income taxes. The Division serves as the focal point of the Service for assistance to the Chief Counsel and the Office of the Secretary of the Treasury in the development of legislative proposals and in the identification and evaluation of administrative implications of such proposals; coordinates and works with other activities of the Service in assisting the Chief Counsel and Tax Legislative Counsel in the drafting of legislation; develops, coordinates and monitors plans to implement provisions of new legislation affecting tax administration; and keeps the Commissioner apprised of significant legislative developments and progress in implementing provisions of new legislation. The Division actively participates with other staffs of the Assistant Commissioners and of the Department of the Treasury in the preparation of legislative proposals and regulation revisions resulting from the research conducted; designs and carries out surveys, studies, polls, and other forms

of research to provide basic data needed for the formulation of legislative proposals and operating programs and plans; and prescribes the nature and content of statistical analyses made by other offices but required for the research functions of the Division.

1113.83 Statistics Division

The Statistics Division conducts research and prepares statistics with respect to the operation of the income tax laws as required annually by the Internal Revenue Code to provide basic information for tax studies and legislation by the Congress and its committees, for administrative use by the Secretary of the Treasury and the Commissioner of Internal Revenue, and for the Federal benchmark statistical programs on income, wealth, and finance; and performs other related research and statistical functions. The Division provides support services for the Reports Management program. The Division consists of the Income, Finance, and Wealth Branch, the Statistical Techniques Branch, the Mathematical Statistics Branch, and the Program Management Branch.

1113.831 Administrative Office

Performs all administrative management activities, including personnel, budget, and fiscal programs, cost estimates, allocations and control of funds, records management, travel, space and equipment utilization. Coordinates and controls, in conjunction with the Facilities Management Division the printing requirements of the Division and statistical processing contracts, other office services required. Serves as a focal point for Division contacts with Personnel, Fiscal Management, and Facilities Management Divisions.

1113.832 Income, Finance, and Wealth Branch

The Income, Finance, and Wealth Branch performs statistical and economic research with respect to the operations of the income tax laws as required by the Internal Revenue Code. It identifies and analyzes actual and prospective needs of users of income, wealth, and financial data reported on tax returns. The Branch plans, evaluates, and modifies these needs to develop an integrated statistical program and prepares specifications for data preparation. It interprets, analyzes, and presents the resulting statistics through publications of the Internal Revenue Service, such as the "Statistics of Income" series, and in consultation with appropriate policy and management officials.

1113.833 Statistical Techniques Branch

The Statistical Techniques Branch performs technical statistical services in support of the program of the Division. It prepares projections and estimates of tax return populations by type of return and geographic area, and produces other workload measures of the Service. It uses statistical techniques to analyze problems and improve efficiency in work programs. It plans, prepares the analysis, and presents the results of statistical studies for the Service, other Federal Agencies, and for approved reimbursable projects. It conducts research in the development and adaptation of statistical techniques designed to promote efficient operations. It prepares Service statistical guidelines and taxpayer aids. It supplies special statistical services in response to requests and advice on applications of statistical techniques to technical and administrative tax problems. It provides the technical service in development of management information and other reports.

1113.834 Mathematical Statistics Branch

The Mathematical Statistics Branch has the Statistics Division's responsibility for the probability sampling portions of the Service's research and operational programs and aiding, on request, other agencies with their sampling problems. This responsibility includes such things as the application of computer methods to sampling techniques used in such programs as Statistics of Income and Taxpayer Compliance Measurement; the use of area survey techniques to measure tax delinquency; assisting in the application of sample audit techniques to processing functions; using time samples to develop cost data for the Long-Range Plan; and review of sampling plans developed in other areas of the Service.

1113.835 Program Management Branch

Designs and develops operational plans for use in producing the statistics required by the Division's program, and prepares related procedures, forms, and instructions. Coordinates budget development for, and the planning, scheduling, and processing of the statistical work performed at decentralized locations. Conducts research into methods for controlling quality. Develops and applies operating techniques for quality control, providing standards of measurement and instituting methods developed through operations research. Evaluates statistics produced in terms of original specifications, costs, and procedures. Serves as the focal point for collaboration between National Office and field statisticians in the execution of continuing programs such as Statistics of Income, Taxpayer Compliance Measurement, and Statistical Quality Control. Guides and coordinates the activities of statisticians in the field processing centers to insure uniformity of method and adherence to common goals. Plans uniform statistical applications to be implemented by statisticians in the field processing centers. Provides the technical and clerical support for the manual compilation of management information and other reports.

1113.84 Systems Development Division

The Systems Development Division is concerned both with electronic

systems and other systems except for the implementation of the new integrated tax administration data processing systems. It conducts a continuing program relative to the availability and capability of electronic data processing systems and other electronic or automation equipment and systems, the feasibility and adaptability of electronic equipment to specific Service tasks, and the development of special modifications for Service purposes. The Division reviews and coordinates projects of other offices involving the adaptation of electronic equipment and participates in the selection and installation of electronic equipment and systems. With respect to other systems, the Division examines and makes recommendations for improvement or extension of internal systems (such as those relating to reporting, processing, accounting, enforcement, records management, and communications), reviews and coordinates system-improvement efforts of other offices and initiates and develops projects of its own; furnishes other offices of the Service, on request, advisory and consultative services on systems problems; studies possibilities of integrating paperwork and data-handling systems and equipment; and surveys, develops and tests equipment used or usable by the Service.

1113.85
Tax Systems Redesign Division

The Tax Systems Redesign Division is responsible for the development of requirements, preparing requests for proposals from vendors, evaluating vendors' proposals and recommending appropriate contract awards, and installing the new integrated tax administration data processing systems. These new systems replace not only the existing systems for revenue accounting and processing, with their limited capacity for serving other segments of the Service, but also provide an integrated data processing system available to all elements of the Service. Staffing and programs of the division represent all of the major organizational components, and close and continuous liaison is required with all users of the systems. The division is responsible for designing, implementing, and installing integrated tax administration systems which involve the service centers, district offices, the National Computer Center, and the National and Regional offices. Responsibilities include such things as: development of major programs and procedural implementation instructions, preparation of detailed systems requirements and computer programs, design of systems acceptability tests, and design and management of data control systems. The division is also responsible for insuring the uninterrupted processing of returns, revenue accounting, and related activities while the original data processing system is being replaced by the new tax administration systems. While extensive coordination with user activities is required and user skills are represented in the division staffing, the division is basically a self-contained organization (except for administrative support) having all the requisite skills and capable of expanding as the number and intensity of assignments increase. Subordinate organizational structure will be established as required at various stages, and the division will be absorbed into the continuing organization at the conclusion of the implementation stage.

1113.86
Internal Management Documents Division

The Internal Management Documents Division is responsible for designing and administering the Service's Internal Management Document System and for establishing standards for style and format of such National Office documents. The division reviews all Internal Management Documents, and memorandums and letters addressed to a group of field officials, issued from the National Office, for adequacy of coordination and clearance; determination of proper category for issuance; conformance with established Service policies, delegations of authority, and organizational titles and designations; effects coordination and clearance of such issuances as may be required; and arranges for publication in the Federal Register of statements of Service organization and functions, and Commissioner's delegations of authority which affect the rights and duties of taxpayers. The division is responsible for substantive review, evaluation and coordination of new and revised statements of Service policy, delegation orders, and organizational changes, prepared for the Commissioner's approval; and effects coordination for Planning and Research matters involving the Freedom of Information Act and liaison with the Tax Administration Advisory Staff.

1113.9
Office of Assistant Commissioner (Technical)

The Assistant Commissioner (Technical) acts as the principal assistant to the Commissioner in providing basic principles and rules for the uniform interpretation and application of the Federal tax laws (other than alcohol, tobacco, and firearms taxes under Subtitle E of the Internal Revenue Code). In carrying out this mission, he: Publishes rulings to announce interpretative positions of the Service; publishes explanatory booklets, pamphlets and other materials for the guidance of taxpayers and Service officials; issues rulings and advisory statements to taxpayers and Service officials; issues opinion letters to sponsoring organizations on master and prototype pension, annuity, and profit-sharing plans; directs programs for clarification and simplification of tax rules; develops (and is responsible for the technical content of) all tax return forms and instructions (other than those relating to alcohol, tobacco and firearms taxes); reviews other public-use tax forms and form letters; acts as com-

petent authority in matters involving interpretation or application of tax treaties; provides advice and assistance on technical matters throughout the Service, and to the Department of the Treasury, other Government agencies, and Congressional Committees; conducts a technical liaison program with Service field offices; conducts a Technical Field Conference program; coordinates with the Research Division of Planning and Research in providing advice and assistance on legislative matters; coordinates with the Office of Chief Counsel and the Department of the Treasury in providing advice and assistance on regulatory matters; reviews all new or amendatory regulations for administrative feasibility and adequacy; administers the activities of the Art Advisory Panel embracing a Servicewide program for providing guidance and direct assistance to field offices in the disposition of income, estate and gift tax cases involving fine arts valuation; coordinates with the Office of the Chief Counsel and the Department of Justice in providing advice and assistance in connection with matters in litigation; and coordinates with the other Assistant Commissoiners, the Department of the Treasury, other Government agencies, and outside professional groups and industry and trade associations on matters of mutual concern. The Assistant Commissioner (Technical) is authorized to prescribe the extent, if any, to which any ruling issued by or pursuant to authorization from him, shall be applied without retroactive effect. He is also authorized to enter into and approve a written agreement (Closing Agreement) with any person relating to the internal revenue tax liability, other than certain excise taxes, of such person (or of the person or estate for whom he acts) in respect of any prospective transactions or completed transactions affecting returns to be filed. The Assistant Commissioner (Technical) is responsible for and supervises the activities of three divisions: Income Tax Division; Miscellaneous and Special Provisions Tax Division; and Technical Publications and Services Division.

1113.91 Income Tax Division—Office of the Director

Has primary responsibility for providing basic principles and rules for uniform interpretation and application of the Federal tax laws in those areas involving: Income and employment taxes to corporate and noncorporate taxpayers (including individuals, partnerships, estates, and trusts); depreciation depletion, and valuation issues; the taxable status of exchanges and distributions in connection with corporate organizations, reorganizations, and liquidations; taxes imposed on self-employment income; and exemption of farmers' cooperatives from tax under IRC 521. In carrying out these reponsibilities, the Division: Issues rulings to taxpayers and technical advice and general technical information to District Directors and Regional Commissioners; advises the Appellate and Audit Divisions of the Service's position on particular issues; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases to be published for the guidance and information of taxpayers and Service personnel; drafts, or reviews, IR-Manual issuances to be published for the guidance of Service personnel; reviews or assists in preparing technical booklets, training materials, pamphlets, and other materials prepared for the guidance of taxpayers and Service personnel; conducts special studies of technical problem areas, including reappraisals of current rules and practices, with a view toward reducing controversy and promoting uniformity; determines the status of certain organizations as agencies or instrumentalities of the United States, a State or political subdivision thereof, or the District of Columbia, or agencies or instrumentalities of governments of foreign countries or political subdivisions thereof; reviews Actions on Decisions announcing the Commissioner's position on adverse decisions of the United States Tax Court, prior to publication in the Internal Revenue Bulletin; initiates recommendations and coordinates with the Research Division of Planning and Research in providing advice and assistance on legislative matters; initiates recommendations and coordinates with the Office of Chief Counsel and the Department of the Treasury in providing advice and assistance on regulatory matters; coordinates with the Office of the Chief Counsel and the Department of Justice in providing advice and assistance in connection with matters in litigation; reviews newly proposed and amendatory regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program which disclose tax administrative problems, abuses, and inequities, as well as the views of field personnel as to the quality and effectiveness of regulations and tax return forms, the need for new or amendatory legislation or regulations, etc.; coordinates on matters of mutual concern with other Technical divisions, the Compliance organization, other offices of the Department of the Treasury, and other Government agencies; supplies the Audit Division with names or essential identifying characteristics of persons or organizations, and otherwise advises and assists the Audit Division in the selection of representative cases, involving issues on which Service position needs to be established, clarified, or otherwise developed; aids the Audit Division in developing the scope of and techniques needed in the examinations or investigations of such issues; supplies information for use by the Audit Division in programming, evaluating, and guiding audit operations throughout the Service; participates in the development of tax return forms and instructions and reviews pertinent portions of public-use forms and instructions; invites outside professional groups and industry and trade associations to participate in conferences and to submit comments, briefs, and suggestions in connection

with tax problems and matters involving Revenue Rulings or Revenue Procedures proposed for the solution of tax problems; conducts conferences in the regional offices to discuss major programs of the Technical organization, to present papers on particular substantive technical areas, to discuss and explore possible solutions to technical areas of concern to field offices, and to discuss other matters of mutual concern; makes determinations with respect to earnings and profits of corporations and the taxable status of distributions to shareholders; acts on applications for changes in or adoption of accounting methods and periods; and acts as competent authority in matters involving interpretation or application of tax treaties. In areas involving the application of Federal tax laws in connection with provisions relating to depreciation, depletion and valuation issues, this Division also: Passes upon requests for approval of plans for the aggregation of nonoperating mineral interests as a single property; post-audits the depreciation, depletion, and valuation issues of cases on which engineering reports have been prepared and a sample of other large cases involving such issues; upon request, provides direct assistance to regional and district offices on cases involving depreciation, depletion, and valuation issues; provides, or secures, expert witnesses in support of the Government position in cases in litigation, and assists Government counsel in preparation and presentation of cases and in negotiations of settlements; prepares and presents material on professional and technical developments at engineering meetings, and upon request, in coordination with Compliance, develops and conducts training programs for engineers; prepares material for inclusion in the Engineers' Coordination Digest calling attention to important new developments and to nonuniform treatment of issues; and administers the activities of the Art Advisory Panel embracing a Service-wide program for providing guidance and direct assistance to field offices in the disposition of income, estate, and gift tax cases involving fine arts valuation. This Division also post-reviews field determination letters relating to the status of farmers' cooperatives under IRC 521. The Director is responsible for and supervises the activities of four branches: Corporation Tax Branch; Individual Income Tax Branch; Engineering and Valuation Branch; and Reorganization Branch.

1113.911
Corporation Tax Branch

In matters involving the application of Federal income tax laws to corporate taxpayers, including the taxation of insurance companies and those relating to consolidated returns of affiliated groups, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances, including material for the Exempt Organization Handbook relating to cooperatives; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; and participates in the Technical Field Conference Program. This Branch also performs the same functions involving either corporate or noncorporate taxpayers with respect to: Income of States, Municipalities, etc.; appearances, etc., with respect to legislation; amortization of pollution control facilities; research and experimental expenditures; inventories, including LIFO; allocation of income and deductions among related taxpayers; sales of low income housing projects; cooperatives and their patrons; exemption of farmers' cooperatives from tax under IRC 521; regulated investment companies and their shareholders; controlled foreign corporations and their U.S. shareholders; foreign tax matters which involve determination of sources of income; nonresident alien individuals and partnerships or of alien residents of Puerto Rico; compensation of employees of foreign governments or international organizations; income affected by treaty; foreign tax credit; earned income from sources without the United States; income from possessions; involuntary conversions; small business investment company stock losses; withholding of tax on nonresident aliens and foreign corporations; mitigation of effect of renegotiation of government contracts; requests for permission for change in or adoption of accounting periods and methods (except methods of accounting for depreciation and depletion); acts as competent authority in matters involving interpretation or application of tax treaties; and makes determinations with respect to earnings and profits of corporations and the taxable status of distributions to shareholders. This Branch also post-reviews field determination letters relating to the status of farmers' cooperatives under IRC 521.

1113.912
Engineering and Valuation Branch

In matters involving the application of Federal tax laws in engineering and valuation areas, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures; Announcements and Releases, and IR-Manual issuances; reviews or assists in

preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; passes upon requests for permission to change methods of accounting for depreciation and depletion and for approval of plans for the aggregation of nonoperating mineral interests as a single property; conducts a post-audit review of field engineer reports and a sample of non-engineer reports which contain depreciation, depletion, and valuation issues for purposes of assessing the field treatment of engineering issues in order to provide uniform guidance, both on an individual basis by report, and on a Servicewide basis by publication in the Engineers' Coordination Digest; provides direct assistance to regional and district offices, upon request; assists the Office of Chief Counsel and the Department of Justice in preparing and presenting cases in litigation, provides or secures expert witnesses in support of the Government's litigating position, and furnishes technical expertise in the negotiation of trial and pre-trial settlements; prepares and presents material on professional and technical developments at engineering meetings, and upon request, in coordination with Compliance, develops and conducts training programs for engineers; prepares material for inclusion in the Engineers' Coordination Digest calling attention to important new developments and to non-uniform treatment of issues; prepares and maintains an up-to-date Engineering Citator; and administers the activities of the Art Advisory Panel embracing a Servicewide program for providing guidance and direct assistance to field offices in the disposition of income, estate and gift tax cases involving fine arts valuation.

1113.913 Individual Income Tax Branch

In matters involving the application of Federal income tax laws to noncorporate taxpayers (including partnerships, estates, and trusts), and with respect to the application of employment tax laws to both corporate and noncorporate taxpayers, and with respect to the taxes imposed on self-employment income, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; and participates in the Technical Field Conference Program. This Branch also performs the same functions involving either noncorporate or corporate taxpayers with respect to: Charitable contributions; tenant-stockholders of cooperative housing corporations; employee stock option and stock purchase plans; real estate investment trusts; and election of certain small business corporations as to tax status and related matters, except the rules relating to certain qualified pension plans.

1113.914 Reorganization Branch

In matters involving the application of Federal income tax laws to exchanges and distributions in connection with corporate organizations, reorganizations, liquidations, and spin-offs, to stock dividends, redemptions, exchanges in obedience to Securities and Exchange Commission orders, to distributions pursuant to the Bank Holding Company Act, and to losses on small business stock, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent

portions of public-use forms and instructions; and participates in the Technical Field Conference Program. This Branch also performs the same functions with respect to determinations as to whether distribution, exchanges, or transfers referred to in IRC 306(b)(4), 355(a)(1)(D)(ii), 367, and 1492 are in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

1113.92 Miscellaneous and Special Provisions Tax Division—Office of the Director

Has primary responsibility for providing basic principles and rules for uniform interpretation and application of the Federal tax laws in those areas involving Estate, gift, and certain excise taxes; organizations exempt from income tax under IRC 501; procedure and administration provisions of the Internal Revenue Code; matters requiring actuarial determinations; and the qualification of pension, annuity, profit-sharing, stock bonus, and bond purchase plans, and the tax treatment of employees and their beneficiaries and deductions for employer contributions under such plans. In carrying out these responsibilities, the Division: Issues rulings to taxpayers and technical advice and general technical information to District Directors and Regional Commissioners; advises the Appellate and Audit Divisions of the Service's position on particular issues; issues opinion letters to sponsoring organizations on master and prototype pension, annuity, and profit-sharing plans; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases to be published for the guidance and information of taxpayers and Service personnel; drafts, or reviews, IR-Manual issuances to be published for the guidance of Service personnel; reviews or assists in preparing technical booklets, training materials, pamphlets and other materials prepared for the guidance of taxpayers and Service personnel; conducts special studies of technical problem areas, including reappraisals of current rules and practices, with a view toward reducing controversy and promoting uniformity; reviews Actions on Decisions announcing the Commission's position on adverse decisions of the United States Tax Court, prior to publication in the Internal Revenue Bulletin; initiates recommendations and cordinates with the Research Division of Planning and Research in providing advice and assistance on legislative matters; initiates recommendations and coordinates with the Office of Chief Counsel and the Department of the Treasury in providing advice and assistance on regulatory matters; coordinates with the Office of the Chief Counsel and the Department of Justice in providing advice and assistance in connection with matters in litigation; reviews newly proposed and amendatory regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program which disclose tax administrative problems, abuses, and inequities, as well as the views of field personnel as to the quality and effectiveness of regulations and tax return forms, the need for new or amendatory legislation or regulations, etc.; coordinates on matters of mutual concern with other Technical divisions, the Compliance organization, other offices of the Department of the Treasury, and other Government agencies; supplies the Audit Division with names or essential identifying characteristics of persons or organizations, and otherwise advises and assists the Audit Division in the selection of representative cases, involving issues on which Service position needs to be established, clarified, or otherwise developed; aids the Audit Division in developing the scope of and techniques needed in the examinations or investigations of such issues; supplies information for use by the Audit Division in programming, evaluating, and guiding audit operations throughout the Service; participates in the development of tax return forms and instructions and reviews pertinent portions of public-use forms and instructions; invites outside professional groups and industry and trade associates to participate in conferences and to submit comments, briefs, and suggestions in connection with tax problems and matters involving Revenue Rulings or Revenue Procedures proposed for the solution of tax problems; conducts conferences in the regional offices to discuss major programs of the Technical organization, to present papers on particular substantive technical areas, to discuss and explore possible solutions to technical areas of concern to field offices, and to discuss other matters of mutual concern; and acts as competent authority in matters involving interpretation or application of tax treaties. This Division also performs the same functions with respect to determinations under IRC 170(b)(1)(A) in all situations involving a provision of Subchapter F of Chapter 1, Chapter 42, or section 6033 of the Code, and in any other situation bearing on the status of an organization as a private foundation. In tax matters dealing with actuarial questions: Provides or secures expert witnesses in support of the Government position in cases in litigation, and assists Government counsel in preparation and presentation of cases and in negotiations of settlements; and furnishes expert consulting assistance to other Service components, including the Office of the Chief Counsel, to the Department of the Treasury, and to other Federal and State Government agencies. This Division also: Post-reviews field determination letters relating to the status of organizations under IRC 501, and relating to qualification of pension, annuity, profit-sharing, stock bonus, and bond purchase plans under IRC 401 through 407; prepares and submits to the Audit Division special audit coordination digests calling attention to district determinations that do not conform to published Service positions on issues under IRC 401 through 407; on a certiorari basis, reviews and de-

cides cases appealed by taxpayers to the National Office for reconsideration of determinations by District Directors under IRC 401 through 407; and provides the final level of appeal in the Service on proposals by District Directors to revoke the exempt status of organizations under IRC 501. The Director is responsible for and supervises the activities of six branches: Actuarial Branch; Administrative Provisions Branch; Estate and Gift Tax Branch; Excise Tax Branch; Exempt Organizations Branch; and Pension Trust Branch.

1113.921
Actuarial Branch

In matters involving the application of Federal tax laws in the actuarial area, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other branches on matters of mutual concern; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; participates in the Technical Field Conference Program; and provides, or secures, expert witnesses in support of the Government position in cases in litigation involving pension plans, insurance, and other tax matters dealing with actuarial questions, and assists Government counsel in preparation and presentation of cases and in negotiations of settlements. This Branch also furnishes expert consulting assistance to other Service components (including the Office of the Chief Counsel), to the Department of the Treasury, and to other Federal and State Government agencies on actuarial questions involved in: Valuation of life estates, remainder interests, contingent assurances, series of payments, and reversionary interests; tax treatment of pension, profit-sharing, stock bonus, annuity, life insurance, accident and health, and other benefit and compensation plans and contracts; deductions for amounts paid or accrued on indebtedness under insurance contracts; and taxation of life insurance companies.

1113.922
Administrative Provisions Branch

In matters involving the application of the procedure and administration provisions of the Internal Revenue Code and similar provisions of related statutes, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon requests submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches and other offices of the Service on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; and participates in the Technical Field Conference Program.

1113.923
Estate and Gift Tax Branch

In matters involving the application of Federal estate and gift laws, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; as requested, furnishes assistance in negotiations or renegotiations of estate and gift tax conventions with representatives of foreign countries; acts as competent authority in matters involving interpretation or application of tax treaties; and participates in the Technical Field Conference Program.

1113.924
Excise Tax Branch

In matters involving the application of Federal excise tax laws other than those involving excise taxes imposed by Chapter 42 on private foundations and certain related parties, and the alcohol, tobacco and firearms taxes (but including the manufacturer's excise tax on firearms under IRC 4181 and 4182), this Branch: Issues rul-

ings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies; and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; and participates in the Technical Field Conference Program.

1113.925
Exempt Organizations Branch

In matters involving the exemption of organizations under IRC 501, this Branch: Issues rulings, technical advice, and general technical information; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; maintains in current status a comprehensive Exempt Organizations Handbook; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; post-reviews field determination letters; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; participates in the Technical Field Conference Program; and provides the final level of appeal in the Service on proposals by District Directors to revoke the exempt status of organizations. This Branch also performs the same functions with respect to exempt organization matters involving: Feeder organizations; prohibited transactions; unreasonable accumulations, or misuse, of income; liability for tax on unrelated business taxable income; requirements for filing annual information returns and other reports; determination of status as a private foundation; determinations under IRC 170 (b)(1)(A) in all situations involving a provision of Subchapter F of Chapter 1, Chapter 42, or section 6033 of the Code, and in any other situation bearing on the status of an organization as a private foundation; termination of private foundation status; special rules prescribed in IRC 508 with respect to IRC 501(c)(3) organizations; excise taxes imposed by Chapter 42 on private foundations and certain related parties, including questions arising under the savings provisions of section 101(1) of the Tax Reform Act of 1969; assessable penalties relating to private foundations; restrictions on examination of churches; determinations of status required under IRC 1504(e) for qualification of certain exempt organizations to file consolidated corporate returns.

1113.926
Pension Trust Branch

In matters involving the qualification of persion, annuity, profit-sharing, stock bonus, and bond purchase plans and the tax treatment of employees and their beneficiaries and deductions for employer contributions under such plans, pursuant to IRC 401 through 407, this Branch: Issues rulings, technical advice, and general technical information; issues opinion letters to sponsoring organizations on master and prototype pension, annuity and profit-sharing plans; drafts Revenue Rulings, Revenue Procedures, Announcements and Releases, and IR-Manual issuances; reviews or assists in preparing technical booklets, pamphlets, and other materials for the guidance of Service personnel and the public; conducts special studies directed toward resolving technical problem areas; reviews Actions on Decisions; provides advice and assistance to other offices of the Service (including the Office of the Chief Counsel), the Department of the Treasury, other Government agencies, and Congressional Committees; reviews proposed regulations for administrative feasibility and adequacy; analyzes and acts upon reports submitted by field offices under the Technical Coordination Program; coordinates with other Technical branches on matters of mutual concern; advises and assists the Audit Division in regard to the Service's audit program; participates in the development of tax return forms and instructions, and reviews pertinent portions of public-use forms and instructions; post-reviews field determination letters and, on a certiorari basis, reviews and decides cases appealed by taxpayers to the National Office for reconsideration of District Directors' determinations; prepares special audit coordination digests regarding conformance of field actions with established positions on stated issues; determines the applicability of the annuity treatment under IRC 72, the death benefit exclusion under IRC 101(b), and the sick pay

exclusion under IRC 105(d), to distributions under qualified plans and exempt employees' trusts; passes upon the tax treatment accorded deferred compensation under nonqualified plans; and participates in the Technical Field Conference Program. This Branch also performs the same functions with respect to pension trust matters involving: Exemption of employees' trusts under IRC 501; collateral matters involving the treatment of medical benefits for retired employees under qualified pension plans, the limitations and restrictions on self-employed persons participating in qualified plans, and the tax treatment of distributions to non-resident aliens; deductions by acquiring corporations for carryovers under IRC 381(c)(11) and (20); feeder organizations; prohibited transactions; liability for tax on unrelated business taxable income; and additional requirements and limitations under IRC 1379 with respect to plans that provide contributions or benefits for shareholder-employees of an electing small business corporation.

1113.93
Tax Forms and Publications Division—Office of the Director

Has primary responsibility in Technical for functions related to: Tax return forms; other public-use forms and form letters; taxpayer publications; internal-use technical publications; field liaison programs; Part XI of the Manual; the "Freedom of Information Act"; technical and general correspondence; Congressional liaison; research facilities and reference services; and control and maintenance of correspondence files and exempt organization application files. In carrying out these responsibilities, the Division: Conducts a program for the development, annually or as needed, of all Federal tax return forms and instructions (other than those relating to alcohol, tobacco, and firearms taxes); coordinates and assists in the work of the National Office Tax Forms Coordinating Committee in planning, reviewing and approving tax return forms materials; assists the National Office Tax Forms Coordinating Committee by reviewing other public-use forms and form letters used by the Service; furnishes technical assistance to the Department of the Treasury and others on tax return matters; conducts a program for publication of the Internal Revenue Bulletin and related publications; conducts a program for preparation and publication of technical booklets, pamphlets, and other materials for the guidance of taxpayers, tax practitioners and Service personnel; reviews tax guide material prepared by other Government agencies; reviews or drafts tax guide material for dissemination through newspapers, other periodicals, radio, and television; reviews tax law training material for classroom and correspondence instruction of Service personnel; drafts expository papers on major technical developments for the instruction of Service personnel; drafts digests of significant developments to keep Service personnel abreast of changes; promotes and coordinates the Technical liaison program with regional and district offices; conducts special surveys of Service field offices; coordinates the Technical Field Conference Program; coordinates the development and publication of material for Part XI of the Internal Revenue Manual; coordinates the activities of the Technical organization under the Freedom of Information Act; coordinates Technical's correspondence program; provides research facilities and reference services; and maintains and processes requests for inspection of, exempt organization application files. The Director is responsible for and supervises the activities of three branches: Tax Forms Development Branch; Technical Publications Branch; and Technical Services Branch.

1113.931
Tax Forms Development Branch

Assists in conducting the Service's public-use forms and instructions, and form letters programs. In carrying out these responsibilities, this Branch: On annual basis, or when otherwise necessary, initiates, develops and revises the technical content of all Federal tax return forms, instructions, schedules, etc., relating to income, employment, estate, gift, and excise taxes (other than those relating to alcohol, tobacco, and firearms taxes); provides the principal support and asistance to the National Office Tax Forms Coordinating Committee in planning, reviewing and approving all tax return forms materials; provides the principal support and assistance to the National Office Tax Forms Coordinating Committee in its review and approval functions relating to other public-use forms and form letters; prepares replies to inquiries from Members of Congress, other Government agencies, professional groups, and the public on matters relating to the forms program; evaluates, and prepares replies to, suggestions on matters relating to tax return forms and other public-use forms; prepares Announcements and Releases, and IR-Manual issuances, relating to tax return forms and other public-use forms; provides advice and assistance to other offices in the Service, the Department of the Treasury, and Congressional Committees in matters relating to tax return forms and instructions; and coordinates with other Technical branches on matters of mutual concern.

1113.932
Technical Publications Branch

Conducts the publications programs of the Technical organization. In carrying out this responsibility, this Branch: Compiles material for publication in the weekly Internal Revenue Bulletin, which is the Commissioner's authoritative instrument for announcing official rulings and procedures of the Service and for publishing Treasury Decisions, Executive Orders, tax conventions, legislation, court decisions, and other items of general interest; compiles all precedent material in the weekly Internal Revenue Bulletins for publication in semiannual Cumu-

lative Bulletins; prepares digests of all substantive materials in the Bulletin for publication in the Index-Digest System, complete with topical indexes and finding lists, for research use by the public and Service personnel; compiles record retention requirements from regulations for publication in the Federal Register; drafts summaries of selected authoritative material for publication in Tax Briefs to keep Service personnel abreast of significant developments in Federal taxation; compiles the Service's Loose-leaf Regulations System and drafts appropriate transmittals and filing instructions; compiles items to be published in the biennial Cumulative List of Exempt Organizations, its bimonthly supplements, and the announcements of current deletions in the Bulletin; initiates actions to preserve the standards and improve the effectiveness of the Bulletin system; drafts plain-language explanations of all Federal tax laws (other than those relating to alcohol, tobacco, and firearms taxes) for publication in booklets such as Your Federal Income Tax, Tax Guide for Small Business, Farmer's Tax Guide, and numerous pamphlets, to inform the public about the rights and duties of taxpayers; drafts plain-language instructional material for publication in the Teaching Taxes program; reviews material relating to Federal taxation in booklets and other issuances initiated by other Government agencies, and by others, when such cooperation is in the best interests of the Service; reviews for technical accuracy releases, articles, notices, and radio and television program materials, prepared for issuance by Public Affairs Division; drafts in-depth analyses and explanations of major developments in Federal taxation for publication in quarterly, annual, and special issues of the Review of Technical Developments, which are used to update the technical skills of Service personnel; participates in the drafting and reviewing of technical tax handbooks and guides for Service personnel and technical law text materials for use in Service training programs; drafts material for publication in Reports on Current Tax Literature to keep Service officials apprised about articles, comments, etc., published outside the Service regarding tax loopholes or inequities, and criticism of Service position; prepares Announcements and Releases, and IR-Manual issuances relating to the publications program; coordinates with other Technical branches, Chief Counsel, Audit Division, and others on matters of mutual concern; and coordinates with Publications Branch of Facilities Management Division and the Government Printing Office in the development of Production Control Schedules, format design, proof processing, and other matters of mutual interest.

1113.933
Technical Services Branch

Issues general technical information letters, coordinates the overall correspondence program of the Technical organization, and provides support services for Technical. In carrying out these responsibilities, this Branch: Issues direct replies to all communications involving requests for information of a general technical or procedural nature, including a substantial portion of Congressional inquiries directed to Technical; serves as liaison office and point of contact on all Congressional office inquiries, oral or written, relating to matters under the jurisdiction of Technical; coordinates with other offices in Compliance, Chief Counsel, Accounts, Collection and Taxpayer Service, and administration on correspondence crossing jurisdictional lines; keeps the Assistant Commissioner (Technical) informed regarding incoming communications involving sensitive or controversial matters; promotes and coordinates the Technical liaison program with regional and district offices involving the submission of field reports on administrative problems, tax abuses, tax inequities, the quality and effectiveness of tax return forms and instructions, and the need for new or amendatory regulations; conducts special surveys to obtain factual information from Service field offices on particular tax areas at the request of the Department of the Treasury or National Office components; coordinates the Technical Field Conference program whereby teams of specialists in the various tax areas and representatives of the Chief Counsel's office and the Audit Division meet with field officials in district offices to discuss technical matters of mutual interest or concern; coordinates the preparation and clearance of material for Part XI of the Internal Revenue Manual; coordinates actions for the Technical organization on matters involving the Freedom of Information Act; maintains a technical reference library and provides research assistance and reference services for personnel of the Technical organization and other offices in the National Office; corresponds with field offices to supply or request needed information on current or prior matters; analyzes, acknowledges receipt, and directs the flow of all incoming correspondence, including requests for rulings and technical advice, general technical inquiries, reports submitted by Service field offices under the Technical Coordination Program, etc., to the appropriate Technical divisions or branches; and processes, maintains, and services all closed correspondence files and related records for the Technical organization. This Branch also maintains and services exempt organization application files that are open to public inspection, processes requests for inspection thereof, and screens such files to delete certain materials that are exempt from public inspection.

1113.(10)
Office of Assistant Commissioner (Stabilization)

The Assistant Commissioner (Stabilization) is the principal assistant to the Commissioner in administering the Stabilizaton Program of the Internal Revenue Service, which includes monitoring and enforcing the stabili-

zation of prices, wages, and salaries pursuant to the coverage, classifications, and implementation procedures established by the Cost of Living Council. Such functions include, but are not limited to: advising the Cost of Living Council on matters concerning compliance with and implementation of decisions and regulations issued by the Council, and suggest changes which would lead to greater voluntary compliance or more effective use of resources; operation and maintenance of a nationwide network of Stabilization offices established in support of the Economic Stabilization Program; dissemination of information and guidance in response to inquiries from the public, to the extent authority has been delegated by the Cost of Living Council; planning for an effective enforcement program, including selecting industry targets, conducting investigations initiated locally or as directed by the Cost of Living Council; receiving, investigating, and resolving by obtaining compliance, where possible, complaints received with respect to alleged program violations, and taking enforcement action or recommending it to the Cost of Living Council, when necessary; receiving and processing price stabilization forms, reports, applications, and other information required to be submitted by firms covered under Phase IV regulations; making decisions and issuing orders with respect to notices of proposed price increases to the extent authority has been delegated by the Cost of Living Council; making decisions and issuing orders with respect to special filings, including applications for volatile pricing authority, loss or low profit pricing, merchandise pricing plans as delegated by the Cost of Living Council; making decisions and issuing orders with respect to individual requests for exceptions from the price regulations, and with respect to requests for reconsideration of initial decisions made and orders issued, to the extent authority has been delegated by the Cost of Living Council; and maintaining adequate records and making periodic reports to the Cost of Living Council. The Assistant Commissioner (Stabilization) is responsible for and supervises the activities of the Technical Programs Division, the Compliance and Enforcement Division, the Planning and Program Staff, and the Administrative Office.

1113.(10)1 Planning and Program Staff

The Planning and Program Staff is the principal advisor to the Assistant Commissioner (Stabilization) for insuring maximum use of Stabilization resources through planning for and evaluating the utilization of these resources. Also coordinates matters affecting all Divisions of Stabilization, provides liaison with the Cost of Living Council, and consults with IRS functional officials in manpower or program issues which bear on Stabilization operations. In matters involving resources, this staff develops and monitors, in cooperation with other offices and the Cost of Living Council, long-range goals; estimates resource needs and prepares financial plans and recommends dollar and manpower resource allocations for all Stabilization activities based upon projected workload; monitors the execution of Stabilization manpower and financial resources; assesses the resource impact of current program and proposed program changes; and works with other National Office activities on manpower allocations. Develops organization, staffing, and position management control guidelines and coordinates all personnel management actions having Servicewide impact. Spearheads in-depth analyses of district and regional office operations, and effectiveness of Stabilization areas, and provides the A/C (Stabilization) with data to meet his needs for NORP participation as well as for on-going management appraisals and decisions. Assesses program accomplishments, trends, or developments of specific interest to the Assistant Commissioner. Coordinates with Internal Audit a program for obtaining additional data relevant to an evaluation of Stabilization program management. Provides recurring and other special reports to Deputy Commissioner, Commissioner, and the Cost of Living Council. Is the principal liaison with Stabilization field offices and provides assistance to the field on matters involving several divisions and represents the Assistant Commissioner at field conferences. Analyzes the biweekly field reports and coordinates for the Assistant Commissioner, division responses to field requests for corrective action and is responsible for identifying field problems and providing assistance when field problems arise as a result of unclear procedures, conflicting instructions, or lack of definitive policy interpretations. Coordinates with Public Affairs Division in developing an effective public information program for Stabilization.

1113.(10)2 Administrative Office

Plans, organizes, coordinates, and directs the administrative management activities of the Office of Assistant Commissioner (Stabilization) at the National level, assisting and collaborating with Division Directors in providing personnel, space management, duplication, supply, and other administrative services.

1113.(10)3 Technical Programs Division

Serves as the organization responsible for activities relating to the processing of price prenotifications, price increase reports, quarterly financial reports, merchandise pricing plans, exceptions, reconsiderations and other documents required to be filed in accordance with Economic Stabilization Regulations. It is also responsible for providing technical and interpretive advice and assistance to the IRS Stabilization Program and to the public.

Develops programs on and exercises functional supervision over Servicewide Economic Stabilization activities involving the processing of price prenotification, price increase reports,

quarterly financial reports, merchandise pricing plans, exceptions, reconsiderations and other documents required to be filed in accordance with Economic Stabilization Regulations. Develops procedures and assists field offices to assure uniformity and consistency of decisions; provides advice to field offices on case-related matters; reviews and approves proposed actions recommended by district offices in certain specific cases. For consistency of decisions, recommends appropriate action, and transmits decisions to district offices; reviews field office case processing to discern trends and precedents; identifies problem areas of nationwide concern, for consideration by the Cost of Living Council; identifies the need for, and recommends to the Cost of Living Council delegations of authority to the Internal Revenue Service; develops management information to be used to keep Internal Revenue Service management and the Cost of Living Council apprised of price prenotifications, merchandise pricing plans, exceptions and reconsiderations program execution. Provides technical and general information to the public; develops or reviews all Stabilization forms and publications; reviews proposed regulations and rulings; furnishes interpretive support to other organizational components of the Assistant Commissioner (Stabilization), serves as the liaison with other Federal, State, and local government agencies and with private or public interest groups. Provides technical assistance to the field and assures program uniformity.

The Director is responsible for and supervises the activities of three Branches: Interpretations Branch, Price Analysis Branch and Publications and Guidance Materials Branch. The Director also serves as Deputy Assistant Commissioner (Stabilization).

1113.(10)31 Interpretations Branch

Serves as the organization responsible for providing technical and interpretive advice and assistance to the IRS Stabilization Program.

Receives, comments on the reviews for administrative feasibility and adequacy Cost of Living Council drafts of regulations; reviews documents, questions and answers, news releases, forms and other publications to ensure technical accuracy; advises on Stabilization disclosure matters, testimony instructions, and release of Stabilization information as requested under the Freedom of Information Act; serves as contact point for all field technical problems; promotes and conducts institutes and conferences designed to foster voluntary compliance; exercises functional responsibility for programs concerning walk-in and telephone requests for public service or assistance, written inquiries, and other requests of a service nature performed in the field; provides assistance and guidance to the field in implementing, monitoring, and evaluating technical and service programs; coordinates activities of the Local Service and Compliance Centers with the Office of the Assistant Commissioner (ACTS).

1113.(10)32 Price Analysis Branch

Plans, directs and exercises functional supervision over field office activities relating to the processing of price prenotifications, price increase reports, quarterly financial reports, merchandise pricing plans, exceptions, reconsiderations and other documents required to be filed in accordance with Economic Stabilization Regulations. Develops procedures and assists field offices to assure uniformity and consistency of decisions; provides advice to field offices on case-related matters; reviews and approve proposed actions recommended by district offices in certain specific cases. For consistency of decisions, recommends appropriate action, and transmits decisions to district offices; reviews field office case processing to discern trends and precedents; identifies problem areas of nationwide concern, for consideration by the Cost of Living Council; identifies the need for, and recommends to the Cost of Living Council delegations of authority to the Internal Revenue Service; develops management information to be used to keep Internal Revenue Service management and the Cost of Living Council apprised of price prenotifications, merchandise pricing plans, exceptions and reconsiderations program execution.

1113.(10)33 Publications and Guidance Materials Branch

Develops publications and guidance material procedures for field and National Office use. Determines the content, directs the compilations, and reviews the Stabilization Program Guidelines (SPG) Service. Develops plain language publications and educational material used to inform Service employees and the public of substantive and procedural matters. Translates selected publications into Spanish for use in the Spanish-speaking communities. Identifies need for and develops publications independently and at the request of the Cost of Living Council; distributes publications throughout the country to appropriate business firms, associations, and other professional organizations. Plans, coordinates, and provides editorial support for publication of forms and form letters; reviews, for administrative feasibility, consistency, and adequacy, all proposed Cost of Living Council public-use forms. Coordinates the presentation and clearance of Stabilization material for the IR Manual. Operates a correspondence unit that serves as the National Office clearing and routing center for all public and Congressional correspondence relating to Stabilization matters; maintains liaison with the Cost of Living Council concerning Congressional inquiries to the field; and maintains adequate records.

1113.(10)4 Compliance and Enforcement Division

In matters involving compliance and enforcement activities under the Phase IV Economic Stabilization regulations, this division: develops and exercises functional supervision of nationwide and local investigative and industry monitoring programs as directed by the Cost of Living Council or initiated by IRS; designs, implements, and reports on CLC-directed pay or price investigations of firms; designs, implements, and reports on CLC-directed pay or price fact-finding surveys for industries, both in the controlled and uncontrolled sectors; designs, implements and reports on IRS locally initiated pay or price investigations for firms in controlled industries; develops and exercises functional supervision of nationwide and local enforcement activities as authorized and directed by CLC; designs, implements and reports analysis of economic developments and trends within broad industry groupings as received from field offices and nationally-gathered providing same to CLC as leads for enforcement and compliance action; engages in other special projects deemed appropriate by CLC and IRS; coordinates investigations involving several districts or regions; provides guidance to certain districts which have operational responsibility for conducting such investigations; informs and reports to CLC on investigation and analysis progress and status; designs and engages in a program of handling citizen complaints of violations of the ESP regulations; coordinates activities with other Stabilization organizational elements; and maintains adequate records. The Director is responsible for and supervises the activities of four branches: Compliance Investigations Branch, Case Control and Reports Branch, Industry Survey and Analysis Branch and Pay Branch.

1113.(10)41 Compliance Investigations Branch

In matters involving compliance administration, this branch: formulates policy and programs involving compliance with the Economic Stabilization Act; designs, initiates, and reports on nationwide and local Cost of Living Council directed price investigations; assists Cost of Living Council in formulating, implementing, monitoring and evaluating audit specifications and procedures, informs Cost of Living Council as to case progress and status; provides assistance and guidance to the field in implementing investigations; coordinates investigations involving several districts or regions; coordinates activities with other Stabilization organization elements and maintains adequate records.

1113.(10)42 Industry Survey and Analysis Branch

In matters involving the survey and analysis of industries, this branch: conducts Cost of Living Council directed price fact-finding surveys of industries; conducts CLC—and IRS-assigned special projects and analysis; engages in special economic analysis and targeting to monitor, analyze and present findings relating to on-going industry surveys where indicated with results and findings given to CLC for action and follow-up authority; maintains a program of nationwide information-gathering on economic developments and trends within broad industry groups by receiving, processing and analyzing information received from field offices, providing information to the CLC as leads for enforcement and compliance action; informs the CLC as to monitoring progress and status; provides assistance and guidance to the field in implementing and evaluating information-monitoring programs; drafts procedures for field information-monitoring programs; coordinates activities with other Stabilization organizational elements; coordinates monitoring operations which are of nationwide significance or involve several districts, and maintains adequate records.

1113.(10)43 Pay Branch

In matters of wage and pay investigations and surveys for both the controlled and uncontrolled industry sectors of the economy, this branch: designs, implements, monitors, evaluates and reports on CLC-directed nationwide pay investigations; designs, implements, evaluates and reports on CLC-directed pay fact-finding surveys and monitoring of nationwide wage and pay matters in the uncontrolled sector; manages and controls wage and pay investigations, surveys and programs; informs the Cost of Living Council as to case progress and status; coordinates activities with other Stabilization organizational elements; coordinates investigations which are of nationwide significance or involve several districts, and maintains adequate records.

1113.(10)44 Case Control and Reports Branch

Designs, develops, installs, monitors, and evaluates reporting systems for the Office of Assistant Commissioner (Stabilization) in coordination with the Cost of Living Council. Consults and participates in the design and development of other Stabilization information systems. Develops statistical indicators to evaluate operations in a particular program area or element in order to identify significant trends. Provides an advisory service to the A/C Stabilization by identifying significant happenings, developing trends, identifying possible trouble areas and forecasting conditions within the Stabilization Program. Develops and monitors, in cooperation with CLC, an interactive computer/remove terminal management information system. Provides computer output reports to IRS/ESP. Provides CLC with manual reports not on the data base. Identifies and fulfills training needs

for remote terminal operators in 29 key districts. Provides a nationwide net of telecommunications and facsimile transmission facilities for the ESP. Provides an automated Case Control system for monitoring directed investigations. Coordinates and develops specifications for Stabilization's IRS data processing requirements. Provides records management for Stabilization. Maintains adequate records and controls.

1113.(11) Office of the Chief Counsel

The Chief Counsel, an Assistant General Counsel of the Treasury Department, serves as a member of the Commissioner's executive staff and as counsel and legal officer to the Commissioner on all matters pertaining to the administration and enforcement of the internal revenue laws and related statutes, and on all legal matters pertaining to the Service's economic stabilization activities. The key officials under his supervision are: Deputy Chief Counsels, Associate Chief Counsel (Litigation), Associate Chief Counsel (Technical), Staff Assistants, Technical Advisors, Special Assistants, Director of the Operations and Planning Division, and Regional Counsel.

1113.(11)1 Deputy Chief Counsels

The two Deputy Chief Counsels act for and represent the Chief Counsel in the development of policies governing the Office of the Chief Counsel, and assist the Chief Counsel in the formulation of tax litigation policy and the interpretation and development of the internal revenue laws.

1113.(11)2 Associate Chief Counsel (Litigation)

Plans, directs, coordinates and controls the policies and programs pertaining to Tax Court Litigation; Criminal Tax; General Litigation; and Refund Litigation work.

1113.(11)21 Tax Court Litigation Division

The Tax Court Litigation Division develops policies, programs, and procedures relating to the disposition of tax cases pending in the United States Tax Court; supervises and coordinates the defense and settlement and the processing and handling of such cases, including preparation of pleadings, recomputations and other documents filed with the Tax Court together with hearings thereon to assure uniform treatment; coordinates and reviews Tax Court matters prepared in the Regional Offices; including the rendering of technical advice to the field offices, the approval of Chief Counsel's Decisions, the review of briefs to be filed with the Tax Court and recommendations of field offices for acquiescence or non-acquiescence in adverse Tax Court decisions; prepares recommendations to the Department of Justice for the Commissioner's appeals to the Courts of Appeals and prepares petitions and records on review in such cases; makes recommendations to that Department regarding offers in compromise or settlement and prepares recommendations for or against filing petitions for writs of certiorari to the Supreme Court in such cases. It supervises the preparation and trial of cases assigned to, and handled by, attorneys in the Trial Branch.

1113.(11)22 Criminal Tax Division

The Criminal Tax Division handles and prepares for final decision those criminal tax cases referred to the Chief Counsel by Regional Counsel or by the National Office. It considers cases in which the Regional Commissioner and the Director of the Intelligence Division of the Office of the Assistant Commissioner (Compliance) do not concur in recommendations of Regional Counsel involving prosecution. The Division prepares acquiescence memorandums or protest letters on decisions by the Department of Justice or United States Attorneys against prosecution and recommendations to the Department of Justice respecting appeals of court decisions in criminal tax cases. It also prepares law opinions in cases involving penalties or other legal questions with respect to criminal cases or investigations or with respect to the disclosure of information. The Division coordinates with the Department of Justice or interested branches of the Service any questions involving investigations or actions respecting the civil aspects of pending criminal cases.

1113.(11)23 General Litigation Division

The General Litigation Division supervises and coordinates legal work of Regional Counsel on collection litigation matters. It reviews certain offers in compromise (except those concerning alcohol, tobacco, and firearms taxes). It prepares advisory opinions on collection litigation matters. The Division prepares and reviews recommendations to the Department of Justice concerning certiorari, appeal and petition for review in relation to all collection litigation cases. It handles certain legal work for the Director of International Operations. The General Litigation Division prepares and reviews recommendations to the Department of Justice concerning the defense of injunction actions to restrain the assessment or collection of federal taxes; offers in settlement; the waiver or release of a right to redeem under 28 U.S.C. 2410; and suits for the civil enforcement of summonses. Similarly, the Division considers recommendations that the Commissioner authorize or sanction affirmative action in insolvency cases (including decendents' estate proceedings), suits for foreclosure of mortgages or other liens and suits to quiet title where the United States is named as a party defendant, cases involving appointment of a receiver in aid of foreclosure of Federal tax liens, and suits for the collection of taxes.

1113.(11)24
Refund Litigation Division

The Refund Litigation Division performs all necessary legal service on behalf of the Internal Revenue Service in connection with taxpayers' suits for refund of taxes (except alcohol and tobacco taxes). It determines and coordinates the legal position of the Service in such suits and incorporates such determinations in recommendations to the Department of Justice with respect to the defense of such suits, the acceptance or rejection of settlement proposals and appeals and petitions for certiorari from adverse court decisions. The Division performs all necessary legal services on behalf of the Service in connection with all civil litigation affecting the Service and not within the responsibility of any other Division.

1113.(11)3
Associate Chief Counsel (Technical)

Plans, directs, coordinates and controls the policies and programs pertaining to Legislation and Regulations, and Interpretative work.

1113.(11)31
Legislation and Regulations Division

The Legislation and Regulations Division has the basic responsibility for representing the Internal Revenue Service in connection with legislation affecting the various internal revenue taxes and for the preparation of regulations required to be issued in connection with those taxes, except for taxes relating to alcohol, tobacco, and certain firearms. In discharging this responsibility, the Division: participates in the development and drafting of new and amendatory internal revenue legislation and in connection therewith furnishes required technical assistance; prepares new and revised regulations; prepares reports on private and public bills; prepares news and information releases relating to regulations; prepares responses to correspondence concerning legislation and regulations from the Congress and the public; and, in developing regulations, arranges and conducts public hearings and meetings with taxpayers and their representatives and with professional and industry groups. The Division prepares Executive orders and related papers authorizing the inspection of tax returns, and reviews and prepares amendments to the Statement of Procedural Rules. The Division represents the Internal Revenue Service with respect to the negotiation and drafting of tax treaties with foreign countries and the preparation of the necessary implementing regulations.

1113.(11)32
Interpretative Division

The Interpretative Division reviews as to form and legality interpretations of internal revenue statutes and regulations and other law and legal materials bearing upon the administration of the Internal Revenue Service except those relating to alcohol, tobacco, and firearms matters; criminal tax investigations and prosecutions; lien and collection matters, including those involving bankruptcies, receiverships and other insolvencies; administrative matters; disclosure matters; and summons enforcement matters. The Division prepares formal opinions of the Chief Counsel in assisting him in carrying out his functions as legal advisor to the Commissioner in the technical area. The Division is also responsible for the legal review of closing agreements.

1113.(11)4
Operations and Planning Division

Operations and Planning Division is responsible for all law work in the Internal Revenue Service other than substantive tax law work; at the direction of the Chief Counsel performs special assignments of a technical nature in substantive tax law. The Division serves as the principal legal advisor to the Assistant Commissioner (Administration), the Assistant Commissioner (Accounts, Collection, and Taxpayer Service) and the Assistant Commissioner (Inspection). The Division is responsible for the supervision and coordination of all legal management work of the Chief Counsel's Office (National Office and all field offices); establishes and maintains appropriate standards of professional competence by members of the legal staff of the Office and evaluates their legal competence; analyzes the workload of the Office, and determines the distribution of personnel available to handle the workload. The Division is responsible for the general supervision of all matters relating to administration and management in the Office of the Chief Counsel. Reviews and prepares for action enrollee and disbarment cases referred to the Chief Counsel by the Director of Practice, and represents the latter in the trial of cases before Hearing Examiners.

1114
Office of Regional Commissioner

1114.1
Mission

The mission of the Office of Regional Commissioner is to execute the broad nationwide policies and programs for the administration of the internal revenue laws, to carry out appellate programs at the regional level, and direct and coordinate the functions and activities of the District Offices within the region.

1114.2
Basic Organization

The principal organization components of the typical Office of the Regional Commissioner are the immediate Office of the Regional Commissioner, the Administration Division, the Appellate Division, the Audit Division, the Accounts, Collection, and Taxpayer Service Division, the Intelligence Division, and the Stabilization Division. An Assistant Regional Commissioner heads each division.

1114.3
Regional Commissioner

The Regional Commissioner administers within an assigned regional area the accounts, collection, and taxpayer service; audit; intelligence; appellate; economic stabilization; and administration programs of the Internal Revenue Service. He carries out Service policies and programs in conformity with delegations of authority and, in this connection, establishes regional standards and programs to assure proper and effective implementation of Service-wide policies and programs within his region. The Regional Commissioner supervises and coordinates the work of the staff of the Regional Office and the District Directors within his region to assure that work is processed in an orderly and timely manner, and that proper and equable emphasis is placed and directed toward the accomplishment of current program objectives. As the principal field official, he evaluates the effectiveness of Service policies and programs, and advises the National Office as to the need for revising such policies and programs to bring about improved operations or service.

1114.4
Assistant Regional Commissioner (Administration)

The Assistant Regional Commissioner (Administration) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the administration activities of the Service under the jurisdiction of the Regional Commissioner to ensure that administration policies and programs are properly executed. In conformity with administration policies, and programs established by the National Office, he develops regional standards and other measures necessary to implement most effectively the administration program of the Service which includes budget and fiscal management, personnel administration, training, public information, property and records management, use of facilities, printing and reproduction, and reports management. He also coordinates organization planning and advises and makes recommendations to the Regional Commissioner thereon; and furnishes guidance for and coordinates management programs. He provides the Regional Commissioner with results of evaluations and other information upon which to base his administration of the regional administration programs and recommends improvements and adjustments therein needed to bring about and sustain a high level of performance in administration activities within the region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of administration policies, programs, procedures and standards in terms of regional and district requirements, provides reports and factual information upon which the National Office can base administration policy and program considerations, and recommends appropriate action with respect to problems encountered in observing and evaluating administration operations. Within the limits of his delegated authority, he provides the Regional Counsel and Regional Inspector with such administrative services as they may require in the performance of their duties. He is responsible for and supervises the activities of four branches: Facilities Management Branch, Fiscal Management Branch, Personnel Branch, and Training and Development Branch.

1114.41
Facilities Management Branch

The Facilities Management Branch coordinates, evaluates and carries out region-wide programs for providing essential support activities designed to increase the effectiveness of the region, reduce its operating costs and improve taxpayer relations. Develops, within the broad guidelines established by the National Office, standards and procedures for such matters as the management of paperwork; space; property and supply; procurement and contracts; production, storage, and distribution of forms and publications initiated within the region and distribution and requirements of National Office forms and publications; emergency planning for civil defense; fire and safety, document and property security; and processes all claims arising within the region under the Federal Tort Claims Act.

1114.42
Fiscal Management Branch

The Fiscal Management Branch performs, coordinates and evaluates budgeting, administrative accounting and financial reporting (other than for revenue collections) for the region, including the preparation of the financial plan within over-all budget limitations, submission of budget data, allotment of funds, maintenance of accounts, and examination of vouchers. This Branch participates in long-range planning involving expenditures for personnel, equipment, administrative services, space and similar items.

1114.43
Personnel Branch

The Personnel Branch develops and evaluates the regional personnel program and standards relating to recruitment and selection, employee relations, disciplinary actions, performance, evaluation, promotions, in-service placements, incentive awards, records, reports and other aspects of a complete personnel program, within the frame work of Service policies, programs and procedures established by the National Office, and conducts the personnel program for the Regional Office. It conducts the position classification program for the region. The Branch represents the region in contacts with employee groups and the Regional Directors of the Civil Service Commission.

1114.44
Training and Development Branch

The Training and Development

Branch is responsible for the administration, conduct, and evaluation of all the Region's Servicewide courses and for providing functional guidance, support, and coordination to local training. These programs include initial orientation, technical training, instructor training, supervisory and managerial training, career development programs, on-the-job and refresher training, and taxpayer education programs. The Branch is responsible for the Regional organizational development program, the planned, systematic approach to equipping Service managers to anticipate, identify, and, through the use of tested techniques such as "team building," overcome the obstacles to effective organizational operation. The Branch is also responsible for the operation of the Regional Training Center(s). Where the Center is not in the proximity of the Regional Office site, a Training Center Officer, under the direction of the Regional Training Officer, supervises its day-to-day operation. The Branch also provides training assistance to State and local government agencies.

1114.5
Assistant Regional Commissioner (Appellate)

The Assistant Regional Commissioner (Appellate) acts as the principal assistant to the Regional Commissioner in planning, directing, coordinating and evaluating the appellate activities of the Service under the jurisdiction of the Regional Commissioner within the framework of Service policies and programs established by the National Office. He is responsible to the Regional Commissioner for a program of hearing and undertaking final settlement of taxpayers' appeals from determinations of tax liability made by District Directors within the region, involving income, profits, estate, gift, and employment taxes, and excise taxes except those imposed on alcohol, wagering, narcotics, firearms, and tobacco; and for a program of hearing and, with concurrence of Regional Counsel, undertaking final settlement of certain cases docketed in the United States Tax Court. His program includes preparing reports to the Joint Committee on Internal Revenue Taxation in Appellate cases involving overpayments in excess of $100,000, and hearing administrative appeals in offer in compromise cases. In the foregoing programs, he represents the Regional Commissioner and exercises authority under delegation of authority from the Commissioner of Internal Revenue. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of appellate policies, programs, procedures, and standards in terms of regional requirements, provides reports and factual information upon which the National Office can base appellate policy and program considerations, and recommends action with respect to problems encountered in Appellate operations. He supervises the activities of all Appellate branch offices in the region.

1114.51
Appellate Branch Offices

The basic settlement work of the Appellate Division is performed in branch offices of the Division which are headed by Chiefs who report to the Assistant Regional Commissioner (Appellate). Chiefs, Appellate Branch Office, may also supervise sub-offices administered by an Assistant Chief or local representative of the Chief. The branch offices hold conferences and make final determinations, within the limits of their delegated authority, on cases involving income, profits, estate, gift, and employment taxes and excise taxes, except those imposed on alcohol, wagering, narcotics, firearms and tobacco, in which taxpayers have requested Appellate consideration. The branch offices prepare reports to the Joint Committee on Internal Revenue Taxation in protested and petitioned cases which involve overpayments in excess of $100,000, and also consider protested offers in compromise. Branch offices, under delegated authority, enter into closing agreements under IRC 7121 in cases under their jurisdiction.

1114.6
Assistant Regional Commissioner (Audit)

The Assistant Regional Commissioner (Audit) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the audit activities of the Service under the jurisdiction of the Regional Commissioner to ensure that policies and programs are properly executed, that audit work is processed in an orderly and timely manner, that equal emphasis is placed and uniform effort directed toward the accomplishment of the current audit program objectives, and that required standards for audit uniformity are being maintained. In conformity with audit policies, and programs established by the National Office, he develops regional programs, standards, and other measures necessary to implement most effectively the audit program of the Service which includes the selection of returns for audit, their examination and investigation, the determination of tax liabilities and penalties where applicable, a regional review of selected district office cases and the administrative disposition of offers in compromise by district Audit Divisions. He provides the Regional Commissioner with results of evaluation and other information upon which to base his administration of the regional audit program and recommends improvements and adjustments in audit operations needed to bring about and sustain a high level of performance within the region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of policies, programs, procedures and standards in terms of regional and district requirements, pro-

vides reports and factual information upon which the National Office can base policy and program considerations, and recommends appropriate action with respect to problems encountered in observing and evaluating audit operations.

1114.7
Assistant Regional Commissioner (Accounts, Collection, and Taxpayer Service)

The Assistant Regional Commissioner (Accounts, Collection, and Taxpayer Service) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the returns processing (except wagering, alcohol and tobacco tax, and firearms returns and applications), data processing, revenue accounting, collecting of delinquent accounts, securing delinquent returns, and taxpayer service activities under the jurisdiction of the Regional Commissioner to ensure that the policies and programs established by the National Office are timely and properly executed and that equal emphasis is placed and uniform effort directed toward the accomplishment of the accounts, collection and taxpayer service program objectives. He exercises line supervision over those activities at the Regional Office and functional supervision over related activities in the Service Center(s) and District Officers within the region. He provides the Regional Commissioner with results of evaluations and other information upon which to base his administration of these programs and recommends improvements and adjustments needed to bring about and sustain a high level of performance within the region. Under the Regional Commissioner, he serves as the primary source of information to the National Office as to the effectiveness of the accounts, collection and taxpayer service policies, programs, procedures and standards in terms of factual information upon which the National Office can base accounts, collection and taxpayer service policy and program considerations and recommends appropriate action with respect to problems encountered in observing and evaluating these activities.

1114.8
Assistant Regional Commissioner (Intelligence)

The Assistant Regional Commissioner (Intelligence) acts as the principal assistant to the Regional Commissioner in planning, coordinating and evaluating the intelligence activities of the Service under the jurisdiction of the Regional Commissioner to ensure that policies and programs are properly executed, and that the intelligence work is processed in an orderly and timely manner. In conformity with intelligence policies, and programs, established by the National Office, he develops regional programs, standards and other measures necessary to implement most effectively the intelligence program of the Service which includes the investigation of alleged tax fraud, certain other civil and alleged criminal violations of tax laws (except alcohol, tobacco and certain firearms tax cases), and such other special investigations as the Commissioner may direct. He provides the Regional Commissioner with results of evaluations and other information upon which to base his administration of the regional intelligence program and recommends improvements and adjustments in the intelligence operations needed to bring about and sustain a high level of performance within the region. Under the Regional Commissioner he serves as the primary source of information to the National Office as to the effectiveness of intelligence policies, programs, procedures and standards in terms of regional and district requirements, provides reports and factual information upon which the National Office can base intelligence policy and program considerations and recommends appropriate action with respect to problems encountered in observing and evaluating intelligence operations.

1114.81
Management and Evaluation Staff

Exercises primary responsibility for the adequacy of district program content and effectiveness of management of Service resources in each district; evaluates costs and benefits of achieving program objectives; develops and maintains statistical indicators of management effectiveness; identifies required changes in program operations through program reviews in districts and assists in redirecting needed emphases in program goals and operations; assists districts in evaluation of personnel; conducts workload analyses to determine proper balance of staffing and other resource requirements; evaluates case selection and management methods together with quality control practices; analyzes effectiveness of publicity concerning Intelligence matters; maintains mutually productive working relationships with members of the National Office, Service Center, and other offices regarding potential fraud situations; communicates information on all significant program and management developments; prepares narrative reports; and works on special projects and assignments.

1114.82
Operations and Technical Assistance Staff

Responsible for all general and special enforcement operational activities consisting of broad impact programs and objectives directed toward criminal violations of tax laws. Provides advice and assistance to district officials in the overall planning and execution of district Intelligence investigative programs, including determination of priorities and resource requirements; coordinates program operations with representatives of other IRS organizational segments and Department of Justice; evaluates and disseminates information and data to the districts, received from the National Office or other governmental agencies etc., relating to known or

potential subjects of Intelligence enforcement efforts; identifies sensitive and significant situations; prepares reports on significant matters to be brought to the attention of the Regional Commissioner or National Office; coordinates special investigations, case development efforts and projects which involve two or more districts; assists districts in establishing and perfecting control practices and procedures with Service Centers and advising district officials regarding the application of data processing techniques to investigative problems. Provides technical guidance on case matters; conducts post review programs in each district; analyzes supplemental requests and Criminal Action Memorandums; identifies technical training needs and participates in development of training programs; conducts refresher training programs and participates in fraud training programs; coordinates case matters with Counsel and Department of Justice; prepares protests on CAM actions; provides technical advice on complex case matters; develops new procedures and investigative approaches; makes annual evaluations of case inventories; reviews cases closed for insufficient resources; identifies indicators of potential case management selection weaknesses critiques investigations in terms of case selection standards and investigative quality; assists districts in evaluating fraud referral program effectiveness and improving quality of investigations and reports.

1114.9
Assistant Regional Commissioner (Stabilization)

The Assistant Regional Commissioner (Stabilization) acts as principal assistant to the Regional Commissioner in planning, directing, coordinating and evaluating the Stabilization activities under the jurisdiction of the Regional Commissioner within the framework of Service policies and programs established by the National Office. He is responsible to the Regional Commissioner for developing programs, standards and other measures necessary to implement most effectively the Stabilization Program of the Service which includes, but is not limited to, responding to inquiries from the public; disseminating information to the public; analyzing and issuing decisions upon application for exceptions and appeals; conducting investigations; resolving by obtaining compliance, where possible, complaints of violations of the Economic Stabilization Program, and recommending enforcement action when necessary; assuring proper allocation and utilization of manpower and resources; and maintaining adequate records and making periodic reports to the Assistant Commissioner (Stabilization).

1115
Office of Regional Inspector

There are 7 Regional Inspectors, one in each internal revenue region. The Regional Inspector, who operates under the direct supervision of the Assistant Commissioner (Inspection), is responsible for the conduct throughout the region of both the internal audit and internal security programs.

1115.1
Assistant Regional Inspector (Internal Audit)

Under the supervision of the Regional Inspector, the Assistant Regional Inspector (Internal Audit) is responsible for the conduct of the internal audit program throughout the region. The internal audit, which includes verification of financial transactions and analyses of operating practices and procedures, serves as the basis for informing appropriate officials of the manner in which operations are being carried out and responsibilities are being discharged as a basis for necessary changes in policies, practices and procedures.

1115.2
Assistant Regional Inspector (Internal Security)

The Assistant Regional Inspector (Internal Security) is responsible for the conduct of the Internal Security program throughout the region. The program, which provides a factual basis for conclusions by management, the Department of Justice or other authority for making decisions, includes personnel background investigations, investigations of complaints and allegations of misconduct or irregularities concerning Service employees and actions of non-Service persons that may affect the integrity of the Service or safety of Service employees, including attempts to bribe or otherwise corrupt Service personnel; this authority includes investigation of attempts to interfere with administration of Internal Revenue laws through threats, assaults or forcible interference and also the unauthorized disclosure of Federal tax information. The program also includes background investigations of certain applicants for enrollment to practice before the Internal Revenue Service, investigations of charges against tax practitioners, formal investigations of accidents involving Service employees or property, and investigations of alleged discrimination because of race, creed, color, or national origin. In addition, he is responsible throughout the region for the conduct of special investigations as directed by higher authority, for the Office of the Secretary and other components of the Treasury Department.

1116
Office of Regional Counsel

(1) There are 7 Regional Counsels, one in each Internal Revenue region. The Regional Counsel, who operates under the Chief Counsel for the Internal Revenue Service, serves as the principal legal advisor to the Regional Commissioner, the Regional Inspector, and the District Directors of Internal Revenue and their staffs.

The Regional Counsel, subject to the Chief Counsel's continuing general supervision and review where appropriate or necessary, directs and supervises a staff of attorneys engaged in processing and handling cases docketed in the United States Tax Court and in furnishing legal advice and performing legal services connected with the tax court, enforcement, and general litigation functions.

(2) Tax Court Litigation Matters —The Regional Counsel's office furnishes legal advice to the Assistant Regional Commissioner (Appellate); in the name of the Chief Counsel, represents the Commission in the trial of cases before the Tax Court and is responsible for the preparation of pleadings, stipulations, and other documents to be filed with the Tax Court on behalf of the Commissioner prior to the entry of a decision by the Court; makes recommendations to the Chief Counsel respecting adverse Tax Court decisions; considers and approves or disapproves the settlement of cases docketed in the Tax Court, subject to the concurrence of Appellate while such cases are in presession status; considers and concurs in, or disapproves, recommendations by Appellate to eliminate the ad valorem fraud penalties in cases not docketed in the Tax Court; and considers and reviews, prior to issuance, statutory notices of deficiency or liability proposed by Appellate, and certain of such notices proposed by the District Directors.

(3) Enforcement Matters — The Regional Counsel's office is responsible for the performance of legal services in the field in connection with criminal cases arising under the internal revenue laws. The office reviews recommendations of prosecution in criminal cases received in the field, and prepares and refers such cases (other than alcohol and tobacco tax cases) to the Department of Justice or, where authorized by the Department of Justice, directly to United States Attorneys, or, where prosecution is not deemed warranted, prepares criminal action memoranda setting forth the reasons against the prosecution and closes such cases with the concurrence of the Assistant Regional Commissioner (Intelligence). On request, the office furnishes aid and assistance to United States Attorneys in criminal tax proceedings in the United States District Courts and Courts of Appeal.

(4) General Litigation Matters—The Regional Counsel's office is responsible for handling legal work with respect to cases under the Bankruptcy Act and other insolvency cases including decedents' estate proceedings; Federal tax liens in suits for foreclosure by mortgagees or other lienholders and in suits to quiet title; applications filed for the discharge of property from Federal tax liens or for the release of such liens; for review and handling of certain offers in compromise; recommendations as to the taking of affirmative action, whether by way of a separate suit or intervention in pending proceedings (with the exception of alcohol, tobacco and firearms matters not relating to proceedings under the Bankruptcy Act, liens, receiverships and other insolvencies); the defense of injunction suits to restrain the assessment or collection of Federal taxes (except with respect to alcohol, tobacco and firearms matters); the assessment and collection of taxes; and of the civil enforcement of summonses.

(5) Stabilization Matters—The Assistant Regional Counsel (Stabilization) is responsible for providing interpretative advice and guidance concerning the rulings and regulations issued by the Pay Board and the Price Commission to the Office of Assistant Regional Commissioner (Stabilization) and answering specific legal questions concerning stabilization matters that may be presented. Also, provides functional support to Regional Counsel's Branch Offices that may be requested to furnish legal advice at the Service's District Director level. In addition, this Office is responsible for the review of litigation cases, involving violations of Pay Board's or Price Commission's regulations or rulings, that are developed at the District Director level by Service personnel and Department of Justice attorneys, and after such review forwarding the cases with appropriate recommendations through the Regional Counsel to the General Counsel of either the Pay Board, or Price Commission for possible litigation action by the Department of Justice, and at the same time reports of potential litigation will be forwarded to the Chief Counsel's National Office Stabilization Division.

1117 Service Centers

1117.1 General

(1) There are 10 Internal Revenue Service Centers located at: Andover, Massachusetts; Austin, Texas; Brookhaven, New York; Chamblee, Georgia; Covington, Kentucky; Fresno, California; Kansas City Missouri; Memphis, Tennessee; Ogden, Utah; and Philadelphia, Pennsylvania. Each Service Center is under the line supervision of the Regional Commissioner having jurisdiction over the area of their location.

(2) Each Service Center is headed by a Director who operates under the general direction of a Regional Commissioner. The Service Center Director is responsible to the National Office, through the Regional Commissioner, for implementing the programs assigned to the Center. He is responsible for budget, fiscal, and personnel operations of the Center under directives of the Regional Commissioner. He also participates with the National Office, through the Regional Commissioner, in planning, coordinating, and evaluating experimental projects to develop improved techniques and methods for processing tax returns. The Regional Commissioner, in turn, is responsible to the National Office for supervising the execution of the Service Center's

program and for recommending adjustments to or modifications of the program. The Regional Commissioner also exercises general supervision over the activities of the Service Center Director in coordinating and maintaining liaison with Regional Commissioners, District Directors, and the Natonal Office in carrying out the programs prescribed for the Centers by the National Office.

1117.2
Service Center Organization

1117.21
General

(1) The principal organizational components of the typical Service Center are the immediate office of the Service Center Director, Management Staff, Administration Division, Audit Division, Data Conversion and Accounting Division, Processing Division, and Taxpayer Service Division.

(2) The organizational structure depicted is intended to prescribe the Service Center organization through the branch level. Regional Commissioners are authorized to establish the Service Center organization below branch level as they see fit.

1117.22
Office of the Director

Within the structure of the Internal Revenue Service, the Internal Revenue Service Center has organizational status comparable to that of the District Offices. It operates under the line supervision of the Service Center Director, who is responsible to the Regional Commissioner in the same manner as a District Director. The Director plans, directs, and administers functions of the Internal Revenue Service Center which provides services for the region(s). Its functions are to process tax returns and related documents through the use of automatic and manual data processing systems and high-speed processing devices and to maintain accountability records for internal revenue taxes collected within the region. Typical programs include the processing, analysis, and accouning control of income tax returns, estimated tax returns, wages and excise tax returns, corporation tax returns, income information documents, and mailing of income tax forms to indivdiual taxpayers. The Director also plans, directs, and administers assigned Audit functions. Responsible for budget, fiscal and personnel operations of the Service Center. In addition, the Philadelphia Service Center assists the Assistant Commissioner (Compliance) in the exchange of authorized routine information with foreign countries having tax treaties with the United States.

1117.221
Management Staff

Provides staff assistance to the Director and line officials in the general management of Service Center operations. Assists by coordinating the preparation of work plans, work schedules, staffing and accession schedules. Monitors the Work Planning and Control System and maintains the daily production control system. As requested, provides assistance in analyzing day-to-day problems concerning systems and procedures. Monitors and coordinates various projects, particularly those in the implementation stage such as IDRS, RMF, and Returns Preparer Program. Coordinates the consolidation and referral of problems to the Regional or National Office. Monitors the Statistics of Income sampling and the Quality Review Program.

1117.23
Intelligence Staff

Advises the Service Center Director in matters relating to the Intelligence function; presents Intelligence objectives to Service Center personnel and assists in training them in characteristics of false and fraudulent returns and other potential criminal violations. Provides liaison between district and regional officials with the Service Center; devises procedures for the most expeditious manner of obtaining returns and transcripts for district officials and establishes guidelines and criteria for the selection of returns to be reviewed. Also provides assistance to district offices in locating addresses of taxpayers and/or witnesses. Evaluates informants' communications received by Service Centers. Also advises district officials in the use of ADP facilities in their investigative processes.

1117.24
Audit Division

Administers the Audit activities centralized within service centers. These include: correspondence audit; classification of returns, claims and related documents; processing Audit/Appellate adjustments; technical and quality review; issuing claims disallowance notices, preliminary letters and statutory notices. Furnishes assistance and technical advice to other service center components, districts, regions and National Office. Provides assistance to taxpayers as requested.

1117.241
Classification Branch

Classifies and screen all types of Federal tax returns and claims for audit at district offices or service centers. Classifies various taxpayer initiated documents related to tax returns. Establishes and maintains a review system to ensure returns and claims with the greatest potential are selected for audit and to provide for the review of returns and claims audited at the service center. Prepares, controls and processes information reports related to the classification of returns. Furnishes technical and procedural advice and assistance to other service center components, districts, regions and National Office. Provides assistance to taxpayers as requested. Conducts a quality review of service center responses to written taxpayer inquiries.

1117.242
Correspondence Audit Branch

Conducts the Centralized Audit examination and verification of tax

returns and claims through correspondence with taxpayers to determine correct liabilities for taxes and penalties. These include the less complex issues that do not require district office examination. Conducts tests to determine the feasibility of additional correspondence work. Issues notices of claims disallowance, preliminary letters and statutory notices. Reviews taxpayer protests, determine disposition and when applicable, refers protested returns to district offices.

1117.243
Audit Processing Branch

Performs necessary processing of Audit/Appellate Documents such as receipt and control, code and edit and error resolution.

1117.25
Offices of the Chief, All Operating Divisions

Receives, analyzes, and evaluates all new programs and procedures; prepares supplemental or clarifying instructions as necessary; and ensures full implementation. Determines resources needed in the Division through the preparation of work plans and schedules, personnel staffing and accession schedules, space requirements, formulation of training needs, and other logistical processes. Participates with other Division Chiefs and the Director in the final allocation of resources to accomplish the total Service Center work program. Coordinates with other Division Chiefs on interdivisional matters, as appropriate. Continuously reviews, analyzes, and evaluates the status of work programs with the aim of keeping the Director informed of operational problems on an exception basis. When appropriate, requests assistance from the Management Staff, or from the Office of the Assistant Regional Commissioner having functional responsibility.

1117.26
Administration Division

Directs and coordinates the personnel, facilities management, training fiscal management, public information, and administrative management improvement programs. Serves as the principal administrative adviser to the Director, Assistant Director, and operating division chiefs. Provides functional leadership for the numerous and varied administrative programs designed to support and increase the effectiveness of Service Center operations. Executes the administrative management analysis program and coordinates the management improvement program for the Service Center. Conducts management studies and provides staff assistance to Administration branch chiefs and operating officials as required. Prepares budget and financial plan estimates, maintains fiscal control, and recommends appropriate financial management actions. Develops and coordinates public information plans, techniques, guidelines, and informational materials. Establishes and maintains good relations with mass media in the vicinity of the Service Center; determines information needed, gathers and analyzes statistical and other data generated, and prepares information material for distribution to media outlets; and coordinates visit of media representatives, and others, from the entire region.

1117.261
Facilities Management Branch

Advises, informs, and assists Service Center management on operations relating to facilities management programs such as: space, property, communications, paperwork (including microfilm), records retention and disposal, distribution, emergency planning, safety, and security. Plans, develops, determines requirements, and evaluates these programs; provides additional, improved, or modified programs as required. Furnishes procurement, transportation, storage, supply, and messenger services; provides general building maintenance and maintenance of office, electronic, processing, and materials-handling equipment.

1117.262
Personnel Branch

Develops, executes and evaluates the Service Center personnel program and standards relating to recruitment, examination, and selection of employees, employee relations, union-management relationships, performance evaluation, promotions, in-Service placements, incentive awards, records, reports and other aspects of a complete personnel program within the framework of policies programs, and procedures established by the National and Regional Offices. Conducts the position classification program within delegated authority. Provides staff assistance to operating officials in all personnel areas.

1117.263
Training Branch

Provides leadership and coordination to the various Service Center training programs; promotes employee development programs and evaluates and reports on all such programs. Conducts studies and analyzes operating data to determine training needs; studies trends and developments in the employee development field and appraises new principles, concepts, methods, training devices, and materials for use in Service Center training programs. Develops or assists in the development of local and Service-wide course materials, audio-visual aids, and training devices. Assists Service Center management in developing a job environment which will enable trainees to maintain and improve their skills. At the request of the National or Regional Offices, provides data processing training for other than Service Center personnel. Prepares training program estimates for developing the Operating Financial Plan; prepares obligating documents for charges to the training portion of the Operating Financial Plan.

1117.27
Data Conversion and Accounting Division

Converts data from source docu-

ments to form processable by computers. Operates computer and peripheral equipment used to verify tax liability and service the accounts of all taxpayers within the Districts assigned to the Center and to convert input data to magnetic tape. Maintains tape files of rejected documents for reinput to Service Center Processing. Prepares computer printouts relating to outputs received from the National Computer Center for mailing to taxpayers, for internal reports and statistics, and for tax information authorized for external use. Programs projects as assigned from the National Office and provides the necessary liaison and programming for maintenance of National Office computer programs. Maintains an accounting system to provide subsidiary records and general ledger accounts that reflect the Director's accountability for the Master File and Non-Master File tax revenue collected within Districts assigned to the Center. Records assessments, collections, receivables, refunds, overassessments, and other elements of revenue accounting affecting accountability. Receives, verifies, balances and processes accounting outputs from the National Computer Center; and prepares special and periodic accounting reports. Determines the validity of taxpayer delinquent accounts and returns notices. Prepares various reports for the Service Center, Region, and National Office.

1117.271
Data Conversion Branch

Transcribes, verifies and corrects pertinent information of all tax returns, information documents and related documents associated with other miscellaneous programs. Processes documents related to all files (IMF, BMF, RMF, NMF, etc.), subsequent activity programs, and documents which have been previously transcribed for which error conditions have been detected in subsequent processing. Responsible for resolving error conditions identified by the Computer Branch. Enters corrections for each error condition into machine-generated listings. Responsible for resolving and reentering blocks out of balance or rejected blocks received from transcription control clerks.

1117.272
Computer Branch

Operates all computer systems used in processing, verifying, computing the tax liabilities, and servicing the accounts of all Master Files (IMF, BMF, RMF, NMF) taxpayers within Districts assigned to the Center, maintains tape library; processes tax information and documents for mailing to taxpayers and for internal use by the Service; generates computer reports; statistical information and other information for use by the National, Regional, District and Service Center offices, other program areas of the Service, and by various States. Processes other programs assigned by the National Office. Provides programming services as required for the maintenance of the system, as directed by the National Office. Performs quality review on computer generated output. Operates an EAM System for preconversion perfection of input data and processing of other Service Center card-oriented projects.

1117.273
Accounting Branch

Maintains general ledger accounts and subsidiary records covering revenue transactions for the recording of assessments, collections, receivables, refunds, over-assessments and other transactions affecting taxpayer's accounts. Controls accounting documents for entry to tax accounts. Establishes and maintains individual accounts for non-ADP (NMF) and pre-ADP tax returns and documents. Receives Master File accounting summaries for posted account transactions and accomplishes required journalization and general ledger postings. Initiates or processes account transfers, account adjustments, debit and credit transfers related to tax accounts. Reconciles National Computer Center accounting control records and refund appropriation accounts of Regional Disbursing Centers with general ledger balances. Prepares all accounting and ledger reports as required. Prepares various reports for the Service Center, Region, and National Office.

1117.28
Processing Division

Receives, blocks, sorts, and controls documents, both Master File and Non-Master File, received from taxpayers and District Offices; deposits and initiates accounting control of remittances. Ships processed documents to District Offices; and prepares a variety of forms, and other material for mailing to taxpayers, tax practitioners, District Offices, and other Government agencies. Examines, perfects, and codes returns and documents for all files (IMF, BMF, RMF, NMF, etc.) for subsequent processing; examines, edits, and codes returns for the Statistics of Income Program; prepares form and pattern paragraph letters to taxpayers requesting additional or clarifying information incidental to the initial processing of returns. Performs research, perfects and resolves processing errors detected during work cycles within the Service Center. Receives, processes and maintains control over applications for Employer Identification Numbers and Social Security Numbers.

1117.281
Receipt and Control Branch

Receives and categorically classifies all incoming returns, documents, remittances, and taxpayer correspondence. Sorts and establishes batch control prior to release of returns and documents into the initial work process, in accordance with work schedules. In coordination with the Management Staff, makes necessary adjustments in work schedules as dictated by actual work receipt patterns to maintain a

steady balanced work flow. Numbers and blocks returns, documents and related remittances; examines remittances and related documents, prepares appropriate registers and Certificates of Deposit prior to disposition of monies to local depository. Performs a variety of machine operations such as labeling, folding and inserting. Ships processed documents to District Offices; and prepares forms and other material for mailing to taxpayers, tax practitioners, District Offices and other Government Agencies.

1117.282
Examination Branch

Examines, edits, perfects and codes tax documents for all files (IMF, BMF, RMF, NMF etc.) for transcription and other purposes: prepares form and pattern paragraph letter correspondence to District Offices and taxpayers to obtain missing or clarifying information necessary for the perfection of the return; and edits codes and extracts information from returns for audit and statistical programs.

1117.283
Input Perfection Branch

Perfects and resolves processing and taxpayer errors detected during work cycles within the Service Center. Prepares correspondence action sheets to obtain additional information from taxpayers and District Offices in order to make returns acceptable for processing. Responsible for control, examination, perfection and final disposition of all RMF rejected tax returns and documents. Perfects and resolves unpostable returns and documents. Resolves unpostable conditions arising from the attempt to input all documents and returns relating to the IMF, BMF, and RMF and prepares necessary input documents. Receives and processes applications for Employer Identification and Social Security Numbers. Maintains control over the assignment of Employer Identification Numbers. Performs all necessary actions concerning the control and maintenance of account numbers. Receives and processes applications from 941 filers to file magnetic tape returns; maintains case history file and control of 941, W2, 1099 and 1087 paper returns prior to approval of magnetic tape filing request.

1117.29
Taxpayer Service Division

Provides services to the taxpaying public by answering inquiries received by telephone, mail, or personal call. Controls, monitors, and takes necessary action on complaints and special cases requiring expedite action. Controls and makes adjustments to taxpayers' accounts on all files (IMF, BMF, RMF, NMF, etc.). Controls and processes statutory case adjustments. Performs microfilm research requested by all functional activities. Establishes, maintains and controls permanent and temporary returns files. Retires returns and documents in accordance with prescribed procedures. Performs output review and necessary correction. Performs payment tracing functions. Processing of all exempt organization returns has been centralized in the Philadelphia Service Center. In view of the scope and size of this function, the Philadelphia Service Center has been authorized an Exempt Organization Returns Branch which is: Responsible for processing, except for deposit and transcription operations, all exempt organization tax returns and other related change documents.

1117.291
Adjustment Branch

Receives taxpayer inquiries initiated by correspondence. Receives and controls requests for adjustments and determines appropriate action to be taken including adjustment to tax, penalty, and interest, and to the entity section of taxpayer accounts. Prepares written replies to taxpayer on contacts by telephone. Processes IMF and BMF Restricted Interest cases, combination overassessment and deficiency cases, Joint Committee cases, Appellate Division Overassessment and Deficiency Cases, Justice Department cases, cases containing second agreements and partial agreements. Processes applications for Tentative Carryback Adjustments. Performs payment tracing functions.

1117.292
Research Branch

Performs research through microfilm, source documents, and other sources for entity and account information requested by all functional activities. Establishes, maintains, and controls permanent and temporary returns files. Retires returns and documents in accordance with prescribed procedures. Performs delinquency checks for Non-Master File returns. Reviews computer output, except that pertaining to taxpayer delinquent accounts and returns, for quality and accuracy and for validity of refunds; corrects any processing errors discovered.

1117.293
Taxpayer Relations Branch

Performs taxpayer service functions in connection with telephone inquiries or personal calls. When necessary, prepares replies to taxpayer inquiries which accompany returns and which indicate that complex issues need to be resolved before the return can be processed. Takes necessary action to process special or unusual cases and complaints. Maintains close liaison with Social Security Administration on unusual problems. Prepares and types replies to taxpayer correspondence and requests for correspondence from other activities which generally require individually tailored letters.

1118
Office of District Director

1118.1
Mission

The mission of the Office of the District Director is to administer the in-

ternal revenue laws within an internal revenue district in conformance with Service policies and programs of the National Office and Regional Offices.

1118.2 Basic Organization

The principal organizational components of the typical District Office are the immediate office of the District Director (including the Stabilization Staff), the Audit Division, Collection and Taxpayer Service Division, Intelligence Division and Administration Division.

1118.3 District Director

The District Director administers, within an internal revenue district, the collection, taxpayer service, audit, intelligence and administrative programs of the Internal Revenue Service. He is responsible for the determination of tax liability, the assessment of such liability, and scheduling and certification of refunds, and the investigation of certain criminal and civil violatons of internal revenue tax laws (except those relating to alcohol, tobacco and firearms). He is also responsible for the collection and deposit of all internal revenue taxes.

1118.4 Audit Division

(1) Administers a district-wide audit program involving the selection and examination of all types of Federal tax returns (except those involving alcohol, tobacco, and firearms taxes), claims, offers in compromise based on doubt as to liability for taxes or for both taxes and statutory additions (except alcohol, tobacco, and firearms taxes), informants' claims for reward, and related activities, including the examination and approval of pension trust plans and the issuance of determination letters. The audit program involves the selective classification of returns for field and office audit, the conduct of district conferences in unagreed cases, participation with special agents of the Intelligence Division in the conduct of tax fraud investigations, and provision of technical support to the year-round taxpayer service program.

(2) Audit Divisions in the Atlanta, Chicago, Cincinnati, Dallas, Manhattan, Philadelphia and San Francisco districts on a region wide basis, (Philadelphia reviews for the Office of International Operations), review all income and excess profits tax cases involving overpayments in excess of $100,000 and prepare reports for the Commissioner's signature to the Joint Committee on Internal Revenue Taxation in all nonpetitioned and nondocketed cases, including estate and gift tax cases.

(3) All district Audit Divisions are responsible for issuing determination letters on the qualification of pension, annuity, profit-sharing, stock bonus and bond purchase plans and for subsequent determinations on the status for exemption of trusts forming a part of such plans. Audit Divisions in the districts of Atlanta, Austin, Baltimore, Boston, Chicago, Cincinnati, Cleveland, Dallas, Detroit, Los Angeles, Manhattan, Philadelphia, St. Louis, St. Paul, San Francisco and Seattle are responsible for matters relating to the exemption of all other organizations. These sixteen key District Offices will be responsible for issuing determination letters, examining exempt organizations activities, issuing notices of revocation and reestablishment of exemption, performing technical review and holding district conferences.

(4) The Division structure conforms to one of three established patterns, depending upon size of the District Office. These patterns all recognize six distinct groups of functions which are known as: Returns Classification, District Conference, Review, Field Audit, Office Audit, and Service. In small District Offices the branch supervisory structure does not exist, while in large offices there may be more than one Field Audit Branch. Some district Audit Divisions in Central Region have a Technical Branch in lieu of a separate Conference Staff and Review Staff.

(5) Each region has centralized the review of the following specialized tax areas to specific districts:

(a) Estate and Gift

(b) Excise Taxes

(c) Insurance

(d) International Issues

1118.41 Conference Staff

Directs and performs the district conference function. This includes holding conferences with taxpayers and their representatives, and preparing conference reports. Also screens taxpayer protests and acts as technical advisor to Chief, Audit Division.

1118.42 Review Staff

Reviews reports of examinations of all types of tax returns to verify the determination of liability made by the examining officer. Directs the issuance of preliminary 30-day letters to taxpayers, reviews protests filed in response to such notices and prepares statutory notices of deficiency. Prepares closing letters and releases in estate and gift tax cases. Furnishes technical advice and assistance on pension trust plans, including examination thereof and issuance of determination letters, in those districts with three or less pension trust specialists where the District Director has assigned such responsibility to this Staff. Is responsible for the control, management and review of offers in compromise, informants' claims for reward and the special procedures applicable in cases involving renegotiation. Prepares Management Information Reports for both agreed and unagreed cases. Has primary responsibility within the district for maintaining quality standards in examinations and reports, and the technical accuracy of all matters subject to review. Issues correction memorandums in all

cases or matters involving substantial errors.

1118.43 Returns Classifying Officer

Develops and administers district program for selecting all types of returns for examination. Conducts special studies to identify noncompliance problem areas and recommends audit programs to cope with them.

1118.44 Field Audit Branch

Conducts field examinations relative to all types of taxes (except alcohol, tobacco, and firearms) to determine correct liabilities of taxpayers for tax and penalties, including the examination of claims for refund, credit or abatement, or for redemption of stamps. Also conducts field examinations of offers in compromise based on doubt as to liability for taxes or for both taxes and statutory additions (except alcohol, tobacco, and firearms taxes), and special field examinations, as requested, including joint examinations with special agents of Intelligence Division where tax evasion may exist. Processes informants' claims for reward making any necessary investigations and prepares reports on such claims, together with recommendations as to the amount of rewards. Performs engineering and valuation work, prepares memorandums to accompany closing agreements, and recommends jeopardy assessments. Furnishes technical advice and assistance on pension trust plans and prepares determination letters except in those districts with less than three pension trust specialists where the District Director has assigned such responsibility to the Review Staff. Provides technical support to the year-round taxpayer service program.

1118.45 Office Audit Branch

Conducts examinations through correspondence or interviews with taxpayers in offices of the Service relative to all types of taxes (except alcohol, tobacco and firearms) to determine correct liability of taxpayers for tax and penalties, and the validity of claims for refund, credit, or abatement, or for redemption of stamps. Also, when necessary, conducts field examinations of all types of taxes (except alcohol, tobacco, and firearms) if such examinations do not require professional accounting skills of examiners assigned to Field Audit Branch. Recommends jeopardy assessments. Provides technical support to the year-round taxpayer service program.

1118.46 Service Branch

Performs clerical services for the Division necessary to the processing of returns, reports of examination, case files and correspondence. Maintains control of all returns and case files assigned to the Audit Division and of number assignments for Management Information Reports on audit cases. Types examining offices' reports, form letters, correspondence and other material as assigned and furnishes clerical, stenographic and typing assistance to all Division offices.

1118.47 Technical Branch

(1) The Technical Branch directs the issuance of preliminary 30-day letters to taxpayers, prepares letters to taxpayers covering deficiencies in bankruptcy and receivership cases which serve as a basis for assessment and filing of proof of claim by the Collection and Taxpayer Service Division; reviews protests filed in response to such notices of deficiency for proper form, compliance with existing requirements and for new issues or facts; and prepares statutory notices of deficiency.

(2) The Branch is responsible for the control, management and review of offers in compromise, informants' claims for reward, cases in which expiration of the statute of limitations is imminent and assessment, overassessment or statutory notice action is necessary prior to forwarding to the Assistant Regional Commissioner (Audit) for review, and the special procedures applicable in cases involving renegotiation. It maintains and controls the preliminary notice file, the statutory notice file, the file on cases suspended pending court or other decision (Form 1254), power of attorney file, fee statement file, and worthless stock and taxability of dividend file, taking appropriate action as required. The Branch is responsible for the district conference functions, which include assignment of conferees to handle the case, the holding of the conference, the manner in which conferences are conducted, the quality of the conference reports and the statistical reporting of the conferences. The Chief of the Technical Branch acts as Technical Advisor to the Chief of the Audit Division on cases under investigation or assigned for district conferences.

1118.5 Collection and Taxpayer Service Division

(1) The Collection and Taxpayer Service Division is responsible for the receipt, processing and retention of firearms and alcohol and tobacco tax returns and applications; the receipt and transmittal of other tax returns and documents received in the district; the deposit to the credit of the Service Center Director of tax remittances received in the district; the collection of delinquent accounts through distraint, seizure, levy and other means; the securing of delinquent returns; the conduct of a year-round taxpayer service program (including issuance of certificates of compliance to departing aliens); examination of offers in compromise based on doubt as to collectibility of taxes (except alcohol, tobacco and firearms taxes), offers in compromise of statutory additions based on doubt as to liabiilty (except alcohol, tobacco, firearms, employment and

withholding taxes and specific penalties), and all offers in compromise of 100% penalties. The Division receives, acts on, and processes information pertinent to bankruptcies, receiverships, assignments, reorganizations, probate proceedings, foreclosures and redemptions after civil foreclosure, bulk sales, gifts and prizes, and dissolutions and initiates investigations for securing delinquent returns where necessary. The Division maintains files or control records of payments received in insolvency, bankruptcy, and decendent cases and of surety bonds and other collateral posted as security for tax liability. It also maintains files and control records of property seized under distraint authority and takes appropriate action with respect to seized property to ensure that proper legal action may be timely taken.

(2) The organization of the Division below the branch level varies depending on the size of the Division.

1118.51 Special Procedures Staff

(1) The Special Procedures Staff is responsible for furnishing advisory assistance on technical delinquent collection and returns matters to the Chief, Collection and Taxpayer Service Division, Chief, Field Branch, Chief, Office Branch and Group Supervisors; providing liaison for the District Director with the Department of Justice, including the U.S. Attorneys, the Chief Counsel and Regional Counsel on all collection matters; ascertaining tax liability and filing of proof of claims in insolvency and decendent's estate proceedings; recommending civil suits to enforce collection or to protect the Government's interests; processing civil suits against the United States or the District Director; examining, reviewing and processing seizure and sale reports; processing applications for discharge of property from the effect of Federal tax liens and for certificates of nonattachment of Federal tax liens and certificates of subordination of the Federal tax lien; processing filed notices of Federal tax liens and certificates of release; processing and maintaining executed collection waivers; analyzing and determining the sufficiency of various forms of collateral offered as security for release of lien or postponement of collection action; furnishing technical advice and assistance and recommendations for or against entry into suitable escrow agreements for the collection of delinquent accounts; reviewing recommendations for and holding conferences on 100% penalty and transferee assessments; post reviewing of accounts reported as uncollectible; reviewing recommendations and holding conferences on offers in compromise cases based on inability to pay; and maintaining files and control records on all the above type cases to ensure that proper legal and other collection actions are taken timely.

(2) In the majority of District Offices this function is organized as a separate Special Procedures Staff. In small offices where the Special Procedures function is a one-position job, it is placed organizationally within the Office of the Division Chief.

1118.52 Office Branch

The Office Branch effects the collection of delinquent accounts and secures delinquent returns through demands made by correspondence, telephone or office interviews. It safeguards the Government's interest by causing the filing of notices of tax liens and serving or causing the service of notices of levies. It transfers to Revenue Officer groups those assignments which require field investigations or can be more efficiently completed by field Revenue Officers. The Branch carries out the Division's responsibility for district-wide execution of the year-round taxpayer service program. It provides taxpayer service within the Headquarters Office and surrounding metropolitan commuting area, including responses to correspondence requests of tax information, and provides functional supervision of taxpayer service at other posts of duty. The Branch screens and assigns cases and maintains assignment files. It prepares periodic reports of collection and taxpayer service activities. It receives and deposits to the credit of the Service Center Director remittances received in the District Office. It receives, processes and maintains files of wagering, alcohol and tobacco tax, firearms returns and applications. It also receives and transmits other returns and documents received in the District Office.

1118.53 Field Branch

The Field Branch is responsible for the management and control of five or more Revenue Officer groups (Type I Field Branch), or three or more Revenue Officer groups and an Office Group (Type II Field Branch). Within the assigned area, the Branch makes collections of delinquent accounts and conducts a continuing program for the securing of delinquent returns. It safeguards the Government's interest through the filing of notices of tax liens, and enforces collection by the serving of levies, and seizure and sale of real and personal property. It recommends jeopardy assessment when deemed necessary to protect revenue, civil actions to secure payment, suits to enforce penalty for failure to honor levies, and penalty assessments as a means of collection or as a method of obtaining compliance with existing laws and regulations. The Branch recommends the issuance of certificates of discharge of property from the effects of tax liens, recommends issuances of certificates of subordination of Federal tax liens, and conducts the investigations necessary to support such recommendations. The Branch examines offers in compromise based on doubt as to collectibility of taxes (except alcohol, tobacco and firearms taxes), offers in compromise of statutory additions based on doubt as to

liability (except alcohol, tobacco, firearms, employment and withholding taxes and specific penalties), and all offers in compromise of 100% penalties. The Branch provides taxpayer service within the assigned area (except in Headquarters Office location).

1118.6
Intelligence Division

The Intelligence Division enforces the criminal statutes applicable to income, estate, gift, employment, and excise tax laws (except those relating to alcohol, tobacco, narcotics and certain firearms), by developing information concerning alleged criminal violations thereof, evaluating allegations and indications of such violations to determine investigations to be undertaken, investigating suspected criminal violations of such laws, recommending prosecution when warranted, and measuring effectiveness of the investigation and prosecution processes. The Division assists other Intelligence offices in special inquiries, drives and compliance programs and in the normal enforcement programs, including those combating organized wagering, racketeering and other illegal activity, by providing investigative resources upon Regional or National Office request. It also assists U.S. Attorneys and Regional Counsel in the processing of Intelligence cases, including the preparation for and trial of cases.

1118.61
Branches A and B

In districts where a branch structure has been authorized for Intelligence Division, the branch functions are as follows: The Branch conducts investigations of criminal tax violations, except those relating to alcohol, tobacco, narcotics, and certain firearms tax cases. The Branch coordinates actions with the Office of the United States Attorney and with other Divisions in the District Office. The Branch assists the United States Attorney and the Chief Counsel in the trial of cases. The Branch evaluates allegations of tax law violations and initiates surveys, examinations and investigation to identify cases which may have prosecution potential. The Branch makes appropriate recommendations as to the disposition of matters coming to the attention of the Intelligence Division and as to the disposition of cases investigated. The Branch assists in the planning, organizing, coordinating and directing the local adoption of intelligence policies, programs and procedures of Regional and National Offices. The Branch keeps informed on investigations to ensure uniformity of actions, adherence to established policies and compliance with procedures; to ensure that evidence is adequate and sufficient and that the action taken is sound and proper; and to ensure that high standards of performance are maintained.

1118.7
Administration Division

(1) The Administration Division provides the personnel, training, budget, and fiscal, procurement and supply, records and communications services and other administrative services within the limitations of the District Director's delegated authority, necessary to the effective operation and management of the District Office. It coordinates the District Office cost reduction and management improvement, Reports Management and Incentive Awards Programs and other special projects.

(2) The organization of the Administration Division varies according to the size of the district, its managerial staffing, and other local conditions, as follows:

(a) The Division is headed by a Chief in districts above 1,000 employees and in those with *no* Assistant District Director.

(b) In districts below 1,000 employees *with* an Assistant District Director, the District Director and the Regional Commissioner may decide whether to have a Chief, a Staff Assistant, or neither.

(c) The typical branch structure in districts above 1,000 employees is Facilities Management; Personnel; and Training. Districts below 1,000 employees are also structured into these branches if the District Director and Regional Commissioner decide they are necessary. However, in small districts (normally those below 400 employees) with a Chief, Administration, the branch structure is not authorized in the absence of compelling circumstances. (See also Administration Staffing Guides Handbook, IRM 1132.)

(3) For districts with a branch structure, the following functional descriptions refer to branches. For other districts, the functional descriptions indicate functions performed by staff personnel.

1118.71
Facilities Management Branch

The Facilities Management Branch provides essential facilities and services necessary to the efficient operation of the District Office. The Branch carries out the space programs of the District Director and conducts periodic surveys to ensure effective space utilization. It procures, requisitions, issues, and ensures effective utilization of equipment, property and office supplies; maintains records on all equipment and property located within the district; and provides communications, duplicating paperwork management, and internal management document distribution services. The Branch also furnishes data necessary for the preparation of that portion of the District Office budget estimates and financial plans which is concerned with funds required for materials and facilities in the district. As required for district management control, it maintains blotter type records of fund commitments for materials and facilities (object classes 22, 23, 24, 25, 26 and 31 as defined in Bureau of the Budget Circular A-12). It administers

document and property security, emergency planning for civil defense, and the safety programs in the district.

1118.72 Personnel Branch

The Personnel Branch furnishes professional advice to district officials responsible for manpower planning and management, to insure effective utilization of human resources in the accomplishment of the district mission. It plans and provides a comprehensive program of staff support, services, and technical advice for district personnel management activities. This includes program areas of recruitment, selection, placement, performance evaluation, promotion, management career programs, manpower utilization, position classification and position management, discipline, grievances, awards, employee benefits, and union relations. The branch serves as the primary point of contact in the day-to-day relationship between recognized labor organizations and district top management and advises managers on aspects of union relations bearing on their responsibilities. It performs necessary support activities of personnel action processing, records maintenance, and personnel reporting. In all programs, it emphasizes the fulfillment of Equal Employment Opportunity Program objectives, special emphasis and other personnel program priorities, and conformance to policies, regulations, and standards set by higher authority.

1118.73 Training Branch

The Training Branch provides leadership and coordination to the district training and taxpayer education programs. It assists district management in identifying training needs and developing local training programs, including the district organizational development program. The Branch coordinates the district execution of training programs and administers the selection and scheduling of employees for training conducted outside the district. It monitors and assists management in conducting OJT programs, and in identifying, developing, and utilizing instructors and OJT coaches. It assists in implementing the Management Careers Program. It manages the taxpayer education program by identifying taxpayer education needs, and developing and administering the program to meet these needs. It provides information and resources to employees regarding self-development opportunities. In addition, it evaluates and reports on all district training and taxpayer education programs.

1118.8 Stabilization Division

(1) Directs and administers the District Economic Stabilization Program involving planning, organizing, coordinating, and evaluating District Stabilization activities which include: responding to inquiries from the public; disseminating information to the public; analyzing and issuing decisions upon application for exceptions and appeals; conducting investigations; resolving complaints of violations by obtaining compliance, where possible, and recommending enforcement action when necessary.

(2) Program management of District Stabilization activities is accomplished through twenty-nine Key Districts which are responsible for technical and managerial guidance to and which exercise functional supervision for Stabilization work performed in the related Associate Districts. The Key District/Associate District relationship is:

KEY DISTRICTS	ASSOCIATE DISTRICTS
Boston	Augusta
	Burlington
	Portsmouth
Brooklyn	NONE
Buffalo	Albany
Hartford	Providence
Manhattan	NONE
Baltimore	NONE
Richmond	NONE
Newark	NONE
Philadelphia	Wilmington
Pittsburgh	NONE
Atlanta	Birmingham
Jacksonville	NONE
Greensboro	Columbia
Nashville	Jackson
Cincinnati	Louisville
Indianapolis	NONE
Cleveland	Parkersburg
Detroit	NONE
Chicago	NONE
St. Louis	Springfield
Des Moines	Omaha
St. Paul	Aberdeen
	Fargo
Milwaukee	NONE
Austin	New Orleans
Dallas	Albuquerque
Oklahoma City	Cheyenne
	Denver
	Little Rock
	Wichita
Los Angeles	Honolulu
	Phoenix
San Francisco	Reno
	Salt Lake City
Seattle	Anchorage
	Boise
	Helena
	Portland

(3) The Division structure conforms to one of three established organizational patterns which are:

(a) two branches: the Compliance and Enforcement Branch and the Technical Services Branch;

(b) a Compliance and Enforcement Branch and a Technical Staff; or

(c) no branch structure—the organization is directly under the Division Chief.

(4) The particular organizational pattern authorized depends upon: the size of the Key District Office and any related Associate Districts over which functional supervision is exercised; the geographic area encom-

passed; and the volume and complexity of the workload of the Key District and any related Associate Districts.

(5) In Districts where a two-branch structure has been authorized for the Stabilization Division, the branches will be the Compliance and Enforcement Branch, as defined in 1118.81 below; and the Technical and Services Branch, as defined in 1118.82 below. In Districts where one branch and a staff group have been authorized for the Stabilization Division, the organization structure will be a Compliance and Enforcement Branch, as defined in 1118.81 below; and a Technical Staff which will perform these duties under the Technical and Services Branch in 1118.82 below, without the Branch supervisory structure. In the small Key Districts and all Associate Districts, the functional description of branches in 1118.81 and 1118.82 below, are performed by staff personnel. Associate Districts may use the organizational title of "Stabilization Officer" for the person who will be the primary representative of the District for Stabilization matters.

1118.81 Compliance and Enforcement Branch

This branch is responsible for matters involving compliance and enforcement activities under the Economic, Stabilization regulations. This branch has operational responsibility for local investigative and industry monitoring programs, and reports on National Office directed pay or price fact-finding investigations and surveys, local enforcement activities as authorized and directed by the National Office and other special projects deemed appropriate by the Regional and/or National Office.

1118.82 Technical and Services Branch

This branch has operational responsibility for providing technical and general information to the public; analyzing and issuing decisions upon applications for exceptions and appeals; furnishing interpretive support to other organizational components of Key and Associate Districts; assuring program uniformity; operating and maintaining the Stabilization reporting and information system; and other special projects deemed appropriate by the Regional and/or National Office.

1118.9 Offices Below the District Headquarters

(1) Offices below the district headquarters (Area, Zone, and Local offices as defined below) perform one or more of certain Collection, Taxpayer Service, Audit, and Intelligence functions such as: the collection of delinquent accounts and the securing of delinquent returns; the receiving and deposit of monies tendered in payment of taxes; conducting taxpayer service and related assistance activities to meet local taxpayer needs; the examination of returns to determine correct liability of taxpayers for tax and penalties; the holding of conferences with taxpayers and their representatives regarding the determination of liability for tax and penalties; and the investigation of alleged criminal violation of the tax statutes. They also contain, to a limited extent, other functions such as administrative support.

(2) Offices below the district headquarters are classified according to these types:

(a) *Area office*—An Area office is a major subdivision of the District Office and usually contains all of its principal functional elements including one or more groups of Revenue Agents, one or more groups of Revenue Officers, an Office Group, and a Teller. Generally, it also contains one or more Special Agents.

(b) *Zone office*—A Zone office is an intermediate size office which includes one or more groups of Revenue Agents or one or more groups of Revenue Officers. Generally, it also contains one or more Special Agents. Usually it does not have a Teller and if it has Office Group personnel, they are supervised from some other office.

(c) *Local office*—All other offices below the district headquarters are classified as Local offices. Primarily, these are small posts of duty where the workload does not warrant the stationing of Revenue Agents and Revenue Officers in group strength.

(3) Program planning and functional supervision for personnel of an Area, Zone or Local office are the responsibilities of the appropriate divisions of the District Office. However, administrative supervision of such an office may be assigned to an individual upon a determination by the District Director that such a position is needed in order to represent all IRS functions to the public, to coordinate functions, and to provide common administrative services. This position is to be assigned as an additional responsibility to one of the regular functional personnel of the office, usually the ranking or senior officer. Each person assigned this additional responsibility will be designated as the "(inserting name of city) representative" of the District Director.

(4) Generally, offices below the district headquarters do not contain Branch Chiefs in any of the functional activities. However, if the workload of an office (including nearby offices supervised by such office) is sufficient to justify five or more Audit groups, the District Director may determine that the needs for local supervision warrant the stationing of an Audit Branch Chief in the office. Similarly, if the workload justifies five or more Revenue Officer groups (counting less than ten Office Branch employees as the equivalent of a group; or ten or more Office Branch personnel as two groups), the District Director may establish a Field Branch Chief. Recommendations for establishing such positions shall be forwarded to the Regional Commissioner for approval

in accordance with regular procedures for effecting changes in organization.

(5) When the personnel of an office below the district headquarters are supervised by Group Managers or Branch Chiefs, all of the functions in such offices will generally receive line supervision from the same city in order to foster functional coordination and efficient utilization of clerical and other manpower. However, when the District Director finds that the best interests of the Service require a different arrangement, he is authorized to make an exception. Exceptions may be particularly needed for those activities, such as Intelligence, which are more thinly represented than the Audit and Collection and Taxpayer Service functions; and for specialists, such as those trained in estate, gift, and excise tax work.

Appendix A
Internal Revenue Regional Offices

San Francisco, CA, ZIP 94102, 870 Market Street.
Atlanta, GA, ZIP 30303 Federal Office Building, 275 Peachtree Street, N.E.
Chicago, IL ZIP 60601 35 East Wacker Drive.
New York, NY, ZIP 10007, Federal Office Building, 90 Church Street.
Cincinnati, OH, ZIP 45202, Federal Office Building, 550 Main Street.
Philadelphia, PA, ZIP 19102, 2 Penn Center Plaza.
Dallas, TX, ZIP 75202, Federal Office Building, 1114 Commerce Street.

Appendix B
Appellate Branch Offices

Birmingham, AL, ZIP 35203, 2121 Eighth Avenue N.
Phoenix, AZ, ZIP 85004 222 North Central Avenue.
Los Angeles, CA, ZIP 90012, 300 North Los Angeles Street.
San Francisco, CA, ZIP 94108, 447 Sutter Street, Room 301.
Denver, CO, ZIP 80202, 20th Floor, Prudential Building, 1050 17th Street.
New Haven, CT, ZIP 06511, 110 Washington Avenue, 4th Floor, North Haven.
Washington DC ZIP 20009, 432 Universal Building North, 1875 Connecticut Avenue, NW.
Jacksonville, FL, ZIP 32202, Federal Office Building 400 West Bay Street.
Miami, FL, ZIP 33130, Federal Office Building, 51 Southwest First Avenue.
Atlanta, GA, ZIP 30303, 275 Peachtree Street NE.
Chicago, IL, ZIP 60601, 35 East Wacker Drive.
Indianapolis, IN, ZIP 46206, 510 Guaranty Building, 20 North Meridian Street.
Wichita, KS, ZIP 67202, 418 South Main Street (Suboffice, Oklahoma City Branch Office.)
Louisville, KY, ZIP 40202, 267 Federal Building, 600 Federal Place.
New Orleans, LA, ZIP 70130, 444 Federal Office Building, 600 South Street.
Baltimore, MD, ZIP 21201, Room 934, Federal Building, 31 Hopkins Plaza.
Boston, MA, ZIP 02203, John F. Kennedy Federal Building Government Center.
Detroit, MI, ZIP 48226, 600 Griswold Bldg.
St. Paul, MN, ZIP 55101 500 Federal Building and U.S. Courthouse, 316 North Robert Street.
Kansas City, MO, ZIP 64106, 1700 Federal Office Building, 911 Walnut Street. (Suboffice St. Louis Branch Office.)
St. Louis, MO, ZIP 63101, 1114 Market Street, Room 919.
Omaha, NE ZIP 68102 3132 New Federal Building, 215 North 17th Street.
Newark, NJ, ZIP 07102, Room 701 Federal Building, 970 Broad Street.
Buffalo, NY, ZIP 14202, 300 U.S. Courthouse, 68 Court Street.
New York, NY, ZIP 10007, 90 Church Street.
Greensboro, NC, ZIP 27401, 320 Federal Place, Room 525.
Cincinnati, OH, ZIP 45201, Post Office Box 2026.
Cleveland, OH, ZIP 44199, 1653 Federal Office Building, 1240 East Ninth Street.
Oklahoma City, OK, ZIP 73102, 200 Northwest Fourth Street.
Portland, OR, ZIP 97201, 1500 Southwest First Avenue.
Philadelphia, PA, ZIP 19102, 2 Penn Center Plaza, Room 927.
Pittsburgh, PA ZIP 15222, Room 1428 Federal Building, 1000 Liberty Avenue.
Nashville, TN, ZIP 37203, 801 Broadway, Room 654.
Dallas, TX, ZIP 75202, 1100 Commerce Street, Room 12B25.
Houston, TX, ZIP 77002, 8031 Federal Building, 515 Rusk Avenue.
Salt Lake City, UT, ZIP 84111, 125 South State Street, Room 3438.
Richmond, VA, ZIP 23240, 400 North Eighth Street, Room 11028.
Seattle, WA, ZIP 98121, Sixth and Lenora Building, Room 1112.
Huntington, WV, ZIP 25701, Ninth Street and Fifth Avenue (Suboffice, Cincinnati Branch Office).
Milwaukee, WI, ZIP 53233, 735 West Wisconsin Avenue, Room 700.

Appendix C
Internal Revenue Service Centers

Fresno, CA, ZIP 93730, 5045 East Butler Avenue.
Chamblee, GA, ZIP 30005, 4800 Buford Highway.
Covington, KY, ZIP 41012, 200 West Fourth Street.
Andover, MA, ZIP 01812, 310 Lowell Street.
Kansas City, MO, ZIP 64170, Federal Building, 2306 East Bannister Road.
Holtsville, NY, ZIP 11799, 1040 Waverly Avenue.
Philadelphia, PA, ZIP 19154, 11601 Roosevelt Boulevard.
Memphis, TN, ZIP 38110, 3131 Democrat Road.
Austin, TX, ZIP 78740, 3651 South Inter-Regional Highway.
Ogden, UT, ZIP 84405, 1160 West 1200 South Street.

Appendix D
Internal Revenue District Offices

Birmingham, AL, ZIP 35203, 2121 Building, 2121 Eighth Avenue North.

Anchorage, AK, ZIP 99501, Alaska Mutual Savings Building, Fifth and F Streets.

Phoenix, AZ, ZIP 85025, Federal Building, U.S. Courthouse, 230 North First Avenue.

Little Rock, AR, ZIP 72201, Federal Office Building, 700 West Capitol Avenue.

Los Angeles, CA, ZIP 90012, Federal Building, 300 North Los Angeles Street.

San Francisco, CA, ZIP 94102, Federal Building and Courthouse, 450 Golden Gate Avenue.

Denver, CO, ZIP 80202, Prudential Tower Building, 1050 17th Street.

Hartford, CT, ZIP 06103, Federal Building, U.S. Courthouse, 450 Main Street.

Wilmington, DE, ZIP 19801, Federal Building, Courthouse and Custom House, 844 King Street.

Jacksonville, FL, ZIP 32202, Federal Building, 400 West Bay Street.

Atlanta, GA, ZIP 30303, Federal Building, 275 Peachtree Street NE.

Honolulu, HI, ZIP 96813, U.S. Post Office, Court & Custom House and Federal Building, 335 Merchant Street.

Boise, ID, ZIP 83702, Federal Building and U.S. Courthouse, 550 West Fort Street.

Chicago, IL, ZIP 60602, State-Madison Building, 17 North Dearborn Street.

Springfield, IL, ZIP 62704, Land of Lincoln Building, 325 West Adams Street.

Indianapolis, IN, ZIP 46204, Federal Building and Courthouse, 46 East Ohio Street.

Des Moines, IA, ZIP 50309, Federal Building, 210 Walnut Street.

Wichita, KS, ZIP 67202, Federal Office Building, 412-418 South Main.

Louisville, KY, ZIP 40202, Post Office, Courthouse, and Custom House, 601 West Broadway.

New Orleans, LA, ZIP 70130, Federal Office Building, 600 South Street.

Augusta, ME, ZIP 04330, Federal Office Building, 68 Sewall Street.

Baltimore, MD, ZIP 21201, Federal Building, 31 Hopkins Plaza.

Boston, MA, ZIP 02203, John Fitzgerald Kennedy Federal Building.

Detroit, MI, ZIP 48226, Cadillac Tower Building, 65 Cadillac Square.

St. Paul, MN, ZIP 55101, Federal Building and Courthouse, 316 North Robert Street.

Jackson, MS, ZIP 39202, 301 Building, 301 North Lamar Street.

St. Louis, MO, ZIP 63101, U.S. Court and Custom House, 1114 Market Street.

Helena, MT, ZIP 59601, Federal Office Building, U.S. Post Office and Court House, West Sixth Street and Park Avenue.

Omaha, NE, ZIP 68102, Federal Office Building, 106 South 15th Street.

Reno, NV, ZIP 89502, Federal Building, U.S. Courthouse, 300 Booth Street.

Portsmouth, NH, ZIP 03810, Federal Building, U.S. Post Office, 80 Daniel Street.

Newark, NJ, ZIP 07102, Federal Building, 970 Broad Street.

Albuquerque, NM, ZIP 87101, Federal Office Building, 517 Gold Avenue SW.

Albany, NY, ZIP 12206, 855 Central Avenue.

Brooklyn, NY, ZIP 11201, U.S. Courthouse and Federal Building, 35 Tillary Street.

Buffalo, NY, ZIP 14202, Federal Office Building, 111 West Huron Street.

New York, NY, ZIP 10007, Federal Office Building, 120 Church Street.

Greensboro, NC, ZIP 27401, Federal Building, 320 Federal Place.

Fargo, ND, ZIP 58102, Federal Building and Post Office, 653 Second Avenue, North.

Cincinnati, OH, ZIP 45202, Federal Office Building, 550 Main Street.

Cleveland, OH, ZIP 44199, Federal Building, 1240 East Ninth Street.

Oklahoma City, OK, ZIP 73102, Federal Office Building and Courthouse, 200 N.W. Fourth Street.

Portland, OR, ZIP 97204, Multnomah Building, 319 S.W. Pine Street.

Philadelphia, PA, ZIP 19106, William J. Green Federal Building, 600 Arch Street.

Pittsburgh, PA, ZIP 15222, Federal Building, 1000 Liberty Avenue.

Providence, RI, ZIP 02903, 130 Broadway.

Columbia, SC, ZIP 29201, Federal Building, 901 Sumter Street.

Aberdeen, SD, ZIP 57401, Executive Building, 640 Ninth Avenue, S.W.

Nashville, TN, ZIP 37203, Federal Building, Eighth Avenue and Broadway.

Austin, TX, ZIP 78701, Federal Office Building, 300 East Eighth Street.

Dallas, TX, ZIP 75202, Federal Office Building and Courthouse, 1100 Commerce Street.

Salt Lake City, UT, ZIP 84110, U.S. Post Office and Courthouse, 350 South Main Street.

Burlington, VT, ZIP 05401, Federal Building, 11 Elmwood Avenue.

Richmond, VA, ZIP 23240, Federal Building, 400 North Eighth Street.

Seattle, WA, ZIP 98121, Sixth and Lenora Building, 2033 Sixth Avenue.

Parkersburg, WV, ZIP 26101, Federal Office Building, Juliana and Fifth Streets.

Milwaukee, WI, ZIP 53202, Federal Building and Courthouse, 517 East Wisconsin Avenue.

Cheyenne, WY, ZIP 82001, Federal Office Building, 21st and Carey Streets.

Appendix E
Regional Inspectors' Offices

Cincinnati, OH, ZIP 45202, 8514 Federal Office Building, 550 Main Street.

Philadelphia, PA, ZIP 19106, Federal Building, 600 Arch Street, Room 4228.

Chicago IL, ZIP 60601, 35 East Wacker Drive, Suite 646.

New York, NY, ZIP 10007, 26 Federal Plaza, 14th Floor.

Atlanta, GA, ZIP 30303, 221 Courtland Street N.E., 4th Floor.

Dallas, TX, ZIP 75202, U.S. Courthouse and Federal Office Building, 1100 Commerce Street, Room 3A5.

San Francisco, CA, ZIP 94111, 160 Pine Street, Suite 500.

Appendix F
Regional Counsel Offices

Birmingham, AL, ZIP 35203, Room 1624, 2121 Eighth Avenue, North.

Phoenix, AZ, ZIP 85004, Suite 1214, Security Center Building, 222 North Central Avenue.

Los Angeles, CA, ZIP 90053, 2018 Federal Building, 300 North Los Angeles Street.

San Francisco, CA, ZIP 94108, Room 628, 447 Sutter Street.

Denver, CO, ZIP 80202, 20th Floor, 1050 17th Street.

Jacksonville, FL, ZIP 32202, Box 35027, Federal Building, 400 West Bay Street.

Miami, FL, ZIP 33130, Room 1502, Federal Office Building, 51 Southwest First Avenue.

Atlanta, GA, ZIP 30301, Federal Office Building, 275 Peachtree Street, NE.

Chicago, IL, ZIP 60601, Room 1622, 35 East Wacker Drive.

Indianapolis, IN, ZIP 46204, 632 Illinois Building, 17 West Market Street.

Louisville, KY, ZIP 40201, 579 Federal Office Building.

New Orleans, LA, ZIP 70130, Room 845, Federal Office Building, 600 South Street.

Boston, MA, ZIP 02203, John Fitzgerald Kennedy Building, Government Center.

Detroit, MI, ZIP 48226, 2300 Cadillac Tower Building.

St. Paul, MN, ZIP 55101, Room 572, Federal Building and U.S. Courthouse, 140 East Fourth Street.

Kansas City, MO, ZIP 64106, 2700 Federal Office Building, 911 Walnut Street.

St. Louis, MO, ZIP 63101, 935 U.S. Court and Custom House, 1114 Market Street.

Omaha, NE, ZIP 68101, Room 3101, U.S. Post Office and Court House, 215 North 17th Street.

Newark, NJ, ZIP 07102, Ninth Floor, 970 Broad Street.

Buffalo, NY, ZIP 14202, 304 U.S. Courthouse, Niagara Square.

New York, NY, ZIP 10007, 26 Federal Plaza, 12th Floor.

Greensboro, NC, ZIP 27420, Room 509, 320 Federal Place.

Cincinnati, OH, ZIP 45202, 7504 Federal Office Building, 550 Main Street.

Cleveland, OH, ZIP 44114, 1620 Williamson Building, 215 Euclid Avenue.

Oklahoma City, OK, ZIP 73101, Courthouse and Federal Office Building, 220 Northwest 4th Street.

Portland, OR, ZIP 97201, 810 Crown Plaza, 1500 Southwest First Avenue.

Philadelphia, PA, ZIP 19102, Room 464, 2 Penn Center Plaza.

Pittsburgh, PA, ZIP 15230, Room 726, Federal Building.

Nashville, TN, ZIP 37202, 703 U.S. Courthouse Building, 801 Broadway.

Dallas, TX, ZIP 75202, Room 12D27, Federal Office Building, 1100 Commerce Street.

Houston, TX, ZIP 77002, 515 Rusk Avenue, Room 8102.

Salt Lake City, UT, ZIP 84111, 3438 Federal Building, 125 South State Street.

Richmond, VA, ZIP 23240, 2018 Federal Building, 8th and Marshall Streets.

Washington, DC, ZIP 20009, Room 422, Universal Building, North, 1875 Connecticut Avenue NW.

Milwaukee, WI, ZIP 53233, Sixth Floor, Continental Plaza, 735 West Wisconsin Avenue.

Seattle, WA, ZIP 98121, 1101 Sixth and Lenora Building.

Baltimore, MD, ZIP 21201, Room 1117, Federal Building, 31 Hopkins Plaza.

(Filed by the Office of the Federal Register on March 28, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 29, 1974, 39 F.R. 11572-11610)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER H, PART 601.—STATEMENT OF PROCEDURAL RULES

Miscellaneous Amendments

Preamble

This document contains miscellaneous amendments to the Statement of Procedural Rules (26 CFR Part 601) which was last amended on December 3, 1973 (38 F.R. 33300).

The Statement of Procedural Rules sets forth the procedural rules of the Internal Revenue Service respecting all taxes administered by the Service.

The amendments to the Statement of Procedural Rules contained in this document are adopted by this document. A discussion of the most significant of these amendments follows:

Section 601.106(h) is amended to provide that the approval of the Assistant Regional Commissioner (Appellate) (rather than the Director, Appellate Division) is required to reopen certain cases closed by agreement of the taxpayer and the Appellate Division.

Section 601.107(c) is amended to reflect revised procedures for the processing of criminal tax cases after investigation.

New material added to section 601.201(r) describes procedures applicable to the issuance of rulings and determination letters with respect to the private foundation status and operating foundation status under sections 509(a) and 4942(j)(3) of the

Internal Revenue Code of 1954 of organizations exempt from Federal income tax under section 501(c) of the Code. These procedures apply in connection with applications for recognition of exempt status under section 501(c)(3) of the Code, or notices filed by organizations on Form 4653, Notification Concerning Foundation Status. Subparagraph (2) of § 601.201 (r), relating to nonexempt charitable trusts, was previously published as subparagraph (6) of such section and is otherwise unchanged.

Section 601.204(b) is amended to indicate that a taxpayer's request to change from the overall cash receipts and disbursements method of accounting to the accrual method of accounting must now be filed with the National Office, instead of with the district director.

The revision of paragraph(d)(1) of §601.401 reflects statutory changes in the amount of wages an employee must receive from two or more employers in a calendar year before he may be eligible for a special refund of social security tax.

Amendments to the Statement of Procedural Rules

This part as filed with the Federal Register on June 29, 1955, was last amended on December 3, 1973 (38 F.R. 33300). The following amendments are made to Part 601:

Paragraph 1. Section 601.106(h) is amended by substituting "Assistant Regional Commissioner (Appellate)" for "Director of the Appellate Division" in subparagraphs (1) and (3) and by revising subparagraph (2) to read as follows:

§ 601.106 Appellate functions.

* * * * *

(h) *Reopening closed cases not docketed in the Tax Court.* * * *

(2) Under certain unusual circumstances favorable to the taxpayer, such as retroactive legislation, a case not docketed in the Tax Court and closed by the Appellate Division on the basis of concessions made by both the Appellate Division and the taxpayer may be reopened upon written application from the taxpayer, and only with the approval of the Assistant Regional Commissioner (Appellate). The processing of an application for a tentative carryback adjustment or of a claim for refund or credit for an overassessment (for a year involved in the prior closing) attributable to a claimed deduction or credit for a carryback provided by law, and not included in a previous Appellate Division determination, shall not be considered a reopening requiring approval. A subsequent assessment of an excessive tenative allowance shall likewise not be considered such a reopening. The Director of the Appellate Division may authorize, in advance, the reopening of similar classes of cases where legislative enactments or compelling administrative reasons require such advance approval.

* * * * *

Par. 2. Section 601.107(c) is revised to read as follows:

§ 601.107 Intelligence functions.

* * * * *

(c) *Processing of cases after investigation.* The Chief, Intelligence Division, shall ordinarily notify the subject of an investigation and his authorized representative, if any, when he forwards a case to the Regional Counsel with a recommendation for prosecution. The rule will not apply if the case is with a United States Attorney.

Par. 3. Section 601.201 is amended by substituting "sections 509(a) and 4942(j)(3)" for "section 509(a)" in paragraphs (b)(1) and (c)(5) and by revising paragraph (r) to read as follows:

§ 601.201 Rulings and determination letters.

* * * * *

(r) *Rulings and determination letters with respect to foundation status classification*—(1) *Rulings and determination letters on private and operating foundation status.* The procedures relating to the issuance of rulings and determination letters on private foundation status under section 509(a), and operating foundation status under section 4942(j)(3), of organizations exempt from Federal Income Tax under section 501(c)(3) of the Code will be published from time to time in the Internal Revenue Bulletin (see for example, Rev. Proc. 73-7, 1973-1 C.B. 753). These procedures apply in connection with notices filed by the organizations on Form 4653, Notification Concerning Foundation Status, or with applications for recognition of exempt status under section 501(c)(3) of the Code. Such notices and statements are filed by organizations in accordance with section 508(a) of the Code in order for an organization to avoid the presumption of private foundation status or to claim status as an operating foundation. In addition, these procedures also relate to National Office review of determination letters on foundation status under sections 509(a) and 4942(j)(3) of the Code and protest of adverse determination letters regarding foundation status.

(2) *Nonexempt charitable trusts claiming nonprivate foundation status under section 509(a)(3) of the Code.* A trust described in section 4947(a)(1) of the Code is one that is not exempt from tax under section 501(a) of the Code, has all of its unexpired interests devoted to one or more of the purposes described in section 170(c)(2)(B) of the Code, and is a trust for which a charitable deduction was allowed. These trusts are subject to the private foundation provisions (Part II of subchapter F of chapter 1 and chapter 42 of the Code) except section 508(a), (b), and (c) of the Code. The procedures to be used by nonexempt charitable trusts to obtain determinations of their foundation status under section 509(a)(3) of the Code will be published from time to time in the Internal Revenue Bulletin

(see, for example, Rev. Proc. 72-50, 1972-2 C.B. 830).

* * * * *

Par. 4. Section 601.204(b) is amended by deleting "Rev. Proc. 67-10, C.B. 1967-1, 585," from the last sentence.

Par. 5. Section 601.401 is amended by substituting "one" for "four" in the fourth sentence of paragraph (a)(1) and by deleting the first two sentences of paragraph (d)(1) and inserting a new first sentence in lieu thereof to read as follows:

§ 601.401 Employment taxes.

* * * * *

(d) *Special refunds of employee social security tax.* (1) An employee who receives wages from more than one employer during a calendar year may, under certain conditions, receive a "special refund" of the amount of employee social security tax (*i.e.*, employee tax under the Federal Insurance Contributions Act) deducted and withheld from wages that exceed the following amounts: calendar years 1968 through 1971, $7,800; calendar year 1972, $9,000; calendar year 1973, $10,800; calendar year 1974, $12,000; calendar years after 1974, an amount equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) effective with respect to that year. * * *

DONALD C. ALEXANDER,
Commissioner.

(Filed by the Office of the Federal Register on March 6, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 7, 1974, 39 F.R. 8917)

TITLE 26 — INTERNAL REVENUE—CHAPTER I, SUBCHAPTER H, PART 601.—STATEMENT OF PROCEDURAL RULES

Comments submitted in response to notices of proposed rule making

Preamble

This document contains amendments to paragraphs (a)(3)(ii) and (b) of § 601.601 of the Statement of Procedural Rules (26 CFR Part 601) and paragraph (d)(9) of § 601.702 of such rules. The amended provisions relate to comments submitted in response to notices of proposed rule making of the Internal Revenue Service.

As amended by this document, § 601.601(b) provides that designations of material as confidential or not to be disclosed, contained in comments submitted in response to notices of proposed rule making, will not be accepted. Further, § 601.601(b), as amended, provides that it will be presumed by the Internal Revenue Service that every comment submitted in response to a notice of proposed rule making is intended by the person submitting it to be subject in its entirety to public inspection and copying.

Paragraph (a)(3)(ii) of 26 CFR 601.601 and paragraph (d)(9) of 26 CFR 601.702 are amended to accommodate paragraph (b) of 26 CFR 601.601, as amended.

The amendment of § 601.601(b) set forth below is effective with respect to comments received in response to notices of proposed rule making of the Internal Revenue Service published in the Federal Register after June 5, 1974.

Adoption of Amendments

This document contains amendments to the Statement of Procedural Rules (26 CFR Part 601) which was last amended on March 7, 1974.

The effective dates of the amended paragraph (b) of 26 CFR 601.601 and paragraph (d)(9) of 26 CFR 601.702, as set forth below, are indicated in such sections as set forth below.

The following amendments are made to 26 CFR Part 601:

Paragraph 1. Section 601.601 is amended by revising the fifth sentence of paragraph (a)(3)(ii) and by revising paragraph (b). These amended provisions read as follows:

§ 601.601 Rules and regulations.

(a) *Formulation.* * * *

(3) * * *

(ii) * * * In order to be assured of the availability of copies of such written comments or outlines on or before the beginning of such hearing, any person who desires such copies should make such a request within the time prescribed in the notice of hearing and shall agree to pay reasonable costs for copying. * * *

* * * * *

(b) *Comments on proposed rules*—(1) *In general.* Interested persons are privileged to submit any data, views, or arguments in response to a notice of proposed rule making published pursuant to 5 U.S.C. 553. Further, procedures are provided in paragraph (d)(9) of § 601.702 for members of the public to inspect and to obtain copies of written comments submitted in response to such notices. Designations of material as confidential or not to be disclosed, contained in such comments, will not be accepted. Thus, a person submitting written comments in response to a notice of proposed rule making should not include therein material that he considers to be confidential or inappropriate for disclosure to the public. It will be presumed by the Internal Revenue Service that every written comment submitted to it in response to a notice of proposed rule making is intended by the person submitting it to be subject in its entirety to public inspection and copying in accordance with the procedures of paragraph (d)(9) of § 601.702. The name of any person requesting a public hearing and hearing outlines described in paragraph (a)(3)(iii) of § 601.601 are not exempt from disclosure.

(2) *Effective date.* This paragraph (b) applies only to comments submitted in response to notices of proposed rule making of the Internal

Revenue Service published in the Federal Register after June 5, 1974.

* * * * *

Par. 2. Section 601.702 is amended by revising paragraph (d)(9) thereof to read as follows:

§ 601.702 Publication and public inspection.

* * * * *

(d) *Rules for disclosure of certain specific matters.* * * *

(9) *Comments received in response to a notice of proposed rule making.* Written comments received in response to a notice of proposed rule making may be inspected by any person upon compliance with the provisions of this subparagraph (9). Comments which may be inspected are located in the Office of the Chief Counsel, Legislation and Regulations Division, Technical Section, Room 4317, 1111 Constitution Avenue, Washington, D. C. 20224. The request to inspect comments must be in writing and signed by the person making the request and should be addressed to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D. C. 20224. Upon delivery of such a written request to the place where the comments are located during the regular business hours of that office, the person making the request may inspect those comments that are the subject of the request. Copies of comments may be obtained by a written request addressed to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224. The person making the request for copies should allow a reasonable time for processing the request. The provisions of paragraph (c)(5) of this section, relating to fees, shall apply with respect to requests made in accordance with this subparagraph. The provisions of this subparagraph shall apply only in the case of requests for the inspection of, or copies of, comments that are submitted in response to notices of proposed rule making of the Internal Revenue Service published in the Federal Register after June 5, 1974. For inspection of, or copies of, comments submitted in response to notices of proposed rule making of the Internal Revenue Service published in the Federal Register on or before such date, see paragraph (d)(9) of 26 CFR 601.702 (revised as of April 1, 1973).

* * * * *

DONALD C. ALEXANDER,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 3, 1974; 8:45 a.m., and published in the issue of the Federal Register for May 6, 1974, 39 F.R. 15754)

Treasury Department Order No. 190-2

Delegation of Authority

By virtue of authority vested in the Secretary of the Treasury, which authority has been delegated to me as Assistant Secretary for Tax Policy by Treasury Department Order No. 190 (Revision 9), I hereby delegate to the Deputy Assistant Secretary for Tax Policy (Tax Legislation) authority to act on requests for changes in accounting for the investment credit in financial reports to Federal agencies, as required by section 101(c) of the Revenue Act of 1971 (P.L. 92-178 [1972-1 C.B. 443]). This authority may be exercised by him in his own capacity and under his own title, and he shall be responsible for referring to the Assistant Secretary for Tax Policy any requests for changes in accounting for the investment credit on which action should appropriately be taken by him.

FREDERIC W. HICKMAN,
Assistant Secretary for Tax Policy.

Dated March 22, 1974.

(Filed by the Office of the Federal Register on March 27, 1974, 8:45 a.m., and published in the issue of the Federal Register for March 28, 1974. 39 F.R. 11444)

United States Tax Court—Rules of Practice and Procedure

Announcement 74-7

New Rules of Practice and Procedure of the United States Tax Court were approved in June 1973, and became effective on January 1, 1974. The rules are issued in accordance with section 7453 of the Internal Revenue Code of 1954. This is the first comprehensive revision of the Court's rules in more than 35 years.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, and Enrolled Agents from Practice Before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the Administrative Law Judge, the following attorney was disbarred from further practice before the Internal Revenue Service.

Name	Address	Designation	Date of Disbarment
John W. Flanagan	Austin, Texas	Attorney	December 21, 1973

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have entered consent suspensions from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have entered consent suspensions from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Charles R. Considine	San Diego, Calif.	Certified Public Accountant	Indefinite from April 1, 1974
Merrill W. Rudd	Rexburg, Idaho	Certified Public Accountant	Ninety days beginning May 1, 1974
Abraham Hantman	New York, New York	Certified Public Accountant	Indefinite from May 13, 1974
Charles F. Butler	Brockton, Massachusetts	Attorney	Indefinite from May 16, 1974
Donald F Buker	Mesa, Arizona	Enrolled Agent	Indefinite from May 17, 1974
James T. Ross	Columbus, Georgia	Certified Public Accountant	Thirty days beginning April 18, 1974
Irving Viasner	Everett, Massachusetts	Certified Public Accountant	Indefinite from June 1, 1974

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The abbreviation and number in parentheses following the index entry refer to the specific item; numbers following the parentheses refer to the page number on which it appears.

Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules

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